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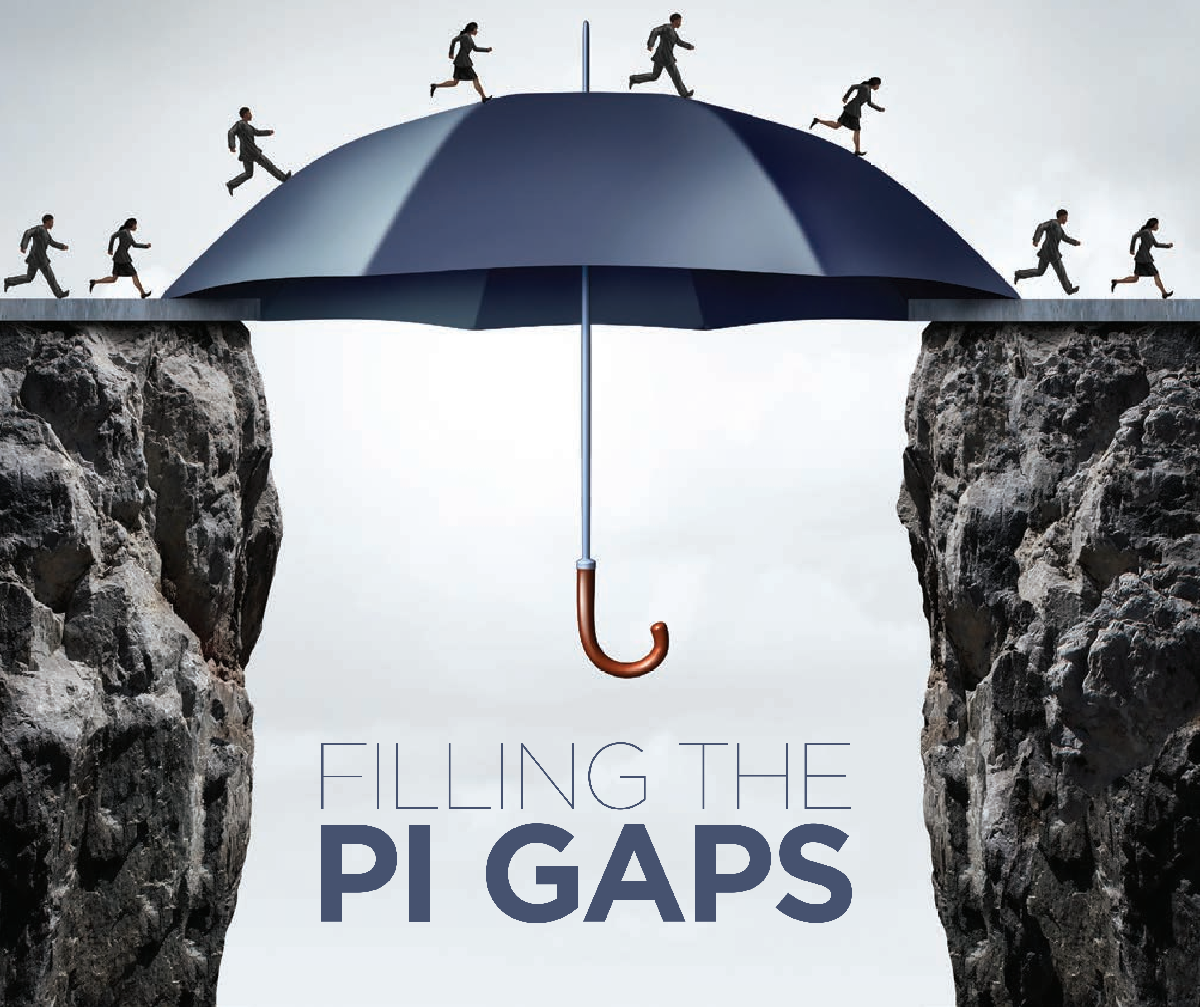

FILLING THE PI GAPS

HEADLINES

- Professional indemnity insurance is a market in its own right worth between $1.3 and $4 billion.
- Brokers need a solid understanding of how professional indemnity operates to ensure clients are not exposed.
- Brokers should be clear on a client's professional activities and get their professional business description right.
- Opportunities include cyber, privacy protection and data ownership.

As the professional services sector has grown, professional indemnity (PI) insurance, once perhaps the remit of specialist brokers, has become a core product offering for many general insurance brokers.

By Tanaya Das

Stuart Davies, NSW State Manager from Arthur J Gallagher told *Insurance Adviser* that PI is one of the main product lines in the liability sector.

"It is a significant market in its own right, with recent APRA statistics reporting local APRA regulated insurers writing around $1.3 billion of gross premium albeit the average written premium reduced by around 9.5 per cent in the 2015 underwriting year when compared to the prior year," he says.

Rhys Mills, Managing Director, Solutions Underwriting Agency, thinks that the Australian PI market is quite sophisticated and provides numerous product and capacity options for brokers and their clients.

There are, however, traps for the unwary.

"Australia is well-recognised globally as being number two behind the US when it comes to litigation – whether it is in PI or other risks. Litigation in this country is a growing trend which helps increase the purchase as well as the need for PI insurance," says Davies.

Byron McPherson, Partner at Reliance Partners, believes that these days PI insurance sells itself but there are many traps for general brokers who are unaware of some of the technical aspects of arranging suitable PI insurance for certain professionals.

"PI insurance is generally a reasonably low frequency, but high severity class of insurance and we are sitting on something of time-bomb, due to a significant mismatch between client expectations of cover and coverage that insurers are actually able to provide. Necessarily this only gets tested when a claim arises," he says.

As Mills says: "Brokers basically need to have a good solid understanding of how professional indemnity operates and how their clients may or may not be exposed in this area."

Matthew Mcphee, National Underwriting Manager at Berkley Insurance Australia adds: "PI policy coverage continues to broaden. Brokers need to analyse the risks their clients are exposed to and ensure the policy wording provides sufficient coverage".

Gaps in coverage

A gap in coverage occurs when the insurer does not fully understand the full scope of the client's professional activities intended to be insured.

Mcphee believes this is an ongoing issue and that the professional business should be described precisely and concisely, including current, future and importantly past activities undertaken by the insured.

If the professional business is not described correctly under the insured's policy then that could result in a problem at claim time.

"A skilled and experienced PI broker needs to ensure this critical component, that is, getting the client's professional business description right is their first and most important priority in negotiating the correct coverage with the insurer," says McPherson.

"I personally have seen many instances where, in reality, a client's advice has become so specialised and unique that it doesn't fit the traditional professional business descriptors used by insurers and customisation is required," he explains.

"A recent example was a client who was an electrical engineer by training and his previous broker had arranged his PI insurance using this as his professional business description. Upon further enquiries he revealed that he was in fact engaged as a systems engineer on a communications/voice switching system for the emergency services. When I raised this with his incumbent insurer they conceded that this was a professional service excluded by their reinsurance and requested I place his policy elsewhere, which I was able to do using this more detailed description."

When in doubt, it is always good to have the professional business description worded as specifically as possible to reflect the actual services being provided, advises McPherson.

Relying on traditional descriptors like engineer, architect, accountant, consultant or lawyer are very often misleading and could actually be inaccurate.

In fact, this could place the broker's own PI insurance at risk, should a client end up not being covered for what they thought they were when a claim is made.

> "The key to growth in this area is actually identifying client risks when they think they have none."
>
> Stuart Davies, Reputation Risk Specialist, Arthur J. Gallagher

On the other hand, Mcphee recommends: "It is important to describe the professional business in broad terms and not to list every minute task undertaken. For example, it's better to describe the professional business as 'consulting engineer' than…'structural engineer', as 'consulting engineer' is a broader description, meaning the scope of coverage will be wider."

Mcphee also warns that a potential gap exists not just for clients but for brokers and Authorised Representatives (ARs).

ARs need to be particularly careful when they leave one AFSL holder and either retire or join another group.

"It is possible a PI policy may only protect ARs for advice given under the current Australian Financial Services Licence (AFSL) holders licence and may not cover advice given under a prior AFSL holder's licence. It is also important that if they are an AR of an AFSL holder that ceases to do business (sold or placed in liquidation) that the AR seeks confirmation of long term run-off cover and the adequacy of the limits," he says.

Opportunities in the sector

Davies urges brokers to look beyond the obvious when addressing risks in this area and emphasises that details are crucial when defending claims.

"The key to growth in this area is actually identifying client risks when they think they have none," he says.

"A lot of growth in PI doesn't come from the traditional professions, it comes from growing, diverse organisations where they might have a non-core division that can be deemed as offering professional services and may well have exposure to negligence."

Mcphee thinks brokers can create opportunities in the PI sector by providing expertise.

HOW TO TALK TO CLIENTS ABOUT PI INSURANCE

1. Give examples. A broker should explain the coverage provided by a PI policy by way of claims examples.
2. Understand the client's business. To be able to describe the professional business correctly to ensure coverage it is essential that brokers understand the business.
3. Collect and provide information. By collating and providing better information, the broker is likely to receive better and more competitive terms for their client.
4. Be mindful of your own exposure. Brokers need to ensure they correctly assess their own PI exposure.

"A broker who is knowledgeable of the coverage being provided and can discuss potential exposures that a particular insured faces can differentiate themselves, creating opportunities. Many underwriters provide claims examples and brokers should select claims examples relevant to each client," he says.

McPherson believes that one of the major overlooked opportunities in the sector is in relation to upselling limits of indemnity.

In recent years, the legal costs associated with defending claims have risen dramatically and the level of complexity of cases has also increased. With premiums relatively low and very competitive in certain professions, it seems an opportune time for clients to significantly increase their current policy limits of indemnity, he explains.

"Many of the standard professions continue to affect just the minimum limit of indemnity recommended by the professional associations, namely $1,000,000 or $2,000,000 with an automatic reinstatement. To my mind, this could very cost effectively be increased to $5,000,000 or $10,000,000 with multiple reinstatements in the current environment. I regularly seek to present to my client a doubling of their current PI policy limit as an alternative for serious consideration."

Mcphee concurs, adding that a broker should always offer the limit of indemnity requested by the client together with an option for a higher limit.

"This is both a potential opportunity to upsell, plus protection against claims against the broker in the event that the insured reports a claim that is more than the limit the insured requested," he notes.

Evolving risks

"Cyber is the biggest emerging risk brokers need to discuss with their clients. Cyber is an incredibly difficult area for brokers to advise their clients on as the policy wordings are so diverse and many of the coverages are confusing and untested," says Mcphee.

McPherson agrees: "Cyber and privacy protection is an emerging area of risk for professional service firms and those that retain large amounts of sensitive client information, such as financial services firms, health and medical establishments and legal are the professions at greatest risk."

Further, whether an affected organisation is small or large is irrelevant; each may hold significant amounts of data.

All brokers should be having a serious discussion with their professional service firm clients on various coverage options, emphasises McPherson.

"We have seen some PI insurers especially in the SME sector add limited cyber liability extensions to their standard PI policies… and as a precursor to a standalone policy response."

Underwriter concerns

Mcphee believes that in the current electronic environment one of the greatest challenges an underwriter faces is obtaining adequate information to be able to assess the PI exposure.

"Brokers and their clients do themselves a disservice by providing incomplete or inadequate information," he says. "If the risk is obscure then the best approach is to provide a couple of paragraphs or bullet points of the activities. Brokers should not provide a 50-page description of the clients' activities without a couple of paragraphs to summarise the activities.

"The more at ease an underwriter is with the risk, the more likely it is that they will provide better and more competitive terms." ☒

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