

# Sting in the tail

**PETER BOBBIN** examines the continuing crisis involving professional indemnity insurance. He warns advisers that superannuation claims can take years to come to the surface.

**WHAT EXACTLY** is adequate compensation? Many people will respond that it is the requirement under section 912B of the Corporations Act for an Australian Financial Services Licensee to have in place a system of compensation for aggrieved and affected clients.

It complements the risk-management systems and compliance practices critical to the licensing requirements of a financial services business in Australia.

Central to adequate compensation is the professional indemnity insurance policy.

In its August 2002 report to the Senate on the state of the PI market in Australia at that time, the Financial Planning Association declared that the PI problem had “reached crisis point”.

It took some time for premiums to return to more normal levels, but the crisis still exists, and it has become personal. Not too many people are aware of this.

I have long been an advocate for proper professional insurance, but all too often, premiums drive an adequate compensation decision. But who is it adequate for?

Consider the following scenario. An adviser had been servicing clients since the late 1980s. Over that time, he saw the client’s family grow up while the client grew old. Changes to dealer structures, especially the frenzied takeover days of the early 2000s, saw the adviser’s business card updated from time to time with each new dealer principal. Throughout this time, the only constant was the adviser’s client base.

The superannuation and retirement plans put into place in those early days provided the client with confidence for a future financial retirement. But then he died, too young to enjoy the lifetime efforts and generation of adviser support.

**It must be understood that superannuation claims have a long tail and can lie in wait for decades before raising their heads to strike.**

The widow was grateful for the nest egg that had built up, that was until her university-educated daughter pointed out that the recommendations from the early years had affected the value of the nest egg. It wasn’t big enough, and it could have been bigger, she claimed.

The lawyer was only too happy to accept the brief. The statement of claim ran for many pages – it had to – not only was the adviser named as first defendant, but so too were each of the dealer groups that spanned the years.

The negligence claim dated from the early 1980s but was said to be refreshed with each new dealer group – on “adoption” of the client the new dealer should have assessed the financial facts and circumstances, and if it had done so, the loss would not have occurred or continued.

Some dealer groups were self-insured. Others enjoyed deductibles of \$500,000. One passed the claim to their PI insurer.

In the first grouping of dealers, no one was willing to take on the claim. There was a slim hope that one would come forward but until then the claim had to be managed. The adviser paid out close to \$45,000 to her solicitor to manage the fiasco.

Many felt the claim was spurious. All felt relieved that the claim exceeded the Financial Industry Complaints Scheme limit. That is, all but the adviser, who kept paying for the solicitor to attend yet another frustrating court appearance that was adjourned again to allow the plaintiff to readjust her pleadings.

## What is adequate compensation?

When looked at from the perspective of the adviser, it is a PI policy that will respond at the time of need, and this raises the question of who is insured.

The law imposes the client liability upon the licence

holder – so it needs to be insured. This leads to the dealer selecting the PI insurance.

When claims are rare and margins are squeezed, the premium cost plays an important role in the PI selection process. This is where large deductibles result in useless insurance; the insurance company does not need to respond to a claim that is less than the first amount that the dealer has agreed it will be liable to pay.

This is where the dealer-rep agreement comes into the equation. The dealer may have a large deductible so as to keep premiums down and because the dealer-rep agreement presses the liability upon the representative. That means the adequate compensation provisions of the law for the consumer are satisfied, but the adequate compensation needs of the adviser are not satisfied!

In our scenario, after months of haggling, an insurer finally took responsibility for the claim. Others still denied any liability; some because they said that their policies operated only on a claims-made basis, or that the run-off cover had expired.

What surprised the adviser the most was that the claim arose out of facts that occurred 20 years ago.

Isn’t there some policy rule that says claims do not survive a prescribed period? Hadn’t the facts supporting the claim gone legally stale? Yes, that is the general rule, but the courts can be inventive, as was again demonstrated very recently by the High Court’s April 2007 decision of *Commonwealth of Australia v Cornwell*.

## The Cornwell case

What was complained of in *Cornwell*’s case was that the commonwealth was vicariously liable for the advice that a superior gave him. In reliance upon that advice, he had lost the opportunity of joining the Commonwealth Superannuation Fund on and from May 8, 1965, and in consequence, upon his retirement on December 31, 1994, received a lesser benefit than that which he would have received had he been admitted to the Fund on and from May 8, 1965.

The *Cornwell* case, even though it was dealing with a 30-year-plus claim of negligence, was a bland deci-



sion. It centred upon when the claim of *Cornwell* first started to run. It was accepted that he had received bad advice and that the result of the advice was less superannuation in retirement.

It was also accepted that limitation laws applied to limit the time that the claim could remain outstanding. The only question was when the limitation principle began. Was it in 1962 when he started employment, 1965 when he qualified for better superannuation that was not taken up, or from 1987 when he became a permanent public servant? Any of these years would have resulted in his claim going stale.

## Continuing crisis on PI insurance

The principle in the Limitation Act was that an action on any cause of action is not maintainable if brought after the expiration of a limitation period of six years running from the date on which the cause of action first accrues to the plaintiff or to a person through whom he or she claims.

When addressing the commencement point, the High Court said: “to show the existence of a completely constituted cause of action in negligence, a plaintiff must be able to show duty, breach, and damage caused by the breach; accordingly, in the ordinary case, it is at the time when that damage is sustained that the cause of action ‘first accrues’ for the purposes of a provision such as s11 of the Limitation Act”.

In other words, the High Court said that the limitation principles started to run only from the day that he could first have been aware of a loss. This was the day that he retired from work, on December 31, 1994. He therefore had until December 31, 2000, to lodge a claim. He did so in November 1999.

There is a continuing crisis on PI insurance in the Australian financial services profession.

The facts of our adviser scenario are true and the *Cornwell* case supports them. It must now be understood that super claims have a long tail and can lie in wait for decades before raising their heads to strike.

If the scenario were to happen when our adviser retired, perhaps there would be no PI insurance for the adviser to fall back upon. ☹