

Market Update

OCTOBER 2020

Changes to professional indemnity requirements for solicitors in New Zealand

AT A GLANCE

The New Zealand Law Society is amending the minimum standards for lawyers in New Zealand who hold professional indemnity insurance.

The changes are material and take effect from 4 April 2021.

Minimum standards of cover are set to increase.

Significant disclosure changes will also be put in place, which may affect the negotiations in future negligence claims.

OVERVIEW OF THE CHANGES

The New Zealand Law Society is amending the minimum standards regarding professional indemnity insurance for lawyers in New Zealand. The changes are material and relate to coverage levels and disclosure requirements.

From 4 April 2021:

- The minimum standard of cover will be *the greater of* \$1.2 million per practice, or \$900,000 per partner/director. This will be on a defence costs exclusive basis.
- Where a solicitor holds no professional indemnity insurance, this must be disclosed to the client at the outset (no change).
- Where a solicitor's insurance does not meet the minimum standards *or* has an aggregate limit that does not automatically reinstate at least once, they must provide full disclosure to their clients.
- Full disclosure includes the identity of their insurer, the policy limit (and whether it is per claim or aggregate) and their excess.

The NZLS is also making specific recommendations for run-off and cyber cover, although these are not part of the minimum standards.

Despite the recommendations and increased consumer protection focus, it remains the case that there is no obligation for solicitors to hold professional indemnity cover.

CHANGES TO MINIMUM REQUIREMENTS FOR PROFESSIONAL INDEMNITY INSURANCE

In New Zealand it is not compulsory for lawyers to hold professional indemnity insurance.

However, a law firm must disclose its professional indemnity insurance arrangements to its clients¹, including where insurance is not held. Currently that consists of advising whether a lawyer or firm has professional indemnity insurance that meets or exceeds the minimum standards.

The changes to the minimum requirements are being increased to reflect inflation in New Zealand (the current requirements were set in 2008). Come **4 April 2021**, the minimum policy limit for a lawyer or firm will be the greater of:

- \$1.2 million per practice (costs exclusive), or
- \$900,000 for each partner (or in the case of an incorporated law firm, for each lawyer who is a shareholder or director) within the practice (again, costs exclusive).

The indemnity limit applies either on:

- an aggregated basis to claims made in the policy period with not less than one automatic reinstatement, or
- an any one claim basis with no aggregate limit.

We sought clarification from the Law Society who confirmed this means the minimum requirements will only be met if the full indemnity limit applies per claim, i.e. if a policy has both an in-the-aggregate limit (which meets the new criteria above) and a lower claim limit (which does not meet the minimum standards above) **full disclosure** will be required – see below.

The excess payable must not exceed the *greater of* 1% of the indemnity limit or \$20,000. For example, a three partner practice will now need to hold a policy limit of \$2.7 million, and their excess must not exceed \$27,000 (if their indemnity limit is no more than the minimum).

The Law Society has been advised that the additional premium for a two-partner law firm, which increases its cover from \$1.5 million to \$1.8 million, is likely to be in the 7.5% to 10% range. Whether that reflects the reality of the current market, though, is something brokers and underwriters will have a better feel for.

CHANGES TO DISCLOSURE REQUIREMENTS IN AGGREGATE POLICIES THAT DO NOT HAVE AN AUTOMATIC REINSTATEMENT CLAUSE OR DO NOT MEET THE MINIMUM STANDARDS

Where a policy does not meet the new minimum standards or operates on an aggregated basis² **full disclosure** is required **unless** the indemnity limit will automatically reinstate at least once in the policy period.

Full disclosure now requires a lawyer or firm to disclose:

- the name of the insurer(s)
- the indemnity limit
- whether the indemnity limit applies to each claim, and
- the excess payable.

Full disclosure may have unwelcome implications at claim time. A claimant will hold policy information that was previously considered confidential between the insured lawyer or firm and its insurers.

Underwriters, brokers and insureds should carefully consider this disclosure requirement at renewal time.

MINIMUM STANDARDS DO NOT INCLUDE DEFENCE COSTS

Significantly, the minimum indemnity limits referred to above are exclusive of defence costs. This change reflects the well-known impact of the *Steigrad*³ charge, which held the charge available to third party claimants under s9(1) of the *Law Reform Act 1936* has priority over defence costs under a costs inclusive policy.

The NZLS recommends lawyers separately insure against defence costs in addition to indemnity cover. So the \$2.7 million cover limit in the example of a three partner practice above would not include cover for defence costs. There does not appear to be any exception to this requirement for underwriters resident overseas and not subject to the *Steigrad* charge.

¹ Rule 3.4(b) of the Lawyers and Conveyancers Act (Lawyers: Conduct and Client Care) Rules 2008

² i.e. the limit is not on a per claim unlimited in the aggregate basis.

³ *BFSL 2007 Ltd v Steigrad* [2013] NZSC 156

OTHER RECOMMENDATIONS FOR SOLICITORS' INSURANCE: RUN-OFF AND CYBER COVER

Although not part of the minimum requirements, the NZLS is also recommending lawyers take run-off cover for an aggregate of at least six years where they retire, sell their practice, merge with another firm, dissolve their practice, or where a lawyer moves from general practice to become a barrister.

The NZLS is also advising law firms to insure against cyber risk – an increasing area of concern for lawyers. There has been at least one finding of unsatisfactory conduct against a lawyer where that lawyer acted on instructions from a hacker he believed was his client.

In *Lawyer D⁴* a lawyer involved in a property transaction was deceived by an unknown third party. The thief emailed the lawyer from the client's email address changing the designated bank account for settlement funds.

The lawyer was found not to have taken adequate steps to confirm the authenticity of the new bank account details before paying the client funds into the account.

The lawyer was censured and ordered to compensate his client for the portion of the settlement funds that had not been returned to the client. The Standards Committee noted they would also have fined the lawyer except in this instance they used their discretion, given his apparent financial position.

COMMENT

No doubt the new minimum standards will require a significant amount of professional indemnity policies to be updated at next renewal or before April next year. The increase in minimum standards may not be too much of a concern – but the disclosure obligations that will apply if the cover does not meet the minimum reinstatement provisions should give underwriters some pause.

Having claimants understand policy limits and excesses would be an unwelcome development in the defence of any solicitor negligence claim.

The simplest solution will be for the market to ensure policies:

- meet the minimum limit, ie \$920,000 per partner, or \$1.2m per firm;
- have an excess the greater of 1% of the limit, or \$20,000;
- on a costs in addition basis; and
- with at least one automatic reinstatement.

Need to know more?

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⁴ <https://www.lawsociety.org.nz/for-the-public/complaining-about-a-lawyer/standards-committee-decisions/2017/acting-on-hackers-instructions/>

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