



January 2024

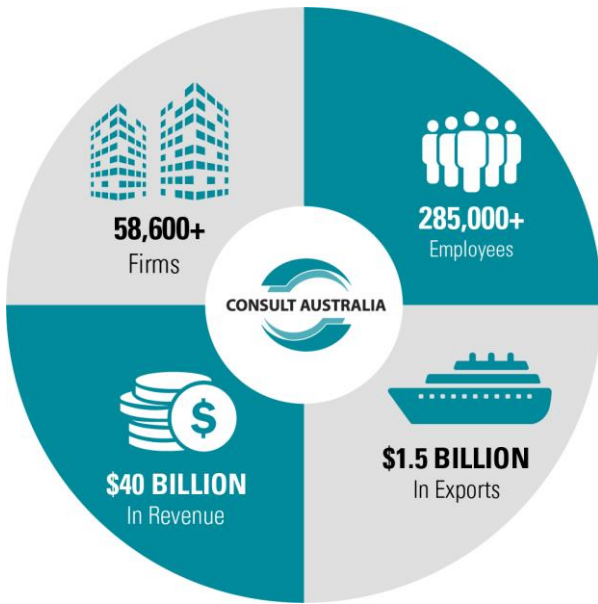
**Professional indemnity insurance in
the building and construction
industry**

**SUBMISSION TO NSW DEPARTMENT OF
CUSTOMER SERVICE**

Consult Australia

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ABOUT US

Consult Australia is the industry association representing consulting businesses in design, advisory and engineering, an industry comprised of over 58,600 businesses across Australia. This includes some of Australia’s top 500 companies and many small businesses (97%). Our members provide solutions for individual consumers through to major companies in the private sector and across all tiers of government. Our industry directly employs over 285,000 people in architectural, engineering and technical services and many more in advisory and business support. It is also a job creator for the Australian economy, the services we provide unlock many more jobs across the construction industry and the broader community.

Our members include:



A full membership list is available [here](#).

EXECUTIVE SUMMARY

Consult Australia thanks the NSW Department of Customer Service for releasing its Options for Change paper relevant to Professional Indemnity Insurance in the Building and Construction Industry. Setting aside time and space to consider these issues in depth is necessary given the considerable and widespread concern in the industry about the affordability and availability of professional indemnity (PI) insurance.

It is noted that the backdrop to this Options Paper is the NSW government's drive for improved consumer confidence in NSW buildings – a policy Consult Australia supports. Central to achieving this policy in practice for the people of NSW is ensuring that the regulatory settings encourage a thriving and accountable industry.

At the core of Consult Australia's advocacy is a solutions mindset. We seek to share our understanding of the interplay between PI and contractual settings and regulatory settings to help the NSW government realise its policy intent.

In this submission we provide introductory comments regarding the current state of the PI insurance market, particularly regarding engineering occupations and the construction sector. In response to the proposed options for change, Consult Australia submits:

- ✓ **Option 1** – Consult Australia **agrees** that the NSW government needs to address the 'adequate' insurance definition in the insurance requirements for registered practitioners under the DBP Regulations. Consult Australia supports reviewing and amending Part 6 of the DBP Regulation to address concerns about the operation of the current requirements – the scope of issues proposed is supported. Consult Australia does not support introducing prescriptive minimum/maximum requirements for insurance in legislation.
- ✗ **Option 2** – Consult Australia **disagrees** that professional standards schemes will sufficiently address issues in the PI insurance market. Consult Australia does not believe that an exemption within the DBP Act for PSS would encourage professional associations to develop a scheme. There are too many other hurdles to implementing a scheme that an association needs to consider (including cost vs benefit) and there are many other matters beyond a scheme that have a better chance of improving the market for PI Insurance (such as prohibiting the contracting out of proportionate liability).
- ✓ **Option 3** – Consult Australia **supports** the use of project-based insurance where available, however it is difficult to comprehend how such an exemption to the insurance requirements would work in practice. Consult Australia recommends that the insurance industry will have the best advice on the limited availability of project specific insurance and/or decennial liability insurance.
- ✓ **Option 4** – Consult Australia **agrees** that more needs to be done to address PI impacts from government contracts. However more action is needed than what is set out in the Options Paper. There would be immediate relief for NSW businesses if there was an explicit prohibition on contracting out of proportionate liability. Consult Australia sets out additional solutions in this submission.

Consult Australia is eager to work with the NSW government to find the best solutions to the issues faced by industry and the people of NSW.

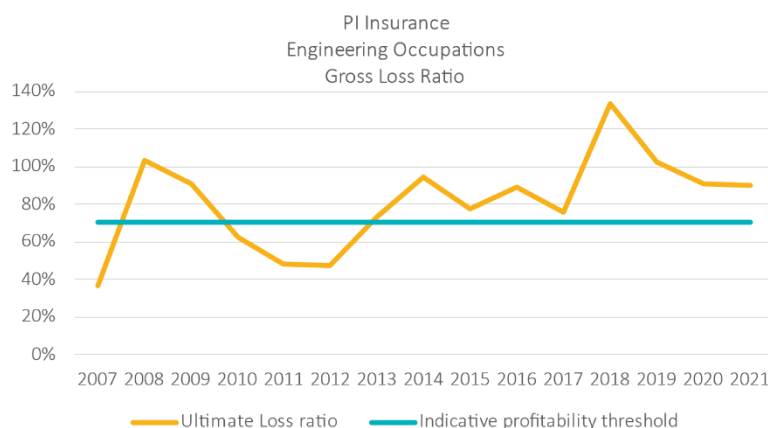
CURRENT STATE OF THE PI MARKET

The insurance market is generally understood to have a cyclical nature, periodically going through hard and soft cycles. Since around 2017 we have seen a particular ‘hardening’ of the professional indemnity (PI) insurance market which has resulted in:

- increases in policy excesses and premiums
- cover restrictions as a loss mitigation technique
- capacity challenges as the demand for insurance outweighs supply.

Consult Australia holds that the current market is not a typical hard cycle that will resolve itself – especially when it comes to the building and construction industry and particularly in respect of engineering occupations.

This is borne out by figures that show a general improvement to PI insurance lines overall but still shows concerning gross loss ratios specific to the PI insurance for engineering occupations. Both the May 2023 APRA [NCPD Analysis: Review of claims trends and affordability of public liability and professional indemnity insurance in Australia](#) and the October 2023 [Optima General Insights 2023](#) report note that PI loss ratios have improved with some ‘green shoots of recovery’ however there remains ‘some pressure’ on construction professions. The figure below demonstrates this clearly, with the gross loss ratios for PI insurance for engineering occupations still sitting above the indicative profitability threshold. Therefore, while there is some softening in insurance overall, it will not necessarily flow to engineering businesses.



Source: Finity's Marketvue estimates from NCPD data

Unfortunately, PI insurance for construction (including engineering occupations) would be such a line as supported by the Optima General Insights 2023:

From the insurance supply side, there seem always to be underwriters enthusiastic about the [construction] sector, perhaps because of the volumes available; however, the appropriate underwriting and pricing structures to create more stable, sustainable portfolios seem to be elusive.

OPTION 1 – REVIEW & AMEND DBP REGULATIONS

Consult Australia **agrees** that the NSW government needs to address the 'adequate' insurance definition in the insurance requirements for registered practitioners under the DBP Regulations. Consult Australia supports reviewing and amending Part 6 of the DBP Regulation to address concerns about the operation of the current requirements – the scope of issues proposed is supported. Consult Australia does not support introducing prescriptive minimum/maximum requirements for insurance in legislation.

Consult Australia has long held concerns about the obligations in Part 6 of the DBP Regulations – see our [submission to the Regulatory Impact Statement](#) of January 2021. Our preferred option continues to be removal of Part 6 and reliance on the simple requirement in the DBP Act that practitioners hold relevant insurance. Some of the key concerns we hold are:

- No PI insurance policy can cover 'any' or 'all' or liabilities a practitioner may be subject to as a result of delivering their services – the cover and conditions of cover are set by the insurance underwriter.
- Liabilities change over time (e.g. contract to contract not year on year renewal of the insurance policy) therefore the obligations to make the determination as well as keep records becomes unmanageable.
- Individual practitioners within a business (except where the individual is a sole trader etc) cannot generally access the full terms of the PI policy, as most commonly the policy is taken out by the business and the business itself may be unable to disclose its coverage terms without insurer approval (i.e. because such action may potentially prejudice an insured's coverage position in the future).
- Individual practitioners do not have a role in commercial contract negotiations and therefore cannot control the liabilities that might attract to their work (except where the individual is a sole trader).
- The insurer maintains the right to accept or reject claims made under a policy – meaning that the insured is never guaranteed coverage.

If the government is not minded to remove Part 6 of the DBP Regulation, Consult Australia would support reviewing and amending the regulations to address widespread industry concern. Amendment of the regulations to address industry concerns is preferable to introducing a prescriptive minimum/maximum requirement for insurance.

Consult Australia agrees with the elements that should be included in the review. Consult Australia further recommends that the review is transparent with proposed redrafting to be open to public consultation with genuine engagement from the government open to change.

It is worth noting that Consult Australia does not fully agree with the disadvantages set out in the Options Paper (page 5). For example, Consult Australia does not agree that specifying prescriptive conditions for PI insurance policies would ensure that practitioners would hold a minimum amount of cover, benefiting consumers. Insurance is a commercial product, the conditions of which are not within the power of the business seeking cover, so prescriptive conditions set by government would not assist the business obtaining relevant cover. Further, given the recent report by Business NSW *Insurance at the Speed of Business* that shows excessive amounts of coverage, especially in respect of PI insurance, we do not agree that there is a risk of under-insurance (assuming parties are only liable for losses flowing from their work and do not accept other unreasonable liabilities – as explored further below).

OPTION 2 – PSS EXEMPTION

Consult Australia **disagrees** that professional standards schemes will sufficiently address issues in the PI insurance market. Consult Australia does not believe that an exemption within the DBP Act for PSS would encourage professional associations to develop a scheme. There are too many other hurdles to implementing a scheme that an association needs to consider (including cost vs benefit) and there are many other matters beyond a scheme that have a better chance of improving the market for PI Insurance (such as prohibiting the contracting out of proportionate liability).

Consult Australia's position on PSS has been made clear in many forums with the government, so we refrain from diving into detail here, save to say there are many other matters that have a better chance of improving the market for PI insurance – including the solutions presented below under Option 4.

OPTION 3 – PROJECT BASED INSURANCE

Consult Australia **supports** the use of project-based insurance where available, however it is difficult to comprehend how such an exemption to the insurance requirements would work in practice. Consult Australia recommends that the insurance industry will have the best advice on the limited availability of project specific insurance and/or decennial liability insurance (DLI).

In the experience of Consult Australia members, project-specific professional indemnity (PSPI) insurance has been a struggle to secure for many years. Further, it is difficult to understand how project based insurance would fit within the reporting under Part 6 of the DBP Regulations. Consult Australia defers to the insurance industry for the best advice on the availability of DLI.

OPTION 4 – GOVERNMENT CONTRACTS

Consult Australia **agrees** that more needs to be done to address PI impacts from government contracts. However more action is needed than what is set out in the Options Paper. There would be immediate relief for NSW businesses if there was an explicit prohibition on contracting out of proportionate liability. Consult Australia sets out additional solutions in this submission.

Consult Australia agrees that PI insurance requirements need to be addressed in NSW government contracts, as well as other contractual settings that impact PI.

In the Options Paper, it is proposed that the Department will liaise with the [NSW Construction Leadership Group](#), given it has charter for the [10 Point Plan](#) and/or facilitate a forum between industry, Infrastructure NSW and infrastructure agencies (including Transport for NSW, Department of Education and NSW Health). Consult Australia suggests NSW Treasury also be involved because they are currently undertaking and implementing a whole of government project on [procurement policy reforms](#), notably contract framework, that relates directly to this issue. This proposed approach will facilitate and resolve the tangible outcomes need to be achieved for government, industry and the people of NSW.

To assist the government, below are some of the core solutions Consult Australia continues to advocate for with all agencies and which need action, rather than just more talk:

- Secure proportionate liability
- Recalibrate insurance levels and obligations

- Set a limit on liability without significant carve outs
- Risk assessment.

Secure proportionate liability

The Options Paper refers to the benefits of proportionate liability, but also concludes:

Despite more proportionate and tailored requirements for PI insurance amounts, Government Contracts and private sector contracts will still be permitted to contract out of proportionate liability.

Proportionate liability is a statutory right, which ensures that a party is only liable in damages for the proportion of the suffered loss that is attributable to that party. It only applies to financial harm and economic loss, not to cases involving personal injury or death. Proportionate liability was introduced nationally through state and territory civil liability legislation to improve the availability and affordability of professional indemnity (PI) insurance in Australia following the insurance crisis of 2001 when the insurer HIH collapsed.¹

The key policy objective of proportionate liability – helping to ensure that PI insurance is available, affordable and dependable – is undermined if design and engineering consultants are required by a client to contract out of the proportionate liability legislation.

The 2001 reforms were positively received by local and international insurers. Anecdotal evidence indicates these measures have assisted in improving the allocation of capital to Australian PI insurers. However, insurers have also indicated that if the application of proportionate liability can be by-passed contractually the insurance market will price and allocate capital to Australian PI risk as if proportionate liability does not apply.

Under the *Civil Liability Act 2022* (NSW) it is permissible to contract out of proportionate liability, and it is more common than not for NSW government contracts to contract out of proportionate liability. This is in stark contrast to the situation in QLD where the civil liability legislation explicitly prohibits contracting out of proportionate liability. Therefore, government clients in QLD cannot and do not contract out of proportionate liability.

To realise the intent of the civil liability reforms and to bring balance back to the market, especially as it relates to the availability and affordability of PI for consulting designers and engineers, Consult Australia advocates for preserving proportionate liability in all professional services contracts.

Consult Australia would be keen to receive advice from the NSW government as to why it cannot follow the lead of QLD government clients.

Recalibrate insurance levels and obligations

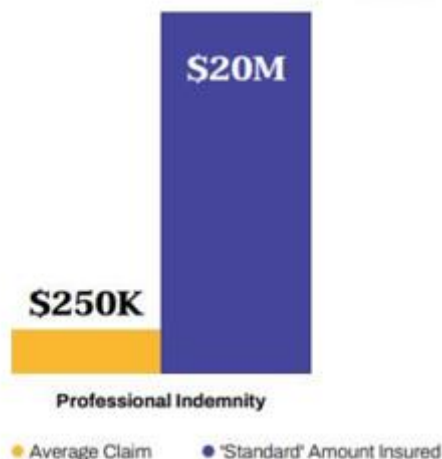
Too many burdensome insurance requirements currently exist in NSW government contracts:

- *Unreasonable policy obligations* – examples include clauses where clients must approve the business' insurance policy and/or see full copies of insurance. These types of obligations are not only unreasonable but also often unable to be met. For example, insurance policies are commercial in-confidence between the insurer and the insured so cannot be shared.
- *Inappropriate insurance limits* – examples include significant high limits such as \$10m PI insurance that do not reflect the risk of the supplied services and/or what is available in the market to such businesses.

Consult Australia's advocacy on insurance matters is supported by the Insurance Council of Australia that says that 'over protection' is a significant issue to be addressed in government

¹ 2015 Treasury Briefing, '[Aftermath of the HIH collapse](#)'.

contracts. We urge the NSW government to also consider the recent report by Business NSW, [Insurance at the speed of business](#), which demonstrates that while the average PI claim was \$250k, the typical PI insurance coverage sought by business was \$20m. This discrepancy is driven in part by the burdensome insurance requirements set by government clients.



Source: Business NSW Survey Results 2023; NPCD Level 2 Data Sector Specific GCP by Claims average 2019-2022

Set a limit on liability without significant carve outs

The concept of a limit of liability recognises the risk/reward balance between the parties. Importantly a limit of liability is an acknowledgement that consulting businesses typically have limited tangible assets, noting that the value of the business lies in the skill and professionalism of the people they employ and the intellectual property they produce.

A requirement for unlimited liability might seem attractive to government on the face of it. In reality, once a consultant’s insurance and assets are exhausted, any unmet liability falls back to the client because the consultant will have no option but to close the business. This is undesirable not only for the client, but also for the people working in that organisation, the other businesses that have contracts in place with that consulting business (e.g. other clients, sub-consultants, suppliers), and the economy more broadly.

Limiting the liability of consultants through the terms of the contract ensures that there is agreement between the consultant and principal about the risks and levels of liability that both parties may be exposed to. In assessing this the parties can:

- agree an amount that provides both with some surety as to their level of exposure
- avoid duplication of contingency funds to cover the same potential risk event
- avoid unnecessarily inflating the cost of the project
- better reflect the risk/reward profile of the project.

Limitation of liability carve outs should not be included in contract drafting because they typically negate the value of the clause as they seek to undermine the operation of the limit. Examples of carve outs that should **not** be permitted:

- insurance proceeds
- indemnities
- third party claims
- property damage
- loss of use of property
- consequential loss.

Risk assessment

All projects carry a certain amount of risk. Every project is different and comes with both inherent and unique challenges. It is important that the NSW government recognise this and acknowledge and account for these risks. Consult Australia recommends that risk assessment is undertaken on all projects and should be an integral part of the procurement process. A straight pass through of risk to contractors/consultants does not equate to risk management and gives project owners a false sense of security.

It also does not demonstrate a balance between risk and reward for each party involved in the project. For example, consultants are appointed to advise and assist their client to deliver a project. A consultant's fee will only be a small proportion of the total project cost – on major projects this can be typically 5% of the total project cost. Therefore, there is a significant imbalance between risk and reward if consultants are required to carry unlimited liability for all loss/damage connected to the project, typically driven through the inclusion of indemnity and warranty clauses in the contractual terms and conditions.

Project owners should instead undertake a risk assessment process to better understand and apportion risk appropriately, acknowledging they also carry ownership of risk.

All government contract clauses should be broad enough to cover the risk to the government. Too often very broad clauses are drafted and included in government contracts that are unnecessary to protect the interests of the public purse. For example, Consult Australia recommends that instead of broad consequential loss provisions, government clients assess what losses need to be protected against (such as loss of use of the final project caused by the consultant) and cover just those consequential losses.

CONTACT

We would welcome any opportunity to further discuss the issues raised in this submission.



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