

Fidelity Cover 11 December 2009

Introduction

Practising lawyers represent a category of professionals required to hold both professional indemnity insurance and fidelity cover. Clients obtain the benefit of protection against losses, whether they are caused by negligence or wrongdoing. This is because solicitors hold trust funds as part of their practice and there is a risk of direct pecuniary loss to a client in the event of a defalcation.

At present, each jurisdiction has a legislative fund ('fidelity' or 'guarantee' fund) for the purpose of compensating losses resulting from a dishonest failure to account or the dishonest default by a law practice. The funds receive annual contributions from practitioners as part of their practising certificate requirements and, in some jurisdictions, from approved clerks and/or foreign-registered lawyers.

Background

Each jurisdiction's fidelity fund is established pursuant to the State or Territory's legal profession legislation. The purpose of the fund is to provide a source of compensation for people who suffer financial loss in the event of dishonest failure to account or the dishonest default by an associate¹. This is based on the core, uniform definitions of 'default' and other key definition provisions in the Model Bill. The fidelity fund is administered by the law society or regulator in each jurisdiction (e.g. in Victoria, it is administered by the Legal Services Board).

In accordance with the Model Bill definition, a dishonest failure to account includes, but is wider than, a misappropriation of trust money for the associate's own purposes. For example, a failure to account may involve a client's money being paid to a third party contrary to the client's instructions, and where the associate's conduct involved dishonesty.

A dishonest default is also covered by the fidelity fund. Where there has been a dishonest act or omission by an associate and a judgment is obtained against that person, the amount of the judgment may be paid by the fund if the associate does not make payment.

Payments of successful claims in relation to failure to account and dishonest default may be subject to caps (maximum aggregate amounts) determined from time to time pursuant to relevant sections of the jurisdiction's legal profession legislation. In some jurisdictions, there is a discretion (vested in the Attorney-General, for example) to make payments over and above the set cap.

The Fund is financed by annual contributions made by solicitors and may be supplemented by allocations from public purpose funds or trust account interest or the imposition on solicitors of an additional levy. All possible steps are taken to recover money from the associates whose

¹ The Model Bill definition of 'associate' includes Australian legal practitioners as well as partners, employees and agents of law practices who are not Australian legal practitioners (s 1.2.4, Model Bill).

conduct resulted in the claim against the fidelity fund and from other persons to whom the misapplied funds can be traced or who are otherwise liable, e.g. a bank, where the bank has converted a cheque.

Snapshot of the current system

Model Bill: The Model Bill contains predominantly ‘core’, but ‘non-uniform’, provisions on fidelity cover, which provide the flexibility for each jurisdiction to tailor fidelity cover to its circumstances. This has been useful and, to some extent, necessary. However, differences between jurisdictions continue to exist in the level of protection that consumers and relevant third parties are afforded. (Also, note that South Australia has yet to adopt the Model Bill.)

Sources of funds: The sources of fidelity funds that are common to all jurisdictions are contributions/levies (in some jurisdictions, this forms part of the practising certificate fee) and money generated from the investment of the fidelity funds. In most jurisdictions, fidelity funds are, or may be, supplemented from either trust account interest or public purpose funds. In one small jurisdiction, the fund may be supplemented with an additional levy (although, this has not been invoked). In another small jurisdiction, all trust account interest is deposited into the fidelity fund.

Payments from fidelity funds: In all jurisdictions, the funds are used to compensate victims of defalcations. However, in some jurisdictions, the funds are also used for other purposes. For example, in three jurisdictions, the funds can be used for regulation. (Note that one of those jurisdictions’ fidelity fund also contains all trust account interest.) In three jurisdictions, fidelity funds are also used for public purposes (mostly Legal Aid).

See **Attachment A** for more information.

Taskforce proposal

Fidelity Funds

The Taskforce proposes to recommend to the Council of Australian Governments that the National Legal Services Board or relevant regulatory authorities consider establishing a single, national fidelity fund at a later stage. A single, national fund would provide uniform cover and uniform remedies for all victims, regardless of where they live in Australia. The pooling of funds could also allow for a higher cap, or no cap at all, on the quantum of compensation, which would allow victims to be compensated fully for their losses. In relation to solicitor contribution amounts, different contributions based on an assessment of each jurisdiction’s risk factors could be retained or the risk could be redistributed and a single, national contribution amount be levied.

The Taskforce considers that a single, national fund is an appropriate long term goal. However, it recognises that its establishment would involve a major restructure of existing statutory accounts and could disrupt existing funding flows. The Taskforce therefore proposes to retain the existing fidelity fund in each jurisdiction at this stage. Under the national regulatory framework, each practitioner would contribute to his/her home jurisdiction’s fund, regardless of whether the practitioner’s law practice operates in one or multiple jurisdictions. The home jurisdiction of a practitioner would be the practitioner’s primary place of legal practice, as evidenced by the practitioner’s practicing certificate.

In the short term, the terms and conditions of fidelity cover would remain unchanged. In the long term, the Taskforce proposes that minimum terms and conditions for cover under a single national fidelity fund model could be established in National Rules. This would be facilitated through the power of the National Legal Services Board to make National Rules on fidelity cover, the maintenance of fidelity funds and claims against a fidelity fund, including the minimum terms and conditions of cover, the requirements and processes for making a claim (e.g. time limits, etc) and the procedure by which a claim is to be processed (e.g. notifications, advertisements, etc).

In the meantime, the Taskforce proposes that these National Rules be based on the legislative principles to be enshrined in the proposed National Law and would incorporate a simplified version of the provisions in the Model Bill.

Fidelity Cover: where a claim would be made

The Taskforce proposes to reduce compliance costs for multi-jurisdictional law practices by allowing each multi-jurisdictional practice to have a single trust account held in one of the jurisdictions in which the law practices operates.

Based on its proposal to allow a practice to have a single trust account, the Taskforce proposes to simplify the Model Bill approach to identifying the relevant jurisdiction in which a claim would be made: the claim would always be made against the home jurisdiction of the associate who defaulted.

Fidelity Cover: administration of funds and determination of claims

The Taskforce also proposes to address any actual or perceived conflict of interest in the administration of funds and determination of claims by requiring the relevant regulatory authorities to ensure that claims against fidelity funds are determined at arms length from the profession and professional associations.

The Taskforce recognises that the role of the profession in this area of regulation raises perceived conflict of interest issues similar to those in the area of complaints-handling. It also recognises, however, the valuable contribution of the profession in this area of regulation. The Taskforce therefore proposes to include in the National Law a legislative principle requiring claims to be determined independently, at arm's length from the profession and professional associations.² The Taskforce also seeks the views of the Consultative Group on options for achieving this, e.g. by ensuring that the majority of people governing the administration of a fidelity fund are independent, by having an independent person assess claims against the fund or by having the National Legal Services Ombudsman (through its delegate in the relevant State and Territory) consider and determine a claim against a fidelity fund.

² Mr Bill Grant, Taskforce member, does not agree with this proposal.

Proposed Regulatory Objectives

The Taskforce proposes the following overarching objective for this area of regulation, which is based broadly on the purpose enunciated in the Model Bill³:

To ensure that consumers of legal services have a source of compensation for defaults by law practices arising from or constituted by acts or omissions of associates.

Proposed Regulatory Principles

The Taskforce proposes the following legislative principles, which are predominantly based on the provisions of the Model Bill:

Principle 1: A person who suffers loss as a result of a default by a law practice is entitled to make a claim against the relevant fidelity fund⁴ in accordance with the National Rules.

Principle 2: A default⁵ by a law practice is a failure of the practice to deliver trust money or trust property received in the course of legal practice, where the failure is due to a dishonest act or omission.

Principle 3: Unless otherwise exempted, an Australian legal practitioner is to contribute to the fidelity fund in accordance with the National Rules.

Principle 4: The relevant regulatory authority is responsible for administering the fidelity fund. Administering the fidelity fund may include arranging insurance for the fund.

Principle 5: Claims against the fidelity fund must be determined independently, at arm's length from the profession.⁶

Principle 6: The relevant regulatory authority may investigate a claim made to it in any manner it considers appropriate.⁷

Principle 7: The Board may issue National Rules⁸ on fidelity cover, the maintenance of fidelity funds and claims against a fidelity fund, including:

- the minimum terms and conditions of fidelity cover;
- the requirements and processes for making a claim, including time limits, etc; and
- the procedure by which a claim is to be processed, including notifications, advertisements, etc.

³ Section 3.6.1 of the Model Bill provides that '(T)he purpose of this Part is to establish and maintain a fund to provide a source of compensation for defaults by law practices arising from or constituted by acts or omissions of associates.'

⁴ The relevant fidelity fund would be defined in as outlined above.

⁵ The Taskforce proposes to adopt the Model Bill definition of 'default' (s 3.6.2).

⁶ Mr Bill Grant, Taskforce member, does not agree with this proposal.

⁷ The relevant regulatory authority would have the investigatory powers to be proposed in the draft National Law.

⁸ The Taskforce proposes that the National Rules be based on a simplified and streamlined version of Part 3.6 of the Model Bill.

SUMMARY OF CURRENT SYSTEM

| State /Territory | Sources of funding | Current contribution (per practitioner) | Total contributions (07-08) | Who administers the fund? | Who investigates claims? | Who determines claims? | What can pay-out cover? | Monetary limit on pay-out | Other info to note |
|------------------|---|---|-----------------------------|--|---|------------------------|--|---|---|
| NSW | Contributions May be supplemented through a levy if funds are insufficient May be supplemented from Public Purpose fund | \$25 (private practice or ILP) \$50 (in-house) | \$884,454 | Law Society Council (which may delegate functions to a Management Committee) | Law Society | Law Society | <ul style="list-style-type: none"> the specific sum lost as a result of the dishonesty interest, and reasonable costs of the new solicitor in regards to the Fidelity Fund claim. | \$1,000,000 for all claims against a particular solicitor or firm, although Law Society has discretion to pay above this amount. \$1,000 for each dishonest default | |
| Vic | Contributions/levy May be supplemented from Public Purpose fund | \$80-325 (depending on 'class of practitioner') | \$1,147,000 | Legal Services Board | Delegated to the Law Institute of Victoria by the Board | Legal Services Board | <ul style="list-style-type: none"> Amount of actual pecuniary loss suffered from the default reasonable legal costs for making and proving the claim, and interest. | None. | <ul style="list-style-type: none"> Legal Services Board has the power to supplement the fidelity fund from the public purpose fund (s 6.7.13, LPA (Vic)) |
| ACT | Contributions (part of practicing certificate fee) May be supplemented through a levy if funds are insufficient | \$130 | \$281,714 | Law Society | Law Society | Law Society | <ul style="list-style-type: none"> Pecuniary loss resulting from the default Reasonable legal costs involved in making and proving the claim, and Interest. | \$50,000 for a claim by an associate of a law practice in relation to a default of the law practice arising from an act or omission of another associate of the practice, and \$200,000 for any other claim. | <ul style="list-style-type: none"> Also used for regulation – \$34,570 used in 07-08 Law Society Council sets annual contribution |

| State /Territory | Sources of funding | Current contribution (per practitioner) | Total contributions (07-08) | Who administers the fund? | Who investigates claims? | Who determines claims? | What can pay-out cover? | Monetary limit on pay-out | Other info to note |
|------------------|--|---|-----------------------------|--|------------------------------|--|--|---|--|
| Qld | Contributions/levy May be supplemented from trust account interest (Legal Practitioner Interest on Trust Accounts Fund) | \$335 | \$2,311,866 | Law Society (which may delegate functions to a Management Committee) | Law Society | Law Society | <ul style="list-style-type: none"> • Pecuniary loss resulting from the default • Reasonable legal costs involved in making and proving the claim, and • Interest. | <p>\$200,000 for a single claim.</p> <p>\$2m for all claims made in relation to a single law practice.</p> | |
| WA | Contributions/levy May be supplemented from trust account interest | \$20 | | The Legal Contribution Trust | The Legal Contribution Trust | The Legal Contribution Trust | <ul style="list-style-type: none"> • Pecuniary loss resulting from the default • Reasonable legal costs involved in making and proving the claim, and • Interest. | Act allows for a cap, but Regulations do not appear to have set one. | <ul style="list-style-type: none"> • Entitled 'guarantee fund' rather than 'fidelity fund' • Supplemented from trust account interest |
| SA | Contributions/levy (part of practising certificate fee) 40% of trust account interest Fines recovered under disciplinary proceedings Supplemented with excess trust account interest (interest accrued on Statutory Interest Account) | | \$556,693 | Law Society (through Deed of Trust) | Law Society | Law Society, but no payments made without Attorney-General authorisation | <ul style="list-style-type: none"> • Actual pecuniary loss suffered by the claimant in consequence of the fiduciary or professional default | <p>None.</p> <p>(However, claim can only be made if 'there is no reasonable prospect of recovering the full amount of that loss' – s 60, <i>Legal Practitioners Act 1981</i> (SA).)</p> | <ul style="list-style-type: none"> • Entitled 'guarantee fund' rather than 'fidelity fund' • Also used for regulation – \$1,929,645 used in 07-08 (for Legal Practice Conduct Board) • Public purpose payments also from fidelity fund (no public purpose fund) – payments made by AG |

| State /Territory | Sources of funding | Current contribution (per practitioner) | Total contributions (07-08) | Who administers the fund? | Who investigates claims? | Who determines claims? | What can pay-out cover? | Monetary limit on pay-out | Other info to note |
|------------------|--|--|---------------------------------------|--------------------------------|--------------------------|------------------------|--|---------------------------|--|
| NT | Contributions/ levy All trust account interest | Determined by the Funds Management Committee, but may not exceed must not exceed \$500. A legal practitioner who has paid levies in the aggregate of \$1,500 during the whole period of the practitioner's practice in the Territory is not required to pay a further levy. | (includes all trust account interest) | The Funds Management Committee | Law Society | Law Society | <ul style="list-style-type: none"> • Pecuniary loss • reasonable legal costs in making and proving the claim, and • interest. | \$200,000 | <ul style="list-style-type: none"> • Fund includes all trust account interest • Also used for regulation • Public purpose payments also from fidelity fund (no public purpose fund) – payments made by AG |
| Tas | Some trust account interest Costs awarded to the Board or Trust in successful proceedings | | | The Solicitors' Trust | The Solicitors' Trust | The Solicitors' Trust | | | <ul style="list-style-type: none"> • Entitled 'guarantee fund' rather than 'fidelity fund' • Public purpose payments made from fidelity fund (no public purpose fund) – AG may invite Legal Aid Commission or Law Foundation of Tas to apply for a grant |