

Professional Liability Insurance Carrier Annual Interviews – 2015

The American Institute of Architects (AIA), the AIA Trust, the American Council of Engineering Companies (ACEC), and the National Society of Professional Engineers (NSPE) conduct an annual survey of insurance carriers to gather general information regarding professional liability insurance (PLI) policies. The purpose of this activity is to understand how the insurance carriers attempt to meet the PLI and risk management needs of design professionals. Further, through the survey process, compiled responses, and this article, our goal is to provide tools that design professionals can use to compare the various PLI carriers and the products they offer. A compilation of the participating carriers' survey responses is available on the AIA website at <http://www.aia.org/members/memberresources/AIAB101873> and the AIA Trust website at <http://theaiatrust.com/filecabinet/SurveyResults.pdf>.

A number of carriers that respond to the survey are also invited to expand on their survey responses in face-to-face interviews with representatives from AIA, AIA Trust, ACEC, and NSPE. Interviewees are asked to provide written responses to questions aimed at eliciting additional information regarding industry trends and risks to design professionals. During the interviews, interviewees are asked to expand on their written answers, and respond to additional questions from the AIA, AIA Trust, ACEC and NSPE representatives.

The following is a summary of the face-to-face interview discussions.¹ The summary begins with a discussion of general industry trends, including the frequency and severity of claims, followed by a review of developing areas of potential risk and how the insurance carriers are responding to such emerging risks. Finally, the summary will review other major policy highlights discussed during the interviews, as well as the carriers' loss prevention programs.

I. Insurance Industry Trends

As has been the case in the recent past, there are a high number of carriers participating in the PLI market. As a result, PLI products and services are being provided at relatively competitive rates. Additionally, mergers and acquisitions of carriers continue, impacting the number of carriers in the market and the strength of those insurers. Overall, the PLI market is recovering as the construction industry continues to recover from the 2008 recession.

¹ The information presented in this paper is not intended to provide legal or insurance coverage advice. While the information may be helpful in evaluating risks related to professional practices, and in making professional liability insurance procurement decisions, it is not a substitute for consultation with qualified legal counsel and insurance advisors.

a. Professional Service Trends

Many carriers were delighted to note that even more firms are proactively keeping up on risk management issues as well as the responsible management of their practices and projects. That being said, the carriers did identify a number of trends in the industry that were concerning to them. Some carriers noted that while the economy is continuing to recover, many firms are left in a situation where they lack enough experienced employees. Layoffs, downsizing, and limited hiring have put a strain on existing employees, which, from the insurers' perspective, can challenge the quality of the services provided and increase the firm's risk exposure. Water infiltration continues to be an issue to be monitored in the detailing of buildings, as it results in frequent claims. Building Information Modeling (BIM) use continues to grow. Drone use also continues to grow and design professionals utilizing drones will be directly impacted by the recent FAA regulations governing the commercial use of drones.

b. Claims Type/Frequency

Claims frequency overall is trending downward, which continues the trend seen over the past five years. Some carriers reported, however, that increasing market activity typically drives increased claims. Larger projects were cited as having more claims than smaller projects, and residential projects continue to have high claims frequency; especially with apartment-to-condominium conversions. One insurer reported 300% to 500% higher claims frequency with condominium projects.

While condominium projects represent a sizable portion of the industry, some insurers avoid them altogether while others use underwriting guidelines based on the design firm's historical condominium experience. Insurers have also taken the initiative to educate the insured on how to research and evaluate the developer's condominium declaration and by-laws, and the funding of maintenance costs, in order to perform up-front risk assessment and gauge how subsequent homeowner dissatisfaction can be managed.

Regarding case law, the California State Supreme Court ruling in the Beacon Residential Community Association case,² held that an architect can be liable for claims from a third party with whom they do not have a contract; in this case, future homeowners of the condominium units. Insurers expressed continued concern that this ruling could lead to increased risk exposure in California, as well as other jurisdictions if the opinion is cited and adopted in other states. As of the time of the interviews in October 2015, however, no insurers reported adverse fallout from this case. The AIA Trust released a new white paper on condominiums entitled, *If You Build, They Will Sue*. This is available at www.theaiatrust.com. It should also be noted

² Beacon Residential Community Association v. Skidmore, Owings & Merrill LLP, 327 P.3d 850 (CA 2014)

that AIA Contract Documents has published a Guide for use in contracting on condominium projects. It is available at <http://www.aia.org/groups/aia/documents/pdf/aiab085986.pdf>.

More positive reporting indicated that insurers are not experiencing claims from Integrated Project Delivery (IPD) and Public Private Partnerships (P3), with Design-Build experiencing fewer claims than the traditional Design Bid Build (DBB) method. The carriers also noted that they are seeing few claims directly related to green/sustainable services, with only minor claims related to emerging technologies and building materials.

c. Claims Severity

Claims severity is a comparison of a project type's market percentage to the total claim dollars paid out. For example, if a project type occupies a small percentage of the market yet results in a high percentage of total claim dollars paid out, the severity for that project type is high.

Claims severity was reported by insurers to be trending upward. Areas identified with higher severity include water infiltration, HVAC systems, K-12, hospitals, and condominiums. One insurer identified the largest firms and the smallest firms as having the worst loss ratios, but for different reasons. Large firms typically participate in larger projects, which lead to larger claims. Small firms, however, experience higher claims severity because, according to some insurers, they lack the resources to manage risk effectively. In both instances, these firms are showing higher loss ratios than mid-size firms. The loss ratio is the ratio of total losses paid out in claims plus adjustment expenses, divided by the total earned premiums. For example, if \$80 is paid out for every \$100 collected in premiums, the loss ratio is 80%.

Some insurers noted that they have begun seeing more owners attempt to make the design professional responsible for product liability. Plaintiffs allege that the designer should undertake a "rigorous" investigation of the product rather than rely on the manufacturer's product data as design professionals typically do. Owners are also attempting to unreasonably increase the pool of available insurance proceeds by requesting increased limits on practice policies that are not consistent with project risk or exposure, requests to endorse the practice policies to identify design firm owners as additional insureds, and increased requests for certificates of insurance.

II. Alternative Project Delivery Methods: IPD, Design-Build, and Public Private Partnerships

As was the case last year, the insurance industry continues to follow the increased use of alternate project delivery methods including IPD, Design-Build, and P3. Although carriers continued to closely watch claim statistics for these project delivery systems, most still have not identified a trend indicating significantly different loss patterns from the more traditional

delivery methods. Although, as noted by one carrier, there may have been a slight decrease in Design-Build related claims.

a. IPD – Integrated Project Delivery

Many carriers continue to express optimism that truly collaborative delivery models like IPD could reduce the number of claims on a project, but they do not have the data to support or refute this supposition. Carriers still have not seen many IPD projects, and very few have written insurance policies for IPD projects.

b. Design-Build

According to the carriers' estimates, Design-Build continues to gain ground on Design-Bid-Build as the most frequently used project delivery method. Many carriers continue to note that while claims frequency appears to be reduced in Design-Build, claims severity appears to be higher than in traditional DBB. Some carriers suggested that this is the result of the more collaborative nature of Design-Build, which allows for early constructive claim resolution. Nevertheless, when claims occur on a Design-Build project, design-builders are very motivated and able claimants against design professionals. One carrier recommended that before entering into a contract with a design-builder, the design professional should verify that the design-builder carries adequate professional liability insurance with a waiver of subrogation. The waiver of subrogation would preclude the design-builder's carrier from recovering against the design professional for any damages paid out under the design-builder's policy.

Some carriers discussed the increased use of "first party rectification" policy coverage. The principle underlying the policy is that early resolution of issues may be far less costly than the full claims process. These policies originated with construction insurance whereby a contractor or design-builder would be provided coverage for the rectification or mitigation of errors, even if those errors may have been caused by someone else. There is one carrier who has indicated it is offering first party rectification or mitigation insurance to design professionals on the theory that such early rectification or mitigation will reduce the cost of claims. The use of this first party rectification or mitigation insurance is new to the industry and subject to wide variation between the carriers. Therefore, the design professional should therefore very carefully investigate any rectification or mitigation coverage that may be available.

c. Public Private Partnership (P3)

Although significant industry discussion is still devoted to the P3 delivery method, the carriers all agreed that P3 projects are exceedingly rare. For those carriers that have encountered P3 projects, they continue to note that claims frequency is reduced, but claims severity appears to increase. This is most likely related to the sheer size of P3 projects, which tend to be very large, thus resulting in large claims. Given the scarcity of P3 projects and related claims, however, the

carriers were largely forced to speculate as to the risks associated with P3 projects, and will continue to monitor the topic.

III. Green/Sustainability Related Services

Many insurance carriers are continuing to provide premium credits for LEED certified projects by their insureds. Carriers continue to note that when contracting for green/sustainability related services, design professionals should avoid contract language that promises too much. Many firms' marketing materials make claims about green products and energy performance outcomes that may not, or cannot, be met. More materials and products are entering the green market and may not meet specifications, because many are new and untested or may fall short of their stated performance. Of note, the AIA Contract Documents program has published a detailed guide, D503-2013, discussing key risk and contracting issues associated with the design and construction of green/Sustainable projects. The Guide is available for download at <http://www.aia.org/contractdocs/referencematerial/aiab098216>.

IV. Cyber Security

This is an area of growth in the insurance industry with carriers indicating a number of concerns including confidentiality of a client's proprietary information as well data availability (i.e. BIM models, FTP sites, and other similar platforms for the storage of project-wide digital information). The carriers also noted that while they expect the frequency of cyber security related claims to be low, those claims that do occur will be severe. One provider pointed out that insureds who deal with healthcare and higher education projects are most likely to seek cyber liability coverage due to an increased potential for cyber breaches. Most of the carriers noted, however, that they had not seen any claims related to cyber security yet.

Nevertheless, many of the insurance providers surveyed indicated that they are now offering cyber liability insurance coverage for design professionals, and one carrier estimated that 25 PLI carriers are now offering some kind of cyber security coverage. One carrier noted that this area is still very new and it is still not entirely clear where claims may come from. Accordingly, some carriers are still trying to allow for this to develop while they underwrite the risk. In the future, look for more coverage options related to cyber security. Providers that currently offer cyber liability coverage will typically pay for the cost of a consultant to come in to assess the cause of a digital data breach and notify parties whose information has been compromised.

V. Loss Prevention Programs

The PLI carriers interviewed all provide tools to educate design professionals and assist their insured in effectively managing risk. This is not surprising given that an effectively managed risk does not result in a claim. Accordingly, design professionals should take full

advantage of the practice tools the carriers make available to help manage project and practice risks. Heeding the advice that is given can prevent design professionals from either experiencing claims that are avoidable or decrease their exposure and the number of hours spent dealing with them.

The types of educational tools offered are typically available on the PLI carrier's website and include white papers on loss prevention topics, case studies, and webinars. Several of the larger carriers provide periodic newsletters issued electronically or in paper form and host a library of risk management briefs. Some also provide in-house training through their broker network for larger firms located in larger cities, but may also provide group training by hosting a learning event for several firms at once. Larger, more established PLI carriers seem to have the largest cache of educational tools, but those who are relatively new to the PLI market are actively building their library. Most of these educational materials and training sessions are limited to policy holders, although some of the broker networks will host training sessions in an effort to entice new clients.

Most of the PLI carriers provide contract reviews with advice returned within 48 hours. Most reviews are performed by in-house counsel or out-sourced to specialty attorneys and cover a variety of topics such as insurability for scope of services, standard of care, indemnification and defense, third party exposure, limitation of liability, and contemporary contract language that should be avoided. This type of review is also to determine the insurability of the contractual language being proposed. The design professional seeking to enter into the agreement must make the professional and business decisions that are appropriate for the given situation.

Early claims resolution and resultant settlement practices are championed by most of the PLI carriers interviewed. To that end, many carriers offer pre-claim assistance. Carriers encourage, although do not mandate, that design professionals provide early notice of a potential claim. This allows the carrier to assist in the pending process to reduce exposure or loss to the insured. Typically, an experienced claims manager or defense attorney is assigned to investigate the potential claim to determine its validity, which may lead to a step by step strategy for dealing with the issue before it becomes a claim, or for risk mitigation if it actually does. Several carriers offer credits toward deductibles, pay initial attorney fees, or provide other incentives for pre-claim notification.

VI. Other Suggestions

Nearly all of the insurance providers stated that both rates and coverage are currently advantageous for design professionals due to the increased number of providers in the market. While they anticipate the number of providers to decrease in the future, premiums are currently very low. They encourage insureds to evaluate providers on factors beyond just price, including

the breadth of coverage and the provider's experience in the professional liability insurance market.

Providers also offered suggestions to design professionals who work on condominium conversion projects. There has been an increase in condominium conversions (apartments to condominiums) in the past five to ten years, which has led to a corresponding increase in claims. Insurance providers cautioned design professionals not to dabble in condominium conversion projects. They have seen design professionals be very successful in this area, but they tend to be design professionals that specialize in these projects. Design professionals that only rarely take on a condominium conversion project often do not have the expertise to handle all the special issues that typically arise.

Insurance providers noted several highlights of their programs and policies, which included cyber liability coverage, claim mitigation assistance, and contract review services. One provider believes that policy coverage is not necessarily a good differentiator amongst competing providers because coverage can easily be copied. Thus, in its opinion, the best way to differentiate the various providers is to assess their experience in professional liability insurance and their level of service. Also, several providers noted that a good policy is one that provides broad professional liability coverage, with less need for endorsements.

VII. Conclusion

Assessing professional liability insurance needs and selecting the carrier/insurance policy that best fits those needs is an important business decision facing design professionals. An insurance policy ill-suited to the unique aspects of a particular practice can leave a firm unnecessarily exposed to significant uninsured risk. Great care should be taken to compare the various insurance offerings available in the industry, and the ability of those offerings to protect your practice. In addition to this white paper and the associated insurance carriers' survey results, the AIA and the AIA Trust have developed a number of other useful tips for buying insurance and managing risk. For more information about the AIA Trust Professional Liability Insurance Database, go to <http://www.theaiatrust.com/pli-database/> and be sure to check out the section on "Tips for Buying Insurance" for helpful overviews and in-depth guides on this complex subject. Other risk related white papers are also available on the AIA Trust website.

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