

Professional Liability Insurance Carrier Annual Interviews – 2016

Each year, the American Institute of Architects (AIA), the AIA Trust, the American Council of Engineering Companies (ACEC), and the National Society of Professional Engineers (NSPE) jointly conduct a 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 Risk Management Program website at <https://www.aia.org/resources/57766-aia-risk-management-program> and the AIA Trust website at <http://www.theaiatrust.com/pli-database/tips-for-buying-insurance/>.

In addition to the survey, the AIA, AIA Trust, ACEC, and NSPE invite a number of carriers that respond to the survey to participate in face-to-face interviews with representatives from each association. The purpose of the interviews is to expand on the information provided in the survey response and allow the carriers an opportunity to provide their thoughts on the status of the construction industry as well as any trends or developments design professionals should be made aware of. In advance of the interviews, the 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 the carriers' loss prevention programs and other issues discussed during the interviews.

1. Insurance Industry and Design Professional Practice Trends:

a. Insurance Industry Trends

Currently, the professional insurance industry is rather stable and is predicted to remain that way for the next five years. There are still a large number of insurers in the market and the related market pressure is creating similar services at relatively competitive rates. Professional firms continue to benefit from a "buyers' market" for insurance coverage. Further, the carriers report that the multitude of market participants and extremely competitive pricing has continued to erode loyalty between insureds and carriers. As has been the case in recent years, however, many insurers questioned the ability of some of the newer/lower-priced carriers to adequately respond and survive once claims begin to be made against the policies they have written.

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.

Another result of the crowded market is that carrier profitability will continue to be a challenge. Despite the competitive market, a number of carriers noted that premium increases are a possibility in the near future as current investment opportunities are not providing sufficient returns on investment, which will require insurance companies to look to premiums in order to maintain profitability. Instability in the stock market and the construction industry has also led to an increase in claims to cover project cost over-runs and owner-initiated change orders, further stressing carriers' bottom lines.

At least one carrier also spoke about the risks associated with international practice because it raises interesting insurance questions. Some countries, such as Russia and China, may not recognize US insurance and insurers/insured may not always know this. Accordingly, it is extremely important to understand how your coverage works, and whether it is effective, when working in other countries.

b. Frequency and severity of claims

General reports are that frequency and severity of claims are up. The increases in frequency and severity is consistent across project and firm sizes. As such, the increases are generally being experienced industry wide.

As is discussed in more detail below, the carriers indicated that the lack of sufficient technically proficient design professionals following the recession resulted in a lot of "bad construction" in and around 2012, which yielded an increase in construction deficiency claims that are coming to the table now. It is unclear at this point, however, what broader impact this may have on the industry.

Claims related to condominium projects, including apartment to condominium conversions, continue to be a leading source of claims. One carrier noted, however, that this may be due to the fact that condominium projects represent one of the larger sectors of construction in the recent post-recession years. As such, according to this carrier, it is possible that condominium related claims are on scale with the market rather than an indicator that these project types are much more risky on a case-by-case basis. It should be noted, however, that most of the carriers attribute the high level of claims to the unique risk factors present in condominium projects.

The carriers also indicated that infrastructure projects are another leading source of claims. In fact, claims related to civil engineering projects are the highest in the design industry. Many of these claims are related to traffic controls and related bodily injury claims. Distracted drivers are creating more accidents, and lower gas prices are putting more people on the road, which may also be impacting this area.

c. Professional Services Trends:

Professional service trends were not widely discussed at this year's interviews, however, there were a few statements worth noting. While little detail was provided on the reasoning, a few carriers noted that some professional services firms are beginning to have trouble getting

insured after an insurance claim has been made. It is unclear, however, whether this is a widespread issue or merely an anomaly. Somewhat related, a number of carriers indicated that firms that seek clients with a Qualifications Based Selection process are more attractive to insurers. Lastly, most of the carriers indicated that Building Information Modeling use continues to grow, which in their view continues to lower professional services risk due to better coordination between design and construction activities. Drone use also continues to grow as regulations become more developed.

A number of carriers indicated that professional firms are being challenged by the quality of their documents from inexperienced staff that are in turn increasing the firm's risk. Many claims continue to involve technical errors in detailing that come from inexperienced staff many firms hired due to the lack of available qualified professionals. The relative dearth of experienced and qualified professionals is a byproduct of the recession, when the number of projects was fewer and firms were forced to lay off employees. Another result of the reduced hiring practices over the last few years is that many recent graduates and younger professionals have been forced to go out on their own. Accordingly, some insurers reported a "younger" insured with less technical proficiency due to the increase of young, new firms following the recession. As the industry continues to recover, however, these new firms are increasing their workload, but their relative inexperience is contributing to an increase in claims in the small firm arena.

2. Alternative Project Delivery Methods: IPD, DB, and Public Private Partnerships

As was the case last year, the insurance industry continues to track the 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.

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 deny this supposition. There have only been a few IPD projects in the industry and while those projects have not led to extensive claims there is not sufficient data to identify any kind of a trend. While the carriers are generally optimistic about IPD's potential, some carriers surmised that it is possible that the reduced claims on current IPD projects are a function of the fact that most firms participating in IPD projects are large and sophisticated firms that are dealing with equally sophisticated contractors as well as owners experienced in construction, all of which can help reduce claims. Accordingly, until such time as sufficient data is available from IPD projects, the carriers remain reticent to make any broad statements about its benefits.

Some carriers did note that while full IPD is not being used as often as may have been anticipated by many IPD advocates, a more popular trend is to adopt certain IPD elements and collaboration tools and apply them to more traditional project delivery methods.

b. Design-Build

According to the carriers' information, Design-Build continues to gain ground on Design-Bid-Build as the most frequently used project delivery method, although Design-Bid-Build remains the most widely used 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 Design-Bid-Build. 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.

Many carriers expressed concern that design professionals working for design-build firms continue to accept uninsurable liability via the incorporation of the Owner/Design-Builder agreement into the Design-Builder/Design Professional agreement. Of primary concern is language included in the Design-Builder/Design Professional agreement requiring design service to be free of defects, which is above and beyond the scope of standard negligence-based professional liability insurance coverage.

In terms of trends in Design-Build, 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 and allowed a contractor to make a claim against the policy to rectify a possible error, thus mitigating the damages, even if someone else may have caused those errors. There is one carrier that has indicated it is offering first-party rectification insurance to design professionals on the theory that such early rectification or mitigation will reduce the overall cost of claims. The use of this first-party rectification or mitigation insurance is new to the design industry and design professionals should carefully investigate any rectification or mitigation coverage that may be available.

c. Public Private Partnership

Although significant industry discussion is still devoted to the P3 delivery method, the carriers all agreed that P3 projects continue to be 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. One issue for P3 projects that are dependent on performance is design professionals retained to study anticipated revenue streams and project performance analysis. 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.

3. Green/Sustainability Related Services

Sustainability focused projects continue to be led by design professionals and owners interested in addressing energy efficiency. As the number of sustainability related projects increases, insurers expect to see sustainability related claims increase as well. The interviewed carriers urged design professionals engaged in sustainability related services to be mindful of the scope of the contracted-for services and how those services are described. The professional

standard of care as it relates to sustainability related design services is a new and developing area and design professionals eager to improve building efficiency can run into trouble if they promise more than they can deliver. By way of example, many firms' marketing materials make claims about green products and energy performance outcomes that may not be met. In many cases those marketing documents are referenced in contracts as attachments, or at the very least, result in the client developing unreasonably high expectations regarding project outcomes. Design professionals should continue to be careful to avoid contract language that promises too much.

Another area the insurers noted related to the ever increasing number of new and untested "green" products and materials. In some instances the sustainability related goals on a project may benefit from the use of a new or untested product or material. For new and untested products and materials, however, it is much more difficult for a design professional to assess whether the product will perform as indicated in the manufacturers' specifications. As such, it is suggested that design professional address the realities of using untested products and materials directly with their clients to allow the client to make an informed decision on whether to use a new and untested product or material. Nevertheless, insurance carriers anticipate claims around the failure of products and materials to meet performance requirements will continue to grow. The insurers interviewed generally suggested that if a design professional is involved in a project with significant sustainability objectives, they should check with their insurance company. Many carriers offer risk management services related to sustainability projects, such as LEED projects, including recommendations for contract language and useful documentation tools.

4. Cyber Security

The most widely discussed topic at this year's interviews was cyber security and the related insurance coverages. This continues to be an area of growth in the insurance industry with carriers indicating a number of concerns, including confidentiality of a client's proprietary information and data availability (i.e. BIM models, FTP sites, and other similar platforms for the storage of project-wide digital information). This section will generally review the types of coverages available.

Until recently, the primary focus for the insurance industry has related to cyber security based damages to third parties. Typically these claims will come from a design professional's client, where the design professional is in some way responsible for a data breach to the client. The carriers recognize that third party cyber related claims against design professionals are rare, but when they do occur, the claims are severe. Accordingly, over the past few years, most professional liability insurance carriers have begun offering coverage for third party cyber related claims.

The specific policies vary from carrier to carrier, but in general the available third-party coverages will pay for damages the third party incurs as a result of the data breach (subject to the applicable policy limits) and will also provide additional protection/services. Most of the third-party coverages include some amount of forensic analysis, which is typically provided by an outside firm. The purpose of the forensic analysis is to determine the scope and cause of the breach. The coverage will also include assistance with the requirements the client may have to

notify individuals whose data has been compromised. Insurers indicated that depending on the nature of the client and the data that has been compromised, the costs associated with notifying affected individuals can be quite large. It should also be noted that the laws related to notification requirements vary from state to state and the assistance provided as part of most of these third-party policies will include evaluation of the various state specific requirements. Finally, most of the policies also include some level of credit monitoring for the individuals affected by the data breach. Some of the carriers also include data restoration as part of the coverage, but this was not universal. Suffice it to say, design professionals would be well served to spend time with their carriers to fully understand the scope of coverage available for third-party claims to ensure that the insurance product they are purchasing fits their particular needs.

This year, in addition to third-party based claims, the carriers expressed an increased concern over first-party related claims as a result of a marked increase in incidents of ransomware. One carrier indicated that it is seeing one or two ransomware-based incidents per month from its insureds.

A ransomware incident typically involves a situation where one, or a number, of a firm's computers have downloaded malicious software that is designed to block the firm's access to its data until a ransom is paid. The parties extorting the firm usually do not ask for an excessively high ransom, increasing the likelihood that the ransom will actually be paid. Accordingly, the ransom is not the significant part of the damages to the firm. The business interruption becomes the largest risk exposure related to ransomware.

As ransomware incidents have increased over recent years, a significant number of carriers have developed, or will be developing in the near future, a first-party based insurance policy solution to protect design professionals against the damages caused by ransomware. Under most first-party policies, the actual ransom payment is not covered, but any subsequent project delays are covered.

As noted above, this is an area of growth in the professional liability insurance world. As a result, the carriers offer a number of different products with various degrees of coverage. Additionally, for some carriers, the policies are part of the standard professional liability policy. For others, the coverage is achieved through endorsement and still others prefer to issue stand-alone coverages. For coverages that are included as part of the overall professional liability insurance a firm carriers, the cyber-security coverage will typically be subject to a sublimit and have its own deductible. However, design professionals should be aware that if the coverage is included in the professional liability policy, any damages paid out on the cyber-security coverage will likely erode the overall limits on the professional liability policy.

While there is little uniformity in how cyber-liability coverages are offered, there was uniformity among the carriers interviewed on the importance of obtaining some level of cyber security coverage. According to the carriers, the threat from cyber-security claims is real to design professionals and currently the cost to obtain protection is relatively inexpensive.

5. Duty to Defend

According to the interviewed carriers, the issue of design professional clients requesting contractual provisions requiring the design professional to undertake the duty to defend the client against claims by third parties has continued to escalate. All of the carriers reported that this request is seen quite often.

The problem with a duty to defend obligation is that it arises from the outset of a case, prior to their being a determination of fault or negligence on the part of the design professional. Coverage under standard professional liability policies, however, is triggered by the negligence of the insured party. In other words, in order for professional liability coverage to indemnify for a claim, the claim has to be a damage caused by the insured design professional's breach of the applicable professional standard of care or other legally imposed duty. The duty to defend, therefore, is treated by the insurance carriers as an additional liability that is assumed by contract and therefore not a covered expense. This means that while a design professional may ultimately be successful in defending a claim brought by a third party against the client and design professional, a design professional subject to a duty to defend obligation will be required to pay the full cost of the client's defense without being indemnified by the insurance carrier.

Universally, the interviewed carriers indicated that they do not expect that the marketplace will move to begin covering these expenses. Some carriers expressed that they will reluctantly consider adding an endorsement to cover a duty to defend on a case by case basis but it is very unlikely that they will agree to the obligation. The carriers believe that the duty to defend is a very expensive proposition if undertaken and would eat up policy limits better used to defend the design professional and pay claims.

The insurers stressed that design professionals should be aware that once a client's defense costs become damages stemming from the design professional's negligence, the policy will cover those expenses. This means that if a third party brings a claim against the design professional and its client, and the court or arbitrator ultimately determines that the design professional was negligent, the expenses the client incurred in defending itself are covered by the insurance policy, at least to the extent related to the design professional's negligence. The insurers make great efforts to educate design professional's clients on this issue and they greatly encourage design professionals to do the same.

6. Loss Prevention

The interviewed carriers again stressed the importance of loss prevention and risk management. The carriers interviewed all provide tools to educate design professionals and assist their insured in effectively managing risk. These services include risk management focused websites, newsletters, seminars and education programming.

Most of the carriers also provide contract reviews with advice returned within 48 hours. These contract reviews are usually provided by in-house legal 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 carriers interviewed. To that end, many carriers offer “free” pre-claim assistance. Carriers encourage, although do not mandate, that design professionals provide early notice of a potential claim. Several carriers offer credits toward deductibles, pay initial attorney fees, or provide other incentives for pre-claim notification.

Accordingly, design professionals should be aware, and take full advantage, of the 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.

7. Other Advice

The interviewed carriers discussed a number of other topics likely of interest to design professionals. These discussions were less in-depth than those reported on above. Below is short summary of each:

- Drones – The carriers noted an increase of inquiries regarding the use of drones on projects. Generally speaking, the carriers view the use of drones as another tool used to provide professional services and design professionals will have coverage for any related damages that are typically covered by your errors and omissions policy. There will not be coverage, however, for any third party bodily injury or property damage. Typically design professionals will need a separate policy or an endorsement on their CGL policy to cover such damages.
- Smart-Vests – The carriers noted a new technology that may impact the nature of construction litigation. Smart clothing and wearables track the location of the individual wearing them, providing detailed information about time, location and frequency of site visits. This information is discoverable in a dispute and design professionals should be aware that their field reports and site-visit reports may be cross-checked with this information.
- Instantaneous Quotes – It was reported by one insurer that two other insurers recently teamed up with a quantitative based hedge fund and are piloting a program that would use publically available information to create instantaneous quotes. The carrier believed that this has the potential to significantly change the professional liability insurance industry because the rapidity of the transaction will increase and the amount of capital coming into the industry will also increase.
- Millennials – A few carriers noted that millennials will soon represent 70% of the workforce, which will require the carriers to prepare better for how millennials will want to buy insurance and otherwise interface with their insurance carrier.
- Meets and Exceeds – Some carriers noted a trend of clients seeking letters from design professionals/carriers guaranteeing that there will be a certain amount of coverage available at a given time. The carriers warned that such guarantees are

impossible under standard professional liability policies and can only be given if the policy is project specific policy.

8. 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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