US Mid-Year Market Overview

Design and Construction Professional Liability

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Special Mid-Year Bulletin

Recently we published our review of the Current Global Insurance Market Conditions for Design and Construction Professional Liability (Professional Liability Sentinel - Issue 14: Q2 2020).

One of the overarching themes of that publication was the rapid deterioration of the professional liability market across the globe.

Unfortunately, the marketplace has continued its troubling trend in respect to both capacity and pricing. One lead insurer has even warned of a 30% rate increase prescriptive position they intend to assess against all large US A&E risks. This acceleration in decline in our opinion necessitated a mid-year bulletin.

Professional Liability Market for Architects & Engineers

In the Architects & Engineers (A&E) market there is seemingly a clear trifurcation of how insurers evaluate between large, medium and small risks. In 2019 insurers began to focus on the pricing for larger risks, with domestic US insurers increasing rates on average by 5%-10%, while those risks placed in London saw rate uplift in the range of 10%-20%. Renewal premium rates for medium and smaller risks were left relatively flat.

In 2020, insurers enhanced their concentration on larger risks. Firms which had escaped rate increase in 2019, have experienced sharp increases this year. And even those firms which had felt the increase in 2019 once again have experienced a similar stinging uptick in 2020. Rate increases for those firms which had experienced an adverse claims history were greeted with exponentially negative figures. Over the two-year period between 2019 and 2020, we are experiencing domestic rate increases between 15%-30%, and even higher rates for those programs based in London. Medium sized risks are now also under careful scrutiny as carriers are clearly looking for ways to control the portfolio. But the segment of the market for smaller risks remains relatively untouched, likely due to the larger number of insurers in that space.

One question we continue to field is, why have the London markets deteriorated at a more rapid pace? We suspect a couple of factors are at play.

- Initially, London has traditionally carried the larger global risks, and these risks have undoubtedly endured a very unfavorable claims experience over the past 2-3 years.
- London carriers also typically participate both on primary and excess layers, more so than domestic insurers, resulting in an intensified loss scenario from a single error or event.

Because of these adverse claims, London markets have not only increased renewal pricing but have also significantly reduced capacity.

Because of the rate increases to the primary layers of coverage mentioned above, many larger design firms have agreed to take higher self-insured retentions. And while this can certainly mitigate some of the designer’s initial sticker shock—often the overall program costs are not reduced due to the significant rate increases we are experiencing on the corresponding excess layers of coverage. And while the news we bring from the marketplace is not good—we continue to believe such news makes it imperative that the designer thoughtfully prepare for their upcoming renewal, to think creatively in how to better balance risks and pricing, and to have realistic expectations of what can be achieved during the renewal process.

Snapshot of US Market Trends

Architects & Engineers

2020 Q1/2				2020 Q3/4
On larger risks domestic insurers are generally looking for rate increases of 5%-10%. For those larger US risks placed in the London market, the rate increases can range between 10%-25%, particularly on Excess Layers that are under greater scrutiny as insurers evaluate their capital deployment.	↑	**Pricing/ Rates**	↑	Over the two-year period between 2019 and 2020, we are experiencing domestic rate increases between 15%-30%, and even higher rates for those programs based in London. The increases on Excess Layers may be higher.
We have seen reductions in total limits being purchased due to reduced available capacity, or premium savings.	↓	**Limits**	↓	Certain insurers are reducing their capacity to no more than $5m per risk.
With the advent of larger claims, insurers are looking for increased retentions, especially with claims inflation running at 3% per year, and firms are considering higher retentions to offset premium increases.	↑	**Deductibles/ Retentions**	↑	This trend will continue, and a number of clients are considering captives to underwrite these larger deductibles/ retentions.
Neutral, present but COVID-19 restrictions are being considered by London insurers.	↔	**Coverage**	↔	This trend will continue.
Overall market capacity has dropped for annual corporate and project policies.	↓	**Capacity/ Appetite**	↔	There are signs that the increased rating is attracting new markets, who may start to write risks in 2021.
While the number of claims coming from contractors are increasing, limitations of liability are proving to be effective in limiting the severity of claims.	↔	**Losses**	↔	This trend will continue for the foreseeable future.

Professional Liability Market for Contractors

The Design-Build delivery model is still relatively immature in the US, and the tail on professional liability underwriting portfolios can take 7-10 years to fully develop, particularly if there are a high proportion of single project policies in an underwriting portfolio. Consequently, whether the pricing for Design-Build Contractors and projects utilizing this delivery model within the US was adequate, is still essentially unknown. However, we are beginning to see some hardening of appetite from the US domestic insurers as follows:

- Pricing is rarely flat with some insurers seeking increased rates of 5%-10%;
- With certain carriers, single project policies will only be offered if the insurer underwrites the annual corporate PL program;
- Restrict the jurisdictions in which they will write project policies (i.e. some carriers no longer are willing to write project policies in NY);
- Higher Self-Insured Retentions, particularly for project policies;
- A restriction of project business to a certain percentage of the insurers' portfolio (approximately 10%-20%);
- Reduction in capacity on certain types of risks, particularly those with a high design content;
- Certain insurers are offering Rectification coverage only if the contractor pursues a claim against the designer first, or on some occasions refusing to offer any type of Rectification coverage;
- More claims reservations being issued by insurers (especially in relation to rectification claims and timeliness of notice given to the carrier).

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Snapshot of US Market Trends

Contractors

2020 Q1/2				2020 Q3/4
To a large extent rating is highly dependent upon client-specific factors, most notably claims history. On "clean" risks, expected rate change is 0%-5% with some carriers declining risks with multiple claims and those with high "design" risk content, particularly in the oil & gas sector. On project policies, we are seeing a more conservative rating approach, with limits on the maximum policy terms and capacity.	⇔↑	Pricing/ Rates	⇔↑	Pricing is rarely flat with some insurers seeking increased rates of 5%-10%.
Clients continue to evaluate limits due to the perceived severity of professional liability losses.	⇔↑	Limits	⇔↑	It is expected clients will continue to evaluate higher limit options, but (especially in the project specific market), the availability of such limits may be impacted by a restriction in market capacity/appetite.
Most clients have maintained their deductible/retention levels; however, carriers continue to push higher retentions on larger clients in an effort to offset the risk of claims deterioration.	⇔↑	Deductibles/ Retentions	⇔↑	We expect this trend to continue in the second half of 2020.
No material changes in the annual or project programs.	⇔	Coverage	⇔	No material changes on an annual program, but coverage restrictions are being implemented on a project specific basis (see notes above).
Capacity is expected to remain available for most insureds, but pricing will escalate.	⇔	Capacity/ Appetite	⇔	We expect this trend to continue in the second half of 2020.
Claims activity in the construction sector was fairly constant, but we continue to see an escalation in the severity of these claims, with year-over-year escalation in claim values and defense costs.	↑	Losses	↑	We expect this escalation to continue. In particular, there is a notable rise in 'Rectification' claims being submitted to carriers on Design-Build projects.

The speed and continued firming of insurers terms – from a fifteen-year period of softening – does evidence a hard market

Hard markets are also associated with a flight of capital out of the insurance market

Is this a Hard Market?

When you consider the last true hard market was over 15+ years ago, you come to appreciate that many practitioners involved in all aspects of insurance have never experienced a hard market, and some observers are musing whether the current conditions can yet be considered a “hard market”.

The speed and continued firming of insurers terms – from a fifteen-year period of softening – does indeed evidence a hard market. But hard markets are also associated with a flight of capital out of the insurance market. But such is not the case at present as nearly $10bn of capital has already been raised in 2020. As such, the current conditions are likely to be categorized as a sustained period of market firming, rather than a truly hard market, which was last seen in the late 1980’s.

Irrespective of terminology and whether it is a “firming” or “hard market”, it is important to prepare for a more complicated process and to manage the expectations of all parties. Behaviors of the underwriters have changed in the current environment. A few examples of these changes, and how to counter them can be found below.

Insurers changing appetites

Previously one could expect that an insurers strategy would remain consistent for at least one year in light of their reinsurance treaty renewals.

But today we are experiencing changes quarterly if not even monthly. For this reason, it is important that the brokers remain in constant contact with insurers and report any changes frequently to their clients.

The process takes longer

Insurers are requiring greater scrutiny of risks and the underwriter may require at least one or two internal “sign-offs” depending upon the complexity or claims activity of the risk being underwritten.

Usually insurers require two weeks to consider risks before offering binding quotes, and on difficult risks it is suggested that insurers are engaged at least two months prior to when terms are required. This length of time can be particularly unhelpful when indications are required for projects that are being bid. And while early communications with the carrier are critical, it is important to remember that insurers will rarely offer formal terms more than 45 days before inception of the policy due to the claims made nature of the professional liability policy.

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More information required

Insurers are requiring more information to evaluate risks than they have historically. And the information sought is often more granular with respect to the specific project, partners, and subcontract designers—particularly those that the carrier finds to create greater risk.

It is important that the broker has been in contact with insurers to understand what the underwriters require at the beginning of the process, otherwise frustrations and delays are likely to occur. This is especially prevalent in the project specific space where carriers are turning to their own internal risk engineering for review and evaluation. As a result, we are seeing a heightened level of technical questions and requests from our clients.

Project Policy Indications

Seeking indications for project specific insurance costs is a certainty for many contractors and A&Es in their bid pursuits. Previously markets would provide indications with only the barest risk details. But currently most markets will require significantly more information and lead time in which to evaluate before providing this earliest of forecasting. Insurers are asking for:

- preliminary contracts between the owner and contractor;
- detailed project cost break-outs and schedules;
- joint venture or teaming agreements and contracts between contractor and engineer or architect for design/build projects;
- specific engineering detail as many risks are being referred to the insurers' internal engineering groups.

Another consideration to keep in mind is the lag time between project bid and award. In some cases, a year elapses between bid indications and the time formal quotes are requested. Because of the firming market, the reliability on the indication is indeed suspect as the probability that the insurers rating on the project may change, or even the possibility the insurer is no longer willing to entertain the risk at all. If possible, the contractor's bid should account for this contingency.

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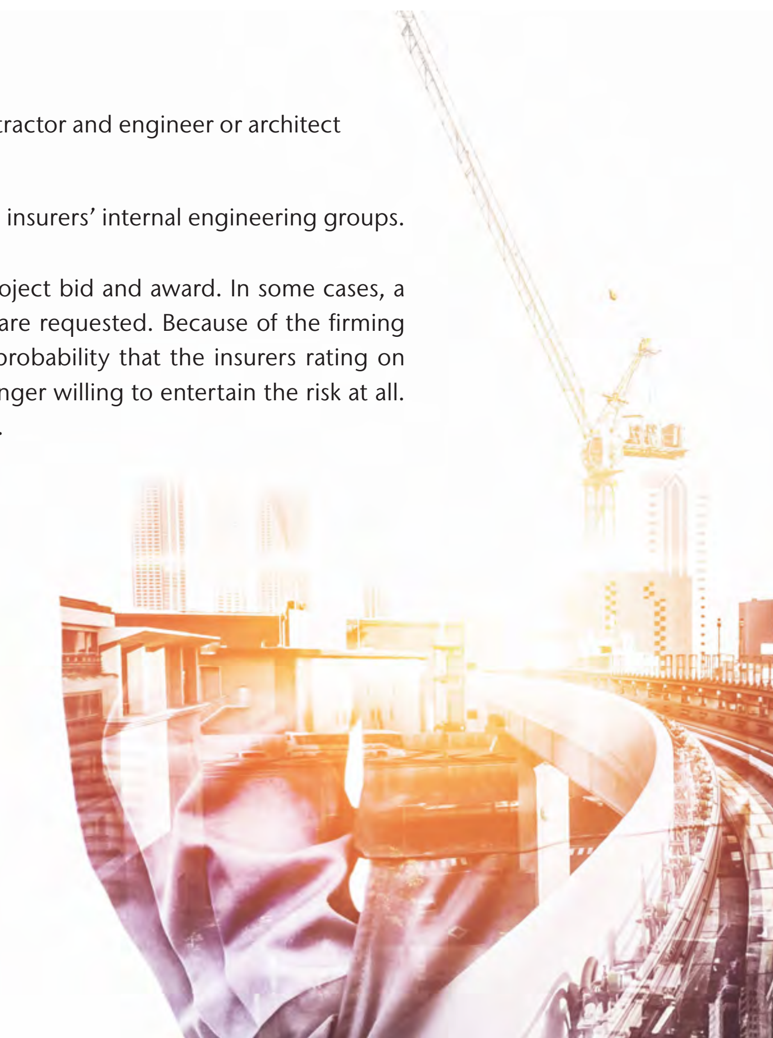

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