North America Mid-Year Market Overview

Design and Construction Professional Liability

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Overview

The COVID–19 pandemic has created sustained economic uncertainty in both the construction and global insurance industries. And professional liability coverage for constructors and designers has indeed been swept up in this insecurity.

While the pandemic did not lead to direct claims involving professional liability, its effects were certainly felt.

Many construction projects were delayed causing the need for project policy extensions.

Those extensions proved to be difficult and costly on account of the hardening market, insurance carriers leaving the space or decreasing appetite since the project policy was bound, and a lack of clarity within the insuring agreement addressing extensions.

The past 18 months have also evidenced a significant increase in claim activity, but a simultaneous lack of resolution to most pending matters due to courthouse restrictions, trial delays, and arbitration continuances.

The uncertainty created by this litigation dynamic has reverberated into the insurance marketplace generating increased scrutiny of the insured's claims, sizeable growth in the insurer's reserves, and eventually, an escalation of pricing when the insured's annual program is renewed.

Unfortunately, we do not foresee this instability resolving in the near term.

What does this mean for the Design and Construction Professional Liability Market in North America?

Loss trends experienced in the architects & engineers arena are now beginning to be felt in the contractors space as the insurers portfolios mature.

The likely causes of these losses are varied, but the owners' unwillingness to take risk within the underlying construction agreement and the designers adherence to limits of liability, leave the contractor in a precarious position relative to professional liability risk.

The market for contractors is likely to follow the architects & engineers with increasing rates, more restrictive terms, and diminished capacity – particularly for project specific policies. In the past, project specific polices have provided insulation for corporate programs whereas now underwriters are using claims experience on these project policies as part of their evaluation under the corporate program.

The reduction in insurer capacity could see the specter of insureds not being able to meet their corporate insurance objectives – or even contractual requirements.

Insureds should be aware that the market conditions are fluid, and while there have been some recent additions to the architects & engineers insurer marketplace, the same cannot be said for insurers underwriting contractor's professional liability.

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Meeting Contractual Obligations

Contracts typically require that the contractor or designer maintain professional liability coverage for a specified duration provided coverage is available at "commercially reasonable rates and terms" – whatever that may mean, as this has not been tested in court. It's possible that in the near future the contractor or designer may be unable to procure the contractually required level of coverage which would result in a potential breach of their contract. And because professional liability coverage is 'claims made', it is the policy when a claim is made that is relevant. Inadequate or non-existent insurance at the time the claim was made could result in claimants pursuing damages against the assets of the contractor or designer.

We have recently seen instances of professional liability insurance being unavailable for extensions of project specific policies. With this is mind we feel it is prudent for insureds to build in contractual provisions into contracts allowing the use of corporate practice policies to fulfill contractual requirements if an insurer does not agree to an extension or the indemnity limit, terms of the extension are unreasonable, or the project policy is likely to be exhausted by existing claims on that project.

Currently there is a lack of common application of extension terms, even the same carrier will apply different methodologies. When evaluating an extension of the project policy period, the insurers seemingly focus on the following:

- What is the current term of the policy (including the ERP) and how long is the policy being extended for? Most insurers will have caps on the maximum term available for a project policy (commonly 10-15 years), and project extension requests may exceed allowances for such terms. Accordingly, the only way to extend a policy is to allow for extension but erode the available ERP.
- How has the project performed to date and what factors have led to the necessity of the extension?
- Is the project on budget? If not, how significant is the variance?
- Have there been claims submitted to the policy?
- What is the current status of the relationship between the insured and the insurer?

Most of the policies that are coming up to expiry are programs that were put into force several years ago when the market for coverage was relatively inexpensive and coverage was broad. Adjusting those terms to today's difficult market situation is indeed complex. Add to those difficulties, oftentimes the Insurers on the project no longer underwrite these same types or risks. On the next page is a case study of such a situation that occurred recently.

Large Design–Build Infrastructure Project Extension

A large design-build project that, due to various factors, was delayed by 14 months. On this project, there were three policies that required extensions; a project specific policy for the design-build contractor, a project specific contractor's pollution liability policy, and a project specific policy for the design team. Each of these policies contained an audit provision, which is a vehicle for insurers to collect additional premium at the conclusion of a project if the project values vary from the original estimates. It was also worthwhile in noting that the project budget was up about 30% from the original estimate and the original policy term for all policies was 6 years (not including the ERP).

Project Specific Contractor's Pollution Liability

- Insurer elected to charge for pro-rata basis for time on risk, plus elected to calculate and charge based on audit provision; however, the insurer did agree to extend the completed operations period on the policy by an additional 14 months.

Project Specific Contractor's Professional

- Insurers elected to charge on a pro-rata basis for additional time on risk; however, due to policy term constraints (max policy term was already reached), extension was only offered on the basis that the term of the ERP would be eroded in proportion to the 14 month extension request.
- Insurer did not elect to charge premium based on audit provision but reserved the right to do so at the end of the construction term.

Project Specific Professional Liability for Design Team

- Insurers elected to charge on a pro-rata basis for additional time on risk, plus they charged based on audit provision.
- Due to policy term constraints (max policy term was already reached), extension was only offered on the basis that the term of the ERP would be eroded in proportion to the 14-month extension request.

All totaled, the insured was looking at an additional premium in the mid seven-figure range. So, was this a successful result?

By and large, it would depend on who you ask. As insurance professionals, we may understand the nuances of the market, but often these discussions are being had with front-line project managers and project owners who don't have the same familiarity with the professional liability insurance market.

To them, there is little logic or reason in the fact that carriers are applying these different methodologies for the same project, and the general perception is that markets are just being opportunistic. In particular, it is difficult for these individuals to understand why, if a carrier will not extend the ERP, then they would be entitled to charge pro-rata for an extension (when arguably there is no extension per se to the total policy term).

This current situation highlights the need for insureds to take a more proactive approach when looking at contracts mandating the insured maintain project specific cover. It is important that we consider the implications of a changing insurance landscape, and as such, are suggesting affirmative contractual language (as we mentioned above) to avoid issues of non-compliance, these provisions should be considered in case of unfavorable, or unavailable, extension terms.

For these legacy programs, we are encouraging insureds to connect early with carriers on these placements to discuss possible extensions, and to try and gain understanding on how these extensions would be evaluated. The time it takes for markets to review and approve seems to be lengthening by the week. Most have internal approval guidelines that require senior management sign off (or in many instances, reinsurance support is required). We also encourage early discussions with owners.

Contractors

Snapshot of North America Market Trends

	2021 Q1		2021 Q2	
Pricing/ Rates	↔↑	The first quarter of 2021 followed the course of 2020, with the contractor's professional market continuing to tighten and insurers continuing to examine risks very carefully, while not the case in the Canadian market, with some insurers declining US domiciled risks with multiple claims and those with high design or design-build risk content.	↔↑	Expected rate increases 5-10% in the US, and 10-15% in the Canadian market. On single project policies, we expect to continue to see more conservative rating approach (higher / more requirements for information), with limits on the maximum policy terms and capacity.
Limits	↔	Clients continue to evaluate limits due to the perceived severity of professional liability losses, however, for the most part, insureds maintained current levels due to financial constraints during the pandemic. As markets more closely their aggregate exposure through their annual and project specific placements, some Canadian markets are limiting their overall exposure.	↔	This position is unlikely to change during 2021.
Deductibles/ Retentions	↔	While insurers continue to try and push higher retentions, the premiums credits being offered often do not warrant the higher retained exposure. Consequently, most clients have maintained their retention levels.	↔	We are starting to see insurers take a more aggressive approach in setting retention levels and have now stopped offering expiring retentions as a means of forcing insureds to retain more risk.
Coverage	↔↓	The market continues to evaluate coverage terms, and in one instance, one of the leading insurers is evaluating the deployment of rectification coverage on large design-build infrastructure projects (either not offering, sub-limiting, or making coverage predicated on first pursuing a 'protective' claim) in relation to their US domiciled risks. Canadian insureds are looking more closely at the US insuring models, and protective cover is being looked at more closely as a solution to the reduction of coverage offered by Canadian insurers.	↔↓	While, there is currently little expectation the market will significantly alter coverage terms and, apart from one market partner, no other insurer is forecasting any changes to coverage terms for US domiciled risk, the Canadian insurers are exploring alternate insuring models.
Capacity/ Appetite	↔	While capacity continues to be generally available, the pricing on the excess limits has come under greater scrutiny by insurers as claims values escalate. Lower excess layers are being priced more akin to primary coverage as insurers are viewing these excess limits as still being in the "burn" layer (i.e., within the first US$15M to US$25M).	↔	Capacity is expected to remain available for most insureds, but pricing will escalate. The availability of single project polices for contractors remains generally stable; however, the ability to procure higher limit options (excess of US$15M to US$25M) is expected to be hampered when such policies are enrolling the design team as insureds.
Losses	↑	Claims activity in the construction sector was relatively constant, but we continue to see an escalation in the severity of these claims, which by and large have manifested as rectification issues.	↑	We expect this trend to continue, with year-over-year escalation in claim values and defense costs.

Architects & Engineers

Snapshot of North America Market Trends

2021 Q1		2021 Q2		
On larger risks insurers sought rate increases of 5%-10% for US risks, and 10-15% in Canadian market. For those larger 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.	↑	Over the last two-years the domestic rate increases have been between 15%-30%, and even higher rates for those programs based in London, particularly excess layers or those in higher risk practice areas like structural or geotechnical engineering. Those risks who have experienced increased rates for two renewal cycles, are now seeing more modest rate increases. There continues to be rate attached to growth and loss experience.	↑	**Pricing/ Rates**
There have been reductions in total limits being purchased due to reduced available capacity, or to limit premium increases.	↓	Certain insurers are seeking to reduce their capacity to no more than US$5m per risk on the majority of their portfolio, although there are new markets coming into the market during the latter part of 2021, which could take up some of the lost capacity.	↓	**Limits**
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. Unfortunately, the premiums credits being offered often do not warrant the higher retained exposure.	↑	This trend will continue, and several clients are considering captives to underwrite these larger deductibles/retentions.	↑	**Deductibles/ Retentions**
"Silent Cyber" clauses have been required for policies placed in London. Annual practice policies have been adapted in certain instances to take account of single project policies with large Self-Insured Retentions, because of potential conflicting "Other Insurance" clauses. Insurers have been carefully reviewing the "extra" coverage extensions, such as pollution or cyber, and in many cases, those extensions are being removed, encouraging insureds to place stand-alone coverage for those exposures.	⇔↓	We expect to see other areas of coverage to come under scrutiny, e.g., infringement of copyright and patents carve-backs, as well as claims resulting from delay in drawings, where no other negligence in the performance of the professional services is alleged. Some of this is driven by loss experience, but more often this is being driven by the decreased underwriting expertise in these ancillary areas.	⇔↓	**Coverage**
A major US insurer has decided to 'pause and review' before offering future single project policies, and the remaining project insurers are being conservative with their capacity. One insurer will not offer terms unless at least 50% of the design is completed, before the contractor submits their bid for the project. This trend has not yet appeared in the Canadian marketplace.	↓	One new Lloyd's syndicate has entered the market, and another due to start underwriting in Q3. While this may ease market capacity constraints for annual practice policies, it is unlikely to help with single project policies.	⇔↓	**Capacity/ Appetite**
No change from 2020, with Q1 2021 still showing more claims coming from design-build contractors where there has been under-design at the bid stage and insufficient contingencies built in by contractors.	↑	While the number of claims coming from contractors is increasing, limitations of liability are proving to be a first line of defense in limiting the severity of claims.	⇔↑	**Losses**

Silent Cyber

Insureds must be cognizant to the growing cyber and data privacy concerns in the wake of COVID-19, which created a shift in the way in which people worked.

Cyber risks, specifically ransomware and social engineering events, are growing in number in frequency and severity, and insurers are taking note. The financials losses that can result are significant, including the cost of IT assistance, third party claims for compensation, business interruption losses, regulatory investigations and penalties, ransomware payments and legal costs, and reputational losses. Cyber insurance should be viewed as a compulsory coverage, given the growing rise of cyber-attacks.

In response to the changing cyber landscape, Insurers – particularly those based in the London market – are imposing silent cyber exclusions.

Silent cyber refers to the unknown exposure in an insurer's portfolio created by a cyber peril which has not been explicitly excluded. That is, the policies do not reference cyber risk in any way – either affirming or excluding coverage – thus remain "silent" for this exposure, and Insurers realize silent cyber can create potentially significant risk to their portfolios.

Non-affirmative policy language, as respects cyber, can result in varying interpretation by insurers which will lead to legal disputes.

Accordingly, many in the professional liability marketplace have started to impose cyber exclusionary endorsements onto their policies. The intent is to define cyber risk and exclude it from non-cyber policies, and all professional indemnity policies written through Lloyd's incepting January 1, 2020 are required to either expressly include or exclude cyber cover.

Silent cyber is problematic for both insurers and insureds. For insureds, it can result in uncertainty as to the existence of and extent of their cyber coverage, which increases the risk of disputes with their insurers. In many cases, a standalone cyber policy may be the best solution to ensure cover and fill gaps resulting from a silent cyber exclusion.

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