Griffiths & Armour

THE SUPERMARKET REVISITED

P.I. INSURANCE

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INTRODUCTION

It has been more than 10-years since Griffiths & Armour published 'Professional Indemnity insurance: the not so super market', a paper written as the financial crash of 2008 took hold and the talk in the insurance industry was of insurer withdrawal, a hardening market, increased cost, restricted policy wordings and generally challenging times.

Given where we are today, still surrounded in continued political and economic uncertainty around Brexit, with volatility rife in the global political system and the problems and promises of profound advances in technology, one might be forgiven for thinking of them as naïve times, halcyon days even, where the world was simple, predictable, boring even.

Boring times these are not and in the problems of the present, there is much to interest those involved in the buying and selling construction professional indemnity ('PI') insurance. Later this year, we will look at these problems in our next major publication 'A Brave New World', which will explore in some detail the insurance market and its particular drivers. In particular, we feel a canter through some of the wider issues that could affect your PI premium is long overdue. Many of us have forgotten that PI costs can go up as well as down, for reasons other than claims performance or an increase in rateable fees, and some will have never experienced the phenomenon of increased cost at all.

In A Brave New World, we also look at issues of quality in construction, problems with procurement, and how in particular the SME sector can help Government and others involved in the built environment to improve quality, price and ultimately the outcomes of projects central to people's lives. Whether it is the homes in which we live, the hospitals at which we receive treatment, or the roads down which we drive, the SME sector has been overlooked and marginalised for too long. Finally, there will be a word or two about current claims trends and 'lessons learned', and we look at the future of engineering - 'digital engineering' - and what tomorrow's world might look like and how we might insure it.

2019 ... WHAT LIES AHEAD AND BEYOND?

Anyone involved in the business of arranging PI insurance will recognise that the market has been subject to too much downward pressure for too long. Whichever features of the PI landscape you consider important, the pressures have been there. Pressure to reduce pricing. Pressure to broaden coverage. Pressure to reduce excesses. And as with any spring under too much compression, at some point that downward pressure is released and the spring snaps back. How far and how fast depends on the composition of the spring and the downward force applied.

Apply the analogy to the insurance market and the results are fairly similar. The insurers that have contrived to put themselves under the greatest pressure, by cutting rates too far for example, will react more quickly and more severely than those who have tread a more moderate path. Recent entrants to the PI market are realising all-too-quickly that not all springs snap back to their natural state. Some simply break. In insurance market terms, this is manifested in insurer withdrawal from the market, a phenomenon not seen in construction PI for 10 years or more.

For our existing clients, it is important to stress that the action taken by our key underwriters over the last 5 years means that all other things equal, we expect you to enjoy the protections you always have at a stable level of cost to previous years. The markets with whom we do business are planning for much the same in 2019/2020 as they did in 2018 ... and before. Yes, there may be comparatively modest upward adjustments to rating, particularly for those practices that need it. Yes, we'll need to take a proportionate response to insured clients with difficult and/or challenging claims experiences. And, yes, our doors will be open to new business, but it will be based on those firms seeking to forge a sustainable relationship for the long term.

Part of the distinctiveness of our facilities is the way in which we go about assisting clients with risk management advice, from contract review, to claims avoidance advice, to presentations and lessons learned. All of this contributes to a portfolio of clients who not only benefit from that risk management advice, but who also collectively bring to the market a 'safer' bet for insurers than A.N.Other consultant. It's for that reason that despite the market turmoil, we continue to benefit from an adequate supply of capacity, relatively 'spike-free' renewals and the ability to provide solutions to clients - current and future - that others simply can't.

There we could end the paper, but that would be to overlook the indisputable step changes that are coming, some of which will inevitably impact our world to some degree and which we summarise below...

A) INSURANCE RATES ARE ON THE UP...

The downward pressure on the market has netted the result that many insureds have paid less for their PI product than at any other time in their history. Whilst those rates have started to nudge back up across the board, significant increases in rate have for the moment been restricted to certain professions and specific sections of the market. That said, we do feel that 2019/2020 will be the year when there is a more general correction across the marketplace and all insured clients should be budgeting for an increased PI bill. The evidence to support this is increasingly less reliant on anecdotes, and we have already in the last 6 months seen around a dozen PI insurers withdraw from the PI market completely, with more announcing reduced appetites for PI business. In turn, these withdrawals will directly impact on the pricing of those left and examples abound in the broader marketplace of significant spikes in cost for otherwise 'plain vanilla' renewals.

When considering why this is the case, it's easy to point to the usual problem of poor claims performance. That wouldn't be wrong, far from it. Individual claims experiences will, of course, drive any one renewal, but the aggregation of the experiences of the many are starting to impact 'claim free' practices too. We'll come back to claims a little later because focusing on that point alone misses some fairly fundamental changes to the insurance market that have come about in the last decade or more. Changes to the composition of the market through consolidation and diversification of major insurers; the rise of re-insurance; systemic changes to the UK insurance environment; and the impact of the wider economy. If these sound dry subjects, they most certainly are, but they are important nonetheless. If you want to have a taste of the other factors, then more information can be found here:

READ MORE

Suffice to say that for now there is a much broader palette of issues that need to be considered when working through your renewal.

Going back to the 'easy' point to be made on claims, it can't be denied that 2017 was a dreadful year for any insurer exposed to the built environment. Natural catastrophes across the globe led to an estimated economic impact of upwards of US$350bn on their own. Given that the US was hit particularly badly, a significant proportion of those losses fell to the insurance market to support, and 2017 is now recognised as the worst year on record for insured catastrophe losses with around US$144bn paid out. Contrast this with a 10-year average of US$59bn of insured losses and it can be seen why so many markets reported bleak results for 2017. Reports from Swiss RE suggest that 2018 will go down as the fourth worst year on record for insured catastrophe claims with insured losses of around US$79bn forecast. Troublingly, the 10-year moving average for insured losses has spiked (again) and now stands at just under US$80bn - that average has increased by 50% in 10-years.

If we step down from the global catastrophe claims environment into something closer to home, all is not well either. During 2018, Lloyd's of London looked into the performance of their non-US PI business. The performance of that portfolio was of sufficient concern to warrant detailed analysis and action from Lloyd's and the report drew some bleak conclusions:

- Non-US PI was the second worst performing market within Lloyd's.
- An abundance of capacity has influenced underwriting decisions, yet attritional losses and expenses are climbing steadily.
- 62% of syndicates are loss making and must implement a remedial action plan. Failure to satisfy Lloyd's that a sustainable profit can be achieved will result in Lloyd's not agreeing syndicate's plans for writing this class of business for 2019.

That action will naturally manifest itself in a push to start turning back the clock on the last 15 years of 'soft' market conditions. There is of course little that any one insured can do with much of this other than to be aware of the issues and alive to the impacts.

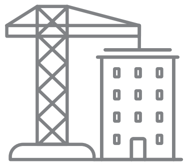
As we've noted, G&A clients will fare better than most and that is a result of the work that both we and our clients have put in over last 5 years. This work has been part of a simple strategy to ensure that our portfolio of clients remain more attractive to the market than others by paying a developing claims profile, but also to insulate them against the cold winds now starting to blow through the marketplace. In these times, as we have seen before, having a group of like-minded clients who understand the value in what we do is a terrific bulwark against these winds. Therefore, for the great majority of our clients, you can expect more of the same. Rates will generally be stable to slightly up, unless circumstances call for a more significant increase. Those will be proportionate, as you would expect.

For the broader marketplace, choppier waters are likely and we are starting to see a steady stream of clients looking for safe harbour. In particular:

Approved Inspectors

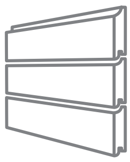
This is a marketplace in turmoil. Following the insurer review into their books of business post-Grenfell, the already niche marketplace for Approved Inspectors (AIs) has shrunk dramatically and there are few insurers now offering cover. We continue to operate what at the time of writing is the only approved scheme for (AIs) in the UK. This is an invidious position and one we certainly hope will be reversed sooner, rather than later. Whilst we will work with the AI profession to seek to offer a solution, it is likely that we will be unable to solve everyone's problems.

Design and construct



Those purchasing design and construct (D&C) polices in the marketplace have seen significant corrections, resulting in substantial increases in rates and reductions in cover. A number of insurers have stopped writing this business and more are announcing reductions in available capacity. D&C PI has always been particularly price sensitive and it's unsurprising having been squeezed so hard that this spring is amongst the first to snap. Again, we will try to assist where possible, but there is no doubt that this segment of the marketplace has been in the vanguard of the rush to the hard market, and it may not be over yet.

Cladding



This has always been problematic for insurers, but the tragedy at Grenfell has completely changed the debate on the issues. Any firm involved in any way with cladding can expect to be under scrutiny, with particular focus on Approved Inspectors, Architects and those involved in fire safety. It is not just these professions who are facing increased levels of scrutiny and enquiry; anyone involved in construction can expect their insurer to have an interest to some degree. For those with significant exposures in these areas, many have seen significant rating increases and, for some particularly heavy exposures, declinatures of cover.

Whilst there is still a spectrum of insurer response to such firms, we expect that the market will continue to harden in this sector and the majority of insurers in this market are taking steps to aggregate cover. At the extreme end, exclusions are starting to appear, though this is only the minority of risks at present.

In relation to the market reaction to Grenfell more generally, we have written at length on some of the broader issues now coming out of the Moore-Bick and Hackitt inquiries. The problems of a lack of quality in the construction sector are not new and we continue to provide advice to insured clients in relation to how they might improve their risk management procedures.

Large limits/capacity issues

The market is shrinking and inevitably that brings with it issues for some in completing placements for clients who buy particularly large limits. The recently concluded Lloyd's review has had a chilling impact on syndicates' business models and most have put their foot firmly on the brake. Consequently, some insured clients in the wider marketplace have run into very significant difficulties with placing their full limits. The situation will deteriorate further before it gets better.

The problems of capacity won't just be restricted to those who buy large limits. There is a feeling that, owing to the reduction in the number of insurers offering PI products, that later in the year, as insurers' reduced capacity limits are reached, there could be a real pinch point in the market. Those whose renewals fall due in November/December ought to watch the developing situation very carefully indeed. Again, we can continue to provide the reassurance that all existing clients required limits will be met in full.

B) POLICY WORDINGS WILL NARROW...

Firstly, we expect no significant change to G&A issued policy wordings for the foreseeable future. We will continue to offer the broadest legal liability policies available. Others may not be so fortunate and pressures can be expected in relation to:

Legal liability policies/negligence based policies

The overwhelming majority of policies are now written on a 'legal' or 'civil' liability basis, meaning that they are capable of responding to contractually assumed liability absent negligence. This is an absolute necessity in today's world, where onerous contracts are commonplace. Some clients might notice in the next 6-months or so a dialling back of that offer, particularly those buying D&C policies.

'Any one claim'/aggregate cover

25 years ago, buying aggregate cover was relatively commonplace. The nature of this cover, as most of you will know, meant that a single limit of indemnity was available to cover all claims notified in the insurance period, usually 12-months. This meant that the limit could be eroded by claims matters, leaving less available should other claims develop. More recently however, 'any one claim' policies are now overwhelmingly the norm. Whilst this has obviously been good news from a coverage point of view, we expect, on the periphery of the market at least, that this position may start to unwind.

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Excesses

For many years now the rule of thumb has been that in order to offer a 'neutral' price from an underwriting point of view, a firm's excess should be around 1% of insured fee income. A firm with a £100,000 of insured fees should expect an excess of about £1,000. The theory was that this would attract neither an underwriting penalty nor discount. This rule of thumb has, for many, been a rule more honoured in the breach, than in the observance, with many benefitting from a lower excess without any premium penalty. That is likely to change for many and careful consideration should be given before trading away this benefit. As with pricing, we expect a 'steady as she goes' approach from our insurance partners.

Particular considerations

Fire safety has dominated many a renewal discussion over the last 12-18 months. Whilst most will have seen underwriting action, usually in the form of aggregate restrictions, in relation to claims involving fire safety, more action could follow. We currently do not anticipate our partner insurers hardening their positions, but those placing cover elsewhere should take care to ensure renewal terms do not significantly alter in this regard.

C) PHILOSOPHIES WILL BE CHALLENGED...

It might seem a strange thing to talk about in the context of insurance, but it really isn't. Whatever broker you have engaged to look after your arrangements, they will have a viewpoint about how best to guard your interests. That viewpoint - that philosophy - will dictate how they are perceived. How they are perceived by you, the client, and how they are perceived in the marketplace. The two facets of that perception will become more critical as we move forward because they will heavily influence the success, or otherwise, of the broker's philosophical model of doing business.

Put simply, if your broker's model has been cutting cost to the bone, changing markets to find the best price on the day and sustaining themselves on the virtue of low cost alone, then you are likely to face testing times. Testing times as you see insurers unwilling to accept claims notifications and dealing with past notifications harshly. Testing times as you see market support withdraw leading to a significant spike in cost or a failure to find cover at all.

Our model, our philosophy, is different. We aim to do nothing more, nor less, than act as our client's trusted adviser in managing and transferring the risks they inevitably face in undertaking the work that they do. This trusted adviser status is one we earn and draws together threads which are as simple as they are complicated.

We aim to achieve four things:

- ✓ To ensure that your insurance protection is technically effective, globally compliant and represents value for money;
- ✓ To ensure that you get the best risk management advice tailored for your business that we can offer;
- ✓ To ensure you are supported by a team of professionals who are connected, engaged in and deeply knowledgeable about your business and the world in which you work.
- ✓ To continue to offer our unique claims commitment, which has been described by many as the closest thing to a guarantee that they have seen

Easy to state, but a lifetime's work in practice. This leads us on nicely to some general advice we can offer to any insured, whether a G&A client or not, about how you can minimise the potential for disruption as you come up to renewal this year.

D) AND FINALLY...RENEWING YOUR PI IN 2019/2020?

Plan early

Start discussions early. Renewals are taking longer to finalise than at any other point in the last decade or more. Even 'straightforward' smaller and medium sized risks (say with fees under £1m and undertaking plain vanilla activity) should expect to be engaging with their broker at least 2-months ahead of renewal. For complex risks buying large limits, unusual risks, or firms impacted by claims, more time will be required. Meaningful engagement can be required 6-months or more ahead of renewal date.

Be prepared for greater information requirements...

Insurers are getting more astute and are digging into the detail in a way that is historically unprecedented. At the time of the last hard market (c. 2001) the internet and with it the huge volume of information it brings was not really an underwriting tool. Today it is. Whatever size you are, expect insurers to scrutinise your website looking for trouble and expect questions from your broker related to information you have put out there. For larger risks, insurers will look at the details of projects posted on websites, social media posts, and other readily available information (they do use Google Maps and Street View!) and they will also be interested in board level changes and financial statements. They routinely cross reference information received against that held on their databases and third party reference agencies.

Aside from the information gathering that they will undertake on their own account, you can expect them and your broker to want more than a simple proposal form. You can expect to receive questions on the following:

- If you are undertaking any 'higher risk' work, then they will have further questions and perhaps separate forms. Higher risk is an ill-defined phrase, but if we were to come up with a list of the usual suspects it would include:
    - Basements
    - Facade engineering
    - Any involvement in cladding
    - Any risk with pollution exposures
    - Any work involving surveying or valuation of residential or commercial property
    - Asbestos
    - Swimming pools
    - Any large or complex projects, particularly where this is out of your normal scope

- Your risk management procedures. How do you go about your Q&A process? Who signs off on work undertaken by junior engineers and how do they go about it.
- Contractual risk management is always a topic of interest and insurers will ask how you go about selling your services. Do you use your own standard forms, or those of the institutions (ACE, RIBA, RICS etc.)? If bespoke contracts are used (and we all know they are the overwhelming majority) what do you do about contract vetting them for acceptability? Is your broker involved? Do you routinely include appropriate limitations and exclusions? Can you (or your broker) provide any statistics to support any of this?
- If you’ve been unfortunate enough to have been involved in a claim, a post-claim review may be required and, indeed, it could be beneficial in drawing insurer’s attention to the particular characteristics of the claim and the remedial measures taken to prevent them occurring again. Drawing up a lessons learned and action taken document can be highly effective.
- Your broker should be helping you understand the particular risks that your business presents to the market and be helping you construct a narrative around why those risks have been identified, understood and mitigated. Do not underestimate the value of such a written narrative or indeed a general overview of the way in which your business operates. If you can tell a good story about how you run your business, you need to make sure that your insurer hears it.

At the end of the day, costs are going up, so the more preparation and detail you can put into understanding insurer’s concerns and, more importantly, addressing those concerns, the better.

We hope you have found this article informative. If you have any comments or feedback on its contents please feel free to get in touch via email:

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OUR VALUES:

SUPPORTIVE

PERSONAL

PROACTIVE

RELIABLE

& that's the difference