Professional indemnity insurance: taking care of business

In this 'back to basics' article, Griffiths & Armour Professional Risks Director, Graeme Tinney, looks at some of the considerations for anyone purchasing professional indemnity insurance and the challenges they are likely to face.

Insurance requirements are a major consideration for any new enterprise, but a consulting engineer has the added concern of professional liability exposure. For that reason, professional indemnity (PI) insurance is generally seen as the key component of their insurance programme and overall risk strategy. But what are the key questions to consider when looking to purchase a policy?

How does professional liability arise?

As a professional person or entity, you owe a duty of care to your client and certain third parties, such as purchasers, funders and members of the public. Unless otherwise defined under contract, that duty is to exercise 'reasonable skill and care' and when that duty is breached, you may become liable for losses incurred. Even where you've done nothing wrong, proving innocence can be very costly.

In recent years, we have also witnessed a hardening contractual landscape in the UK where firms are being required to take on onerous obligations under bespoke forms of contract; all of which only serves to increase potential exposure to professional liability.

What are the first steps when assessing your requirement for PI insurance?

It should be appreciated that PI insurance is there to mitigate the financial burden of any claims. Put another way, it is a mechanism to transfer financial risk. It is just one element of an overall risk management strategy, and it is equally important for firms to consider how to manage and reduce their exposure through client/project selection, appropriate contractual measures and achieving a fair balance of risk and reward across their activities.

Assessing and managing liability risks in that way will not only offer greater protection but will leave firms better placed to reach informed decisions on the amount and nature of cover they need to purchase.

How much cover do I need and for what?

PI insurance should principally provide protection in two ways. It should indemnify the insured in respect of:

- any awards made to a plaintiff in a civil action
- costs incurred in the defence of such actions.

One should never assume that because a project is small or appears straightforward that it carries no risk. Even gratuitous advice can result in liability and, while it is understandable to think about losses in the context of remedying defects, claims can (and often do) include items such as consequential loss and personal injury, which can significantly impact on financial exposure.

With all of that in mind, careful consideration needs to be given to the amount of cover (or 'limit of indemnity') and the basis upon which that limit applies.

In general, limits are available on an 'aggregate' or 'each and every' claim basis. Aggregate provides a limit to cover all claims in any one year, while the wider each-and-every claim cover will apply separately to each claim notified during the policy period. Wider forms of cover will also provide for legal defence costs in addition to the limit of indemnity. In all cases, the cover should be retroactive, covering claims that may arise from work undertaken prior to the inception of the policy.

In seeking to determine the level of cover required, there are numerous factors that can be taken into consideration, such as:

- the activities of the individual firm
- the scale and complexity of projects
- liability assumed under contract and the associated PI insurance requirements
- the profile of your clients and the procurement route
- the broader legal and economic landscape within which the firm is operating
- exposure to enhanced risks, such as consequential and/or pure economic loss.

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In truth, there is no 'right answer' when it comes to the level of cover, but minimum requirements will apply to some professions and a specialist PI insurance broker should be able to advise on market trends to assist in the evaluation and decision-making process.

Who is the policy covering?

While the existence of PI insurance will be of some comfort to your clients, it is not there to cover the client's risk or the projects you are engaged in. The purpose of PI insurance is to protect your financial interests and to respond to liability that could attach to you from the services you are providing. In that sense, it is a personal form of insurance and it is important that the confidentiality of the arrangements is respected.

The definition of 'insured' (business) under the policy should, however, extend beyond the insured firm to include principals, directors and employees operating on behalf of the firm. It is also important that indemnity is provided in respect of liability attaching to the insured from the actions of subconsultants, but this is not to suggest that the policy will offer protection to such subconsultants themselves, and such separate entities should generally be required to maintain their own PI insurance arrangements.

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Are all policies the same?

As with all classes of insurance, policy wordings can be difficult to decipher.

In the past, this has sometimes led to an overemphasis on cost and – while that is a significant factor for any business – it should never be the sole determinant in deciding on the placement of insurance.

There are in fact a whole range of policy wordings. These can vary from very basic negligence-based wording to a much broader specification, which is specifically designed to cater for the kind of liabilities that engineers are routinely facing. In an increasingly challenging PI market, many insurers are also looking to protect their position through the introduction of specific exclusions and restrictions, and it is important that the potential impact of these is fully explained and understood.

Again, this is where a specialist broker should be able to assist. As well as understanding the detail of the policy wording and how it compares to your liability exposure, the broker should be able to advise on the track record and approach of the particular insurer. At the end of the day, PI insurance is really a promise of support and you need to have confidence that the promise will be delivered upon when it is most required.

How easy is it to source PI insurance?

In recent years, it has proven very challenging for many firms in the UK to source PI insurance protection. A combination of factors within the construction and insurance markets (which we have reported upon extensively) has led to a loss of insurer confidence and, consequently, underwriting appetite: a situation where the supply of insurance has therefore not been sufficient to meet demand. That loss of appetite manifests in the number of firms seeking cover or the amount and specification of cover they are able to secure.

The key to achieving better outcomes is to start the process early and to provide insurers with a detailed insight into your business. The more you understand insurers' concerns and, more importantly, how effectively your submission addresses those concerns, the better placed you will be to secure the best outcome possible at that particular point. If you have a good story to tell about how you run your business and how you manage your professional liability exposure, you need to make sure that insurers hear it, and hear it from a source that they respect.

How long will I need to maintain PI insurance for?

Unlike many other forms of insurance, PI insurance operates on a 'claims made' basis. This means that the policy responding to a claim is the policy in place at the time a claim or circumstance is first reported to insurers, which may be many years after services have been provided or a project has reached completion.

To protect against the possibility of claims arising from work undertaken in the past, cover must be maintained on a continuous basis. This has particular implications where firms cease trading or an individual chooses to retire, and we will explore these implications and the issue of 'run-off' cover in our next 'back to basics' article.

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