

A/E RISK REVIEW

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Finding PL Coverage in a Seller's Market

The following material is provided for informational purposes only. Before taking any action that could have legal or other important consequences, speak with a qualified professional who can provide guidance that considers your own unique circumstances.

Nobody has to tell you that when it comes to professional liability insurance, it's a seller's market. Rates have increased by double digits for the past couple of years. Major insurers have pulled out of the market, reducing your number of options. And those insurance companies that have remained have become more and more selective about the types of firms they choose to insure.

Meanwhile, your clients certainly aren't relaxing their insurance requirements. In fact, many are asking for higher limits of coverage. So that leaves you between a rock and a hard place. Professional liability insurance is becoming more expensive and harder to get, while some clients are demanding that you purchase more coverage than ever before.

So what is a design firm to do? How can you control costs while meeting client demands? Your best advice is to begin planning today for your next professional liability insurance renewal. Don't wait until 30-60 days before your expiration date. Meet with your professional liability agent or broker now to begin planning your strategy for keeping your insurance available and affordable. Following are some areas for discussion and a few general tips to follow.

Take Advantage of Premium Credit Programs

Whether you are increasing or simply maintaining your current limits, one sure-fire way to control premium costs is to take advantage of your insurer's premium credit programs. These programs reward design firms with savings of up to one-third or more of their annual renewal premiums by following the insurance company's prescribed loss prevention measures. And remember, as your insurance premiums increase, the number of dollars you save through these programs also increases. Here are two common types of premium credit programs you should look for and take full advantage of:

Loss prevention education programs. Some professional liability insurers offer premium credits, typically 10%, for firms that take advantage of their annual loss prevention education program. This usually requires that your professional staff attend an education seminar provided by your insurance agent or broker and then successfully complete a quiz or other academic project that tests your new knowledge. Because most of these programs qualify for AIA/CES continuing education credits as well, attendees receive three benefits – lower insurance costs, needed education credits and, perhaps most important, knowledge that helps avoid a disastrous claim.

Limitation of Liability programs. Some insurers also provide premium credits of up to 25% when design firms agree to use Limitation of Liability clauses in all of their contracts with clients. These contractual clauses establish ceilings on the dollar amount a design firm is liable for in the event of a project dispute or claim as a result of professional errors or omissions. Clients are often willing to negotiate such clauses when they are educated on the risk-reward inequities that most design firms face when such clauses are absent.

Consider Alternatives to Higher Practice Policy Limits

Suppose you currently carry \$1 million in professional liability coverage, but your large new client is asking for \$5 million. Can you afford it?

Even with rising rates, professional liability insurance is still relatively affordable. And with claims severity on the rise -- not to mention the ever-growing number of projects you have worked on over the years that are now subject to potential claims -- higher limits may be in order regardless of current client demands.

Considering 1) the potential disaster that could occur if you are hit with a severe claim or multiple claims, and 2) the number of jobs you could lose if you have insufficient limits, you have to ask yourself whether you can afford *not* to increase your limits.

If increasing your aggregate practice policy limits is simply too big of a hit on your pocketbook, you might want to consider a few options that are less expensive but provide added protection for your clients:

- 1. Specific-project excess.** Suppose you are offered a dream job on the type of project that is right up your alley, but the client is demanding higher limits than you currently have. With specific-project excess coverage, it is possible to maintain your current limit on your practice policy while purchasing a higher limit to cover a specific project. For example, you can maintain a \$1 million practice policy and purchase a \$5 million limit on one project for substantially less than raising your entire policy to \$5 million.
- 2. Specific-client excess.** Let's take the previous example one step further. Suppose you find a new client who wants you to work on multiple projects, but demands higher insurance limits. Specific client excess is similar to specific project excess, except the higher limits apply to all projects performed for a particular owner. Again, this increased coverage is more affordable than raising your entire limit.
- 3. Split limits.** Instead of purchasing a \$5 million practice policy you might purchase a \$2 million/\$5 million split-limits policy. Here, the

policy limit on a single claim is capped at \$2 million, but the total coverage for any one year is \$5 million. This eliminates the chances that your policy would be wiped out by another claim and increases the chances that coverage will be there for all of your clients' projects.

Ask Your Broker About Project Insurance

There is one coverage option that provides a project owner the higher limits it demands, guarantees that coverage will be there when needed -- and can actually *reduce* your insurance premiums. This unique coverage option is called project insurance.

With a project insurance policy, the owner realizes the following benefits:

A single policy for a single project - and that project only. All members of the design team can be covered under one policy, and the limits are dedicated to that project only.

Full control over policy terms. The owner chooses the policy limits and the duration of coverage -- often available up to five years after substantial completion.

Guaranteed coverage. Most project policies are noncancellable, as long as premiums are paid, policy conditions aren't breached and no material misrepresentations or concealment have been made on the application.

No premium rate surprises. The project policy premium is determined according to a guaranteed rate based on final construction cost.

Single-point claims responsibility. Insuring the entire design team with one policy makes it easier to solve problems with less finger pointing and more cooperation.

So what's the catch? Why would an owner turn down the project policy option? Typically, project owners pay for the project policies, since they benefit most from the coverage. However, costs can be offset and shared with design firms through premium reimbursements or negotiated lower fees. (Since fees on the project likely won't be counted to determine practice policy premiums, a design firm saves money on its annual insurance costs.)

Unfortunately, fewer insurance companies are offering project insurance these days. Brokers who specialize in professional liability insurance for design firms can be invaluable in helping to find such coverage. They can also help explain the benefits and costs to the owner, coordinate implementation and provide loss prevention assistance throughout the life of the project.

Despite the advantages, owners may be unwilling to incur the cost of a project policy. A less expensive alternative may be owner protective insurance.

Owner Protective Insurance

An owner protective (OP) policy provides protection for the project owner in the form of excess coverage over and beyond the architects' and engineers' practice policies. That is, the design team's individual practice policies provide primary coverage and come into affect first. Then, if the responsible party's practice policy limits are depleted, the OP policy comes into affect to cover some or all of the additional damages, depending on the policy conditions and limits.

Because the OP policy comes into force only after the practice policy of the design firm has been exhausted or is otherwise unavailable, owner protective insurance is typically less expensive than a project policy. OP policies can be purchased annually or for the life of the project. Retroactive coverage can often be provided on projects already in the construction phase. Environmental engineering exposures can also be covered. "Blanket" OP policies may also be available for an owner's multiple projects.

In most cases, the design firms must maintain a minimum level of coverage (often \$1 million) on their practice policies. These limits may be higher for projects with substantial construction values. Also, any litigation costs incurred by the owner to bring the claim are not covered.

As an example of an OP policy in action, suppose there is a \$1.5 million loss to an owner's project that is determined to be the result of the negligence of the prime architect. The architect has \$1 million in coverage through a practice policy. The architect's primary policy would cover the first \$1 million in damages and the OP policy would cover the balance of \$500,000. However, if \$50,000 of the losses were made

up of the owner's litigation expense, the policy would cover only \$450,000.

Your Broker is Your Ally

Over the past few years it has become more and more expensive to secure professional liability insurance. For firms with claims histories, it is even becoming more difficult to find coverage at all.

As we've shown, there are a number of coverage options that design firms can discuss with their insurance agents and brokers. A qualified professional liability broker should be more than willing to help you evaluate your needs, discuss your options and help educate a demanding client on the various options available. Your broker can even help you bring a client with unreasonable or uninsurable demands back to realistic coverage expectations.

Can We Be of Assistance?

We may be able to help you by providing referrals to consultants, and by providing guidance relative to insurance issues, and even to certain preventatives, from construction observation through the development and application of sound human resources management policies and procedures. Please call on us for assistance. We're a member of the Professional Liability Agents Network (PLAN). We're here to help.