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PLI Market 2017: Insurers Strive for Equilibrium in Dynamic Environment

Ames & Gough Architects & Engineers Professional Liability Insurance Market Survey

I. Introduction & Overview

Although most insurers providing architects and engineers (A/E) professional liability insurance saw their premiums grow in 2016, the glass might be considered half full from their perspective. As was the case in 2015, the premium growth can be traced primarily to the overall increase in the revenues of insureds. For the insurers, the good news of this growing exposure base is tempered by the fact that competition remains intense among the many insurers participating in this specialty market.

Meanwhile, A/E firms are benefitting from this competitive market dynamic, driven largely by the fact that insurers are enjoying stable claims experience. A majority of insurers surveyed report claim activity, as measured by frequency, has been flat, helping to once again sustain the profitability of this specialized line of business. These factors put downward pressure on rates which meant many A/E firms saw their overall premium rates remain flat or slightly decrease in 2016. As these trends continue, A/E firms without claims likely can expect flat premium rates in 2017.

Despite the competitive environment, underwriters generally are maintaining rigorous standards in evaluating exposures. Notably, they remain focused on recent and historic claims experience while continuing to monitor emerging exposures. These include the risk of cyber incidents, expanded use of drones and the erosion of protections for design firms under economic loss doctrines.

The Ames & Gough *2017 Architects & Engineers Professional Liability Insurance Market Survey* examines up-to-date pricing and coverage trends. We offer perspectives to help design firms manage their professional liability exposure, which continues to be among their most significant risks. The annual survey, now in its seventh year, reports on responses from senior underwriting executives at 19 of the leading A/E professional liability insurance companies. This year's survey includes a significant increase in insurer participants, reflecting the expanded number of insurers now providing this coverage.

The insurers that participated in the 2017 survey were: AIG (Lexington), Arch (PUA), Argo Pro, Arrowhead, Aspen, AXIS, Beazley USA, Berkley Design Professional, Berkshire Hathaway, Chubb, CNA, Everest, Great American, Liberty (LIU), Markel, Navigators, OneBeacon, RLI, and Travelers. They account for over 80 percent of the overall U.S. market for architects and engineers professional liability insurance. We are grateful for their participation in our study and are pleased to present the findings in this report.

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II. Survey Findings

What Happened in 2016?

New business and exposure changes caused premium growth

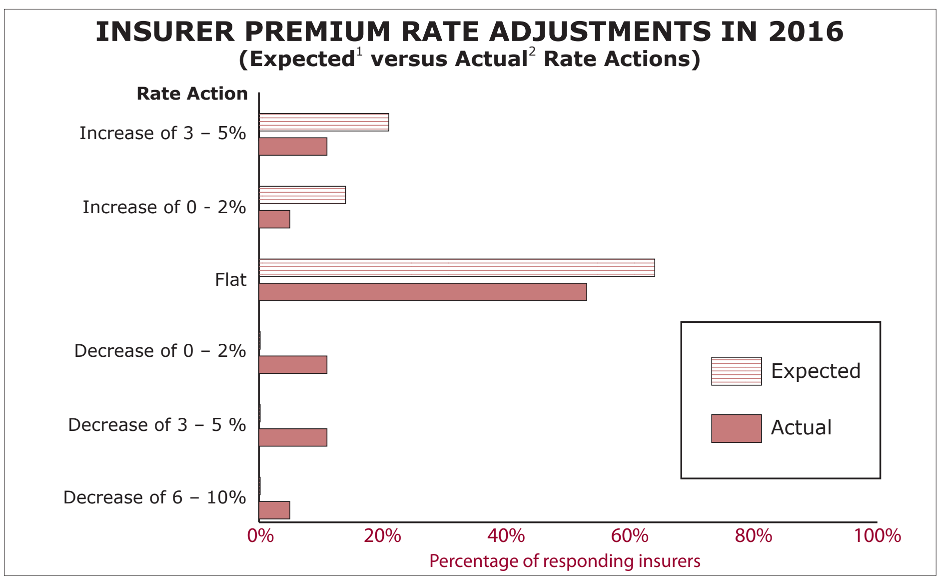
The majority of insurers (63 percent) in the survey reported that their professional liability insurance business, in terms of written premium, grew in 2016. Meanwhile, 32 percent indicated their premium volume was flat and 5 percent reported their book of business declined last year.

For the third consecutive year, all insurers that experienced an increase in premium attributed their growth to new business. Half of these insurers also pointed to revenue growth, project mix changes or adverse loss experience as contributing to premium growth. The one insurer whose business declined cited the loss of clients to competitors as the reason.

Indeed, competition continues to have a significant impact on premium rates as insurers strive to grow their business or maintain relationships through renewals. Meanwhile, claims experience stabilized and in some cases improved, which has made insurers more comfortable with keeping rates stable.

Rates flat for most insurers. Although 53 percent of the insurers surveyed indicated their professional liability insurance rates held steady in 2016, 32 percent lowered their rates and only 16 percent saw rates increase. By contrast, a year earlier, 8 percent had lower rates and 38 percent of the insurers experienced rate increases.

The impact of the competitive environment can best be seen by comparing insurers' expected 2016 rate actions (as reported in last year's survey) with their actual results. As you can see (in the chart below), any rate increases insurers achieved in 2016 were modest. Only two insurers saw an actual rate increase of 3 percent or more. And one other insurer reported an increase in 2016 of up to 2 percent (an identical number expecting such an increase when the year began). Notably, no insurers in the 2017 survey achieved overall increases exceeding 5 percent, nor did any insurers anticipate such increases at the start of 2016.



Notes:
1. Expected rate action based A&G's 2016 survey results (14 insurers).
2. Actual findings based on A&G's 2017 survey results (19 insurers).

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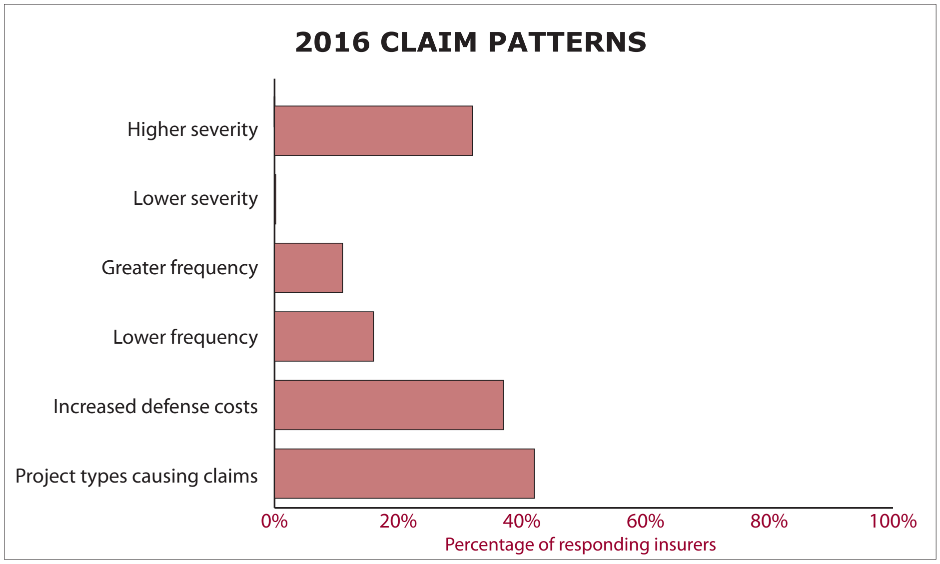
Claims experience steady or improving: For the second consecutive year, 79 percent of the insurers surveyed reported no change in their overall claim activity compared to prior years; in 2016, however, a greater percentage of insurers (21 percent) than in the past saw their claims experience improve and none had worse experience.

In regard to individual claim patterns, 32 percent of the insurers reported an increase in claim severity and 37 percent noted an increase in defense costs impacting overall claim payments. While 11 percent saw an increase in frequency of claims, 16 percent reported lower claims frequency. Additionally, 42 percent indicated specific project types, such as single- and multi-family residential, schools, roads/highways (including bodily injury type claims) and parking structures, as the cause for a higher number of claims.



Note: Insurers provided multiple answers, so the responses sum to over 100%.

Most insurers (63 percent) responded that no specific geographic location experienced an increase in claim activity. The remaining 37 percent indicated they experienced increased claim activity in certain geographic regions. Among them, 29 percent cited higher claim activity in the Northeast region and 29 percent pointed to Southwest as having more claims. Of the two insurers experiencing a regional decrease in claims, one identified the Central region and the other, the West Coast.

Insurers responded with the following data with respect to their largest single claim payment in 2016: The majority (53 percent) paid a claim of $1 million or higher, including two insurers that reported their largest claim was between $5 million - $9.9 million and one that paid between $10 million and $19 million. The potential for large claims, continued escalation of defense costs, and higher contractual requirements are helping fuel the trend towards A/E firms purchasing additional limits. Today, it's more common for design firm clients to seek limits as high as $5 million or even $10 million.

While only one insurer in last year's survey paid a network security and cyber-related claim related to a firm's professional services, three insurers in the 2017 survey reported paying such claims. This may be a trend to watch as more insurers experience cyber-related claims arising from performing professional services. In addition, some insurers face greater cyber liability exposures from endorsements for this coverage added to their professional liability policies.

A&G Insight: While some cyber-related claims may be picked up by an A/E firm's professional liability policy, either because the loss arose out of providing professional services or because the PLI policy includes a cyber endorsement, we are seeing more firms purchase stand-alone coverage. Such stand-alone policies are typically more robust, especially with regard to so-called "first party" exposures, such as notification and credit monitoring requirements, business income losses, ransomware, network and data damage, and other related losses.

Drive for Stability Reflected in Planned 2017 PLI Rate Actions

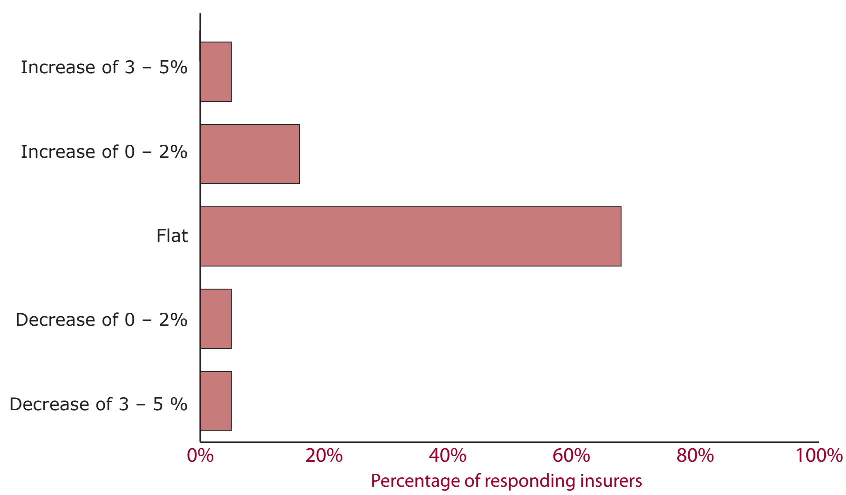
Facing competition, most insurers now seek flat rates

While we began to see the impact of competition on the marketplace two years ago, the momentum is building and having a wider impact on insurer expectations with respect to their rates. Most insurers surveyed (68 percent) indicated their plan for 2017 is to keep professional liability insurance rates flat. An additional 11 percent are planning modest rate decreases. Besides competition, these insurers cite better than expected recent and historic claims experience as generally influencing their decisions on rates.

Meanwhile, 21 percent are planning modest rate increases of up to 5 percent; these insurers point to rate inadequacy, as well as historic and recent adverse claims experience (last two years), as the impetus for their decision-making.

Among those planning rate increases in 2017, 75 percent will target the hikes to high-risk projects, including residential construction and schools. One insurer's planned increase is focused on high-risk disciplines, such as structural and/or geotechnical engineering, and one is targeting a specific geographic region for rate increases.

INSURERS' PLANNED RATE ACTIONS FOR 2017



The good news for design firms is that the A/E professional liability insurance marketplace has no shortage of insurance companies now offering this specialty product line. For 2017, this will likely result in renewals with flat or only slightly increasing premium rates for firms with good loss experience and less risky disciplines – as well as for those firms experiencing revenue growth. In addition, as they look for new ways to win or keep accounts, more insurers have added endorsements for cyber-liability and some are now contemplating endorsements for drone operations.

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Thinking of Changing Insurers? Look Before You Leap.

Given the wide array of insurers willing to offer competitive terms, the option of reducing the cost of professional liability insurance by changing insurers may seem attractive to many A/E firms. In their decision-making, however, firms should also consider the potential benefits of maintaining a long-term partnership with their existing insurer. For example, insurers that have a multi-year relationship with their insureds may be more willing to consider unique coverage grants or be more flexible when presented with a claim that falls in a "grey area."

That stated, it is good practice to review alternatives every three or four years. In deciding whether to make a switch, firms should carefully weigh the following:

- Are there key differences in coverage terms and conditions from the current policy versus the proposed alternative policy?
- What billings are used by the insurer specifically for rating purposes? Each insurer has their own rating formula (i.e., past year billings, average of billings over three years, etc.), which can have a direct impact on the premium. Depending on the insurer's formula, a lower premium one year may not be the case the following year.
- How about risk management and claims-handling services? How do they compare? Notably, some insurers have well-developed claims networks and processes, while others don't have the same capabilities, making the claims process more arduous for the insured.
- What is the financial strength of the potential new insurer?
- How long has the potential new insurer been committed to the A/E PLI marketplace?

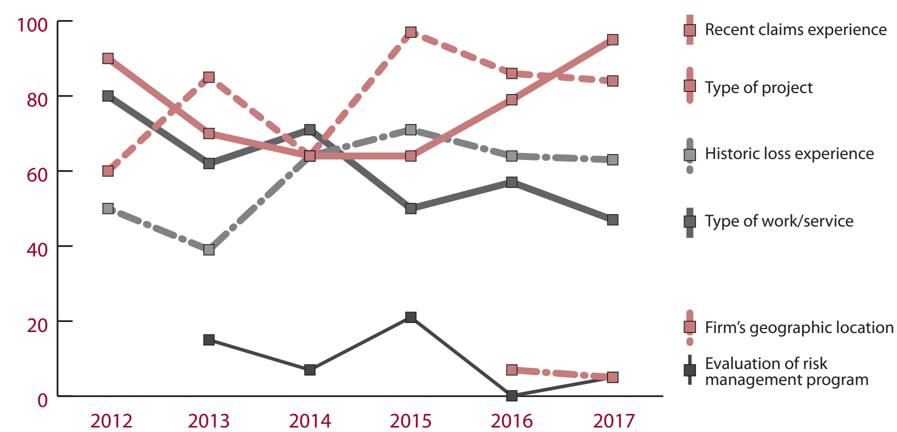
Don't overlook claims and potential claims. If you do elect to change insurers, be sure you understand the new insurance company's requirements for reporting a claim or circumstance that could evolve into a claim. In addition, be sure to work with your broker to report any known claims or circumstances to your incumbent insurer.

Insurers Fine-Tune Priorities in Establishing Premiums for Individual Risks

Greater vigilance around recent claims

Although insurance underwriters consider several factors in analyzing a particular risk, they are now placing more emphasis on an A/E firm's recent claims experience. This year, 95 percent of the insurance companies surveyed identified recent claims among the top factors for raising a specific firm's PLI premium rates. That's a big jump from the 79 percent of insurers citing the same issue a year ago. Meanwhile, the other three top factors carried essentially the same weight on a year-over-year basis. In both 2017 and 2016, insurers also identified the following top factors as key drivers of their individual account rating decisions: type of projects (84 percent), historic claims experience (63 percent), and type of work/service (47 percent). Of note, while the quality of a firm's leadership/firm governance had been a consideration in last year's survey, none of the insurers included it among their key underwriting criteria this year.

TOP FIVE UNDERWRITING CONSIDERATIONS (2017 vs. five prior years)



Note: Insurers provided multiple answers, so the responses for each year sum to over 100%.

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A&G Insight: While the underwriting factors noted above and a firm's revenues play an important part in determining premium, underwriters also consider other factors as they examine a firm's overall risk profile. For example, lower-exposure services, such as feasibility studies, abandoned projects, or international work; the percentage of a firm's billings paid to insured subconsultants; and the use of limitation of liability provisions in contracts may result in further discounts affecting overall premium. The relatively low percentage of insurers citing a firm's internal risk management practices may be somewhat misleading; many underwriters now consider that factor a given in terms of how A/E firms are managed and governed. Cutting back on these measures will likely expose a design firm to loss, which could affect its ability to take full advantage of the current professional liability insurance market conditions.

Other Key Findings:

Underwriters keep pulse on emerging issues: The insurers surveyed were asked about emerging risk trends being monitored from an underwriting standpoint. The four most prominent issues were: judicial rulings that are eroding protections for design firms under state statutes, such as economic loss doctrine (79 percent); evolving project delivery methods (e.g., design-build and public-private partnerships), cited by 68 percent; innovation, such as the use of BIM and technology and new construction materials/methods, and international exposures (each at 32 percent).

Stable capacity: In 2017, as in past years, the availability of adequate capacity for A/E professional liability insurance coverage has been stable. Firms in need of higher insurance limits, such as to fulfill contractual insurance requirements, may be able to obtain them from their current insurer or through the participation of multiple insurers. Specifically, among insurers in the survey, five will provide policy limits of up to $5 million; eight can offer up to $10 million in limits; one, up to $15 million; one, up to $20 million; and three, up to $25 million in limits for qualified firms.

A/E firms encouraged to maintain contractual diligence in pursuing infrastructure projects: When asked if the aggressive plans currently being discussed to develop and repair the U.S. infrastructure were raising any specific underwriting concerns, 63 percent of the insurers cited the failure of A/E firms to adhere to effective contractual best practices when negotiating new projects. Most insurers (53 percent) also expressed concerns about A/E firms accepting contractual responsibility outside their expertise and 32 percent expressed wariness related to the inability of A/E firms to effectively assess and manage subconsultants.

Insurer claims service, a key differentiator: As the marketplace remains competitive, insurers recognize the continued need to emphasize their capabilities and offerings that will resonate with design firms. Quality claims service continues to be the most prevalent, cited by 74 percent of the insurers; next were breadth of coverage and risk management support, each cited by 53 percent. Although not a point of emphasis in the past, this year 37 percent cited competitive premiums as a key differentiator, ahead of longevity/stability/commitment (26 percent).

III. Closing Commentary

For the most part, A/E firms are continuing to benefit from a buyers' market for their professional liability insurance. With premium rates generally competitive and more insurers offering coverage extensions, many design firms – even including those in a growth mode – are seeing opportunities to hold down costs and, in some cases, to increase limits.

Even in a soft market, however, it's no time for A/E firms to cut corners on sound risk management practices. Underwriters continue to seek firms that practice active risk management and seek to execute fair and reasonable professional service contracts. Additionally, participation in risk management training, such as the various webinars offered by many insurers, can result in premium savings at renewal.

In light of the myriad insurers offering coverage, having a specialist A/E insurance broker can bring value in analyzing a design firm's specific insurance needs and securing the most favorable program.

ABOUT AMES & GOUGH

Ames & Gough, founded in 1992, has established itself as a committed, superior resource for design professionals, law firms, and other consulting firms and professional organizations in need of professional liability insurance and risk management assistance. In addition, the firm's capabilities include management liability, employment practices liability, cyber, kidnap & ransom and related insurances; as well as more typical property and casualty insurances. The firm has offices in Boston, Philadelphia, and Washington, DC.

Visit the Ames & Gough website at www.amesgough.com.