PLI Market 2021: As Claims Experience Deteriorates, Insurers Seek New Rate Hikes

Ames & Gough Architects & Engineers Professional Liability Insurance Market Survey

I. Introduction & Overview

Amid unprecedented times, the construction sector remained relatively resilient in 2020. In the face of the COVID-19 pandemic, A/E firms adapted their business operations to meet the needs of ongoing projects. Given the disruptions over the last year, one cannot help but wonder, will we see even more in the coming year?

As we enter 2021, Ames & Gough (A&G) is paying close attention to the continued influence of the pandemic on the A/E/C industry both domestically and abroad. Of particular interest: the economic circumstances in individual states and the construction sector altogether, as well as the ability of design firms to maintain operations and meet contractual obligations. While there remains much uncertainty around many of these topics, we were able to draw important insights from leading insurance companies on a range of key issues. We are pleased to provide you with the 11th edition of the *Ames & Gough Architects & Engineers Professional Liability Insurance Market Survey.* The survey findings provide a summary and analysis of the following:

- 2020 market review
- Insurer strategies on risk appetite, premium rates and limit capacity
- Claims activity and patterns
- Opportunities for premium credits
- Future market outlook
- Emerging trends

This year's survey includes responses from underwriting executives at 20 leading insurers providing A/E professional liability insurance. On a combined basis, they represent a significant percentage of the current overall marketplace for this line of coverage. Participants in the 2021 survey were: AIG/Lexington, Arch (PUA), AllRisks/RT Specialty, ArgoPro, Aspen Insurance, Beazley USA, Berkley Design Professional, Berkshire Hathaway, CNA (Victor Insurance), National Casualty (Euclid Design Underwriter), Everest, Great American, The Hartford/Navigators, Liberty Mutual/Ironshore, Markel, RLI, Hudson Insurance (Riverton Insurance UW), Starr Companies, Tokio Marine HCC, and Travelers.

We are thankful for each insurer's participation and are pleased to share the findings in our report.

II. Survey Findings
What Happened in 2020?

Overall, insurers saw premiums grow in 2020. There was a number of factors contributing to this growth. Seventy-five percent of survey participants reported their professional liability written premium grew in 2020, while the remaining 25 percent experienced flat premium levels. Among insurers reporting premium growth, 40 percent saw only a modest increase, while more than half achieved growth above 15 percent.

Of the insurers that experienced premium growth, 93 percent attributed it to new policies written. Meanwhile, three-fourths of the insurers traced growth to their policyholders' increased billings. More than half pointed to insureds opting for higher limits and the same percentage cited higher premium rates. To a lesser degree, premium growth was due to the insured's adverse loss experience (27 percent) and higher-risk project or service mix (20 percent).

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Even as the insurers surveyed benefited from the resiliency of the construction sector, including the ability of their A/E/C clients to work through unprecedented issues, some openly wonder about the sustainability of that growth in the context of the pandemic.

**Note: Based on 15 insurers reporting 2020 premium growth*

Insurers saw an uptick in premium rates in 2020. Although A/E firms continued to enjoy a generally favorable rate environment in 2020, many saw single-digit rate increases. Based on the information received from insurers, 73 percent implemented a rate increase of up to 5 percent. For 20 percent of those polled, rates went up 6 percent or more. That's a significant difference from the previous year when 60 percent of insurers surveyed kept rates flat and 40 percent achieved a rate increase of no more than 5 percent. The upward pressure on rates appears to be gaining momentum this year based on indications provided by the survey participants.

Continued rise in claims severity in 2020. Approximately half of the respondents reported worsening claim results in 2020, while the other half indicated claim results remained similar to the prior year. Nonetheless, all the carriers surveyed expressed concerns about this trend continuing.

This year's survey revealed significant increases in severity. Furthermore, 25 percent reported having more claims in 2020 related to certain project types, such as residential and infrastructure.

Insurers were asked to identify specific disciplines that resulted in the highest frequency and severity of claims in 2020. As in the previous year, architects and civil engineers were reported to have had the highest frequency, followed by structural and mechanical engineers.

With respect to claim severity, most insurers cited structural engineering as the discipline with the highest claim severity, followed by architecture, civil, geotechnical and mechanical engineering. Not surprisingly, the insurers noted that the largest claims tended to be those involving bodily injury, design defects, as well as property damage or construction delays.

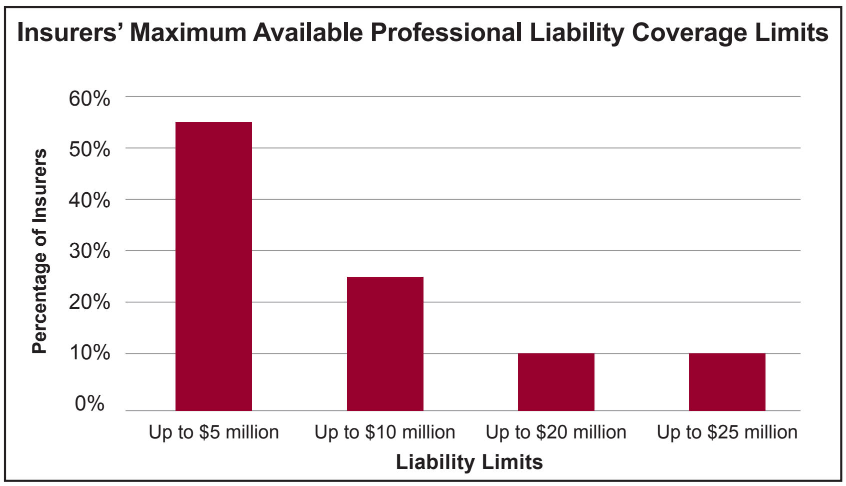
"We have noted more breakdowns in QA/QC and true technical errors," said Larry Moonan, Executive Vice President and Chief Operating Officer, Berkley Design Professional, a Berkley Company. "We think this is related to the challenge the industry has had in attracting and retaining qualified staff, and the advent of technology," particularly "too much reliance on technology for QA/QC."

However, Georges Pigault, Vice President, Liberty Mutual/Ironshore, sees other reasons for the reduced ability of A/E/C firms to improve their QA/QC in certain projects, citing "lower fees," "difficulty in hiring qualified staffing" and "remote working due to COVID-19 leading to potentially reduced quality and breakdown in communication."

More insurers seeing increases in regional claims activity. Even though the majority of insurers (60 percent) in this year's survey indicated that no specific geographic area had an increase in claims activity, that's a decline from last year when 73 percent reported no such trend. For the 40 percent of insurers in this year's survey that experienced increased claims activity in specific geographic areas, all regions across the country were impacted. By contrast, last year, only a few regions were specifically identified. Notably, among those citing regional claim activity in this year's survey, 40 percent saw more claims in the Northeast and 35 percent in the Southwest. Meanwhile, 30 percent reported higher claim activity outside the U.S. and 30 percent saw more claims each in the Southeast and West Coast. The higher claim levels are in part associated with more business activity in each region.

Most insurers report making multimillion-dollar claim payouts. We asked the participants to indicate the dollar range of their largest single A/E PLI claim payout in 2020. In response, 45 percent reported paying a claim of between $1 million to $5 million. One in four of the insurers paid a claim of $5 million or more, including 10 percent that made staggering payouts between $10 million to $20 million. Although many factors are outside an insured's control, active participation in the claims resolution process can help facilitate a timely and economical resolution of a given claim.

New questions surface over sustainability of capacity. As the potential for large claim payouts increases, insurers' willingness to offer substantial capacity may be waning. A majority of the insurers surveyed continue to offer higher limits in response to the expanding needs of their A/E clients. Among those surveyed, the availability of liability limits breaks down as noted in the chart below.



It is important to note that while more than half of the insurers surveyed are open to offering limits of $5 million and above, obtaining higher limits now involves greater underwriting review. In other words, higher limits are available, but only after a firm and the project are thoroughly vetted.

A&G Insight: Higher limit requests are becoming commonplace. However, the limits being required may far exceed the limits maintained by an A/E firm and perhaps not even be commensurate with the risks associated with the services or fees on a given project. When faced with these requests, we would advise firms to have a substantive discussion regarding either the noncompliance or disproportion between risk and higher limits requirement.

When clients are unwilling to reduce the limits specified in their contracts, a few options are often available. These include increasing overall limits, purchasing additional limits by endorsement or excess policy placements. However, keep in mind that all insured risk profiles are not the same.

In evaluating requests for higher limits, insurers take into account the various elements of a firm's risk profile (i.e., annual billings, disciplines, claims history) to determine the maximum limits to be offered. For A/E firms, it is most important to be proactive during early negotiations with clients to help manage higher limit requests.

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Planned 2021 PLI Rate Actions: Insurers Seek Larger Rate Hikes.

The abundant capacity and intense competition that helped stabilize A/E professional liability insurance rates in recent years is now being tempered by an increase in claims severity and higher claims expenses. Unlike in the past, nearly all insurers (80 percent) are seeking increases in 2021.

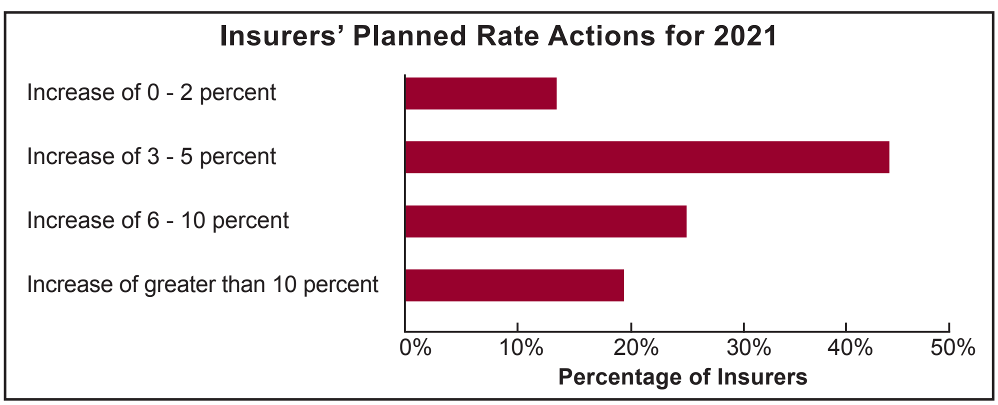
The survey found that most insurers are seeking rate increases that are incrementally larger than what they obtained in prior years with a number of insurers now eyeing double-digit hikes. More specifically, 57 percent of the insurers surveyed are seeking increases of up to 5 percent this year, 25 percent plan increases of 6-10 percent, and 19 percent are seeking rate increases greater than 10 percent.

Not surprisingly, the overwhelming majority (81 percent) plan to target accounts with adverse loss experience, while 56 percent will be looking for across-the-board rate increases. Meanwhile, 56 percent also indicated they will evaluate a firm's discipline as a primary rate driver. The targeted disciplines include, but were not limited to, structural engineers, architects, and civil engineers.

"We've seen an uptick in civil engineering claims in Texas, and in particular in those involving residential subdivisions and other residential project types," observed Sandip Chandarana, Director at Professional Underwriters Agency. With respect to related rate actions, he noted: " … we've implemented a 3 percent rate increase as a result of this increased exposure, although this is subject to change if the economic downturn continues longer than anticipated."

Insurers continue to take into account project types and geographic areas when contemplating rate action. The industry claim trends continued to pinpoint residential projects and in particular condominiums as being high risk. Meanwhile, some insurers identified Florida, Texas, and New Jersey as states where rate hikes may be implemented.

In this environment, A/E firms with favorable loss experience and risk profiles that appeal to the various insurers' appetites may be in the best position to avoid significant rate actions in 2021.



Underwriters' concern with high-risk disciplines, other issues. Geotechnical and structural engineering, as well as architecture continue to be disciplines that underwriters view as higher risk. Insurers' historical claims data indicate higher frequency and severity of claims arising from these disciplines. This leads the insurers to apply higher rates in an effort to address historically elevated claims costs associated with these disciplines.

Ninety-five percent of those surveyed cited structural engineering as among the top three disciplines in terms of risk, followed by geotechnical engineering (75 percent) and to a lesser extent, architecture (40 percent).

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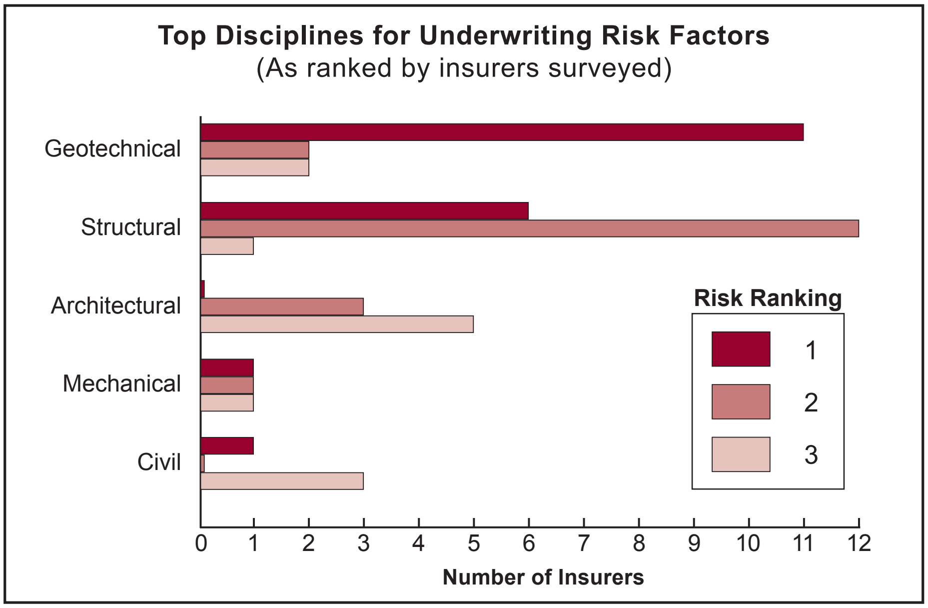
Other higher risk underwriting factors. Entry into higher risk service disciplines or project types were ranked as two of the underwriters' biggest concerns. Also garnering higher concerns were fast track and designer-led design/build project delivery, construction complexity with increased costs, and public-private partnerships. Insurers remain focused on these areas as they assess their potential impacts on A/E professional liability insurance rates.



**Note: To a lesser extent insurers also cited process engineering, surveying, construction manager and HVAC as higher risk disciplines.*

A&G Spotlight: A/E Industry not Immune to Cyber Risk.
The year 2020 was a landmark one for many reasons, one of which was the proliferation of cyber-attacks on the business community at large – and A/E firms were certainly not immune to this exposure. It is quite amazing to think that businesses shifted their workforce in a blink of an eye to a remote platform. However, this movement tested firms' security infrastructure and as a result, this shift was one of the leading drivers for cyber-crime attacks given the opportunity for cyber criminals to more easily infiltrate systems.

Given the current cyber security climate, firms should continue to strengthen their system security to avoid potential cyber breaches. One of the tools a business can take advantage of is the pre-breach services available through its cyber-insurance policy to assist in identifying potential system vulnerabilities. Putting the appropriate security measures in place to help mitigate a cyber-attack is also becoming a critical component in meeting insurance underwriting requirements to obtain or renew insurance coverage.

More recently, insurers are taking a very cautious approach due to the rise in frequency and severity of cyber claims (i.e., ransomware, data breach and restoration costs, social engineering, etc.). With the uptick in cyber-related claims and the resulting reduced insurer profitability, cyber premium rates are on the rise and we anticipate this to continue. More and more contracts are incorporating some form of cyber insurance as part of the overall insurance requirements. In addition, we are also seeing higher limits being required (i.e., $5 million or higher). We foresee this trend will continue.

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Other Key Findings:

COVID-19 and social trends raise concerns. We provided the survey participants an opportunity to comment on any risk trends that are currently being monitored. Many identified COVID-19 as a potential risk factor. Specifically, some noted project delays and costs overruns, as well as potential disruption the pandemic could have on the economy and the A/E/C industry altogether, including potential issues for HVAC systems being blamed for infection. As in the past, some insurers cited the potential for social inflation to drive up claim costs, as well as concerns about rate inadequacy.

Completing PLI application and potential premium credits. We asked participants to comment on areas within an application where insureds could qualify for premium credits in an effort to reduce overall premiums. Ninety-five percent identified fees attributable to feasibility studies, planning and reports as low-risk services. Furthermore, 85 percent pointed to the use of a limitation of liability clause tied to a specified dollar amount. Seventy-five percent cited the presence of a quality assurance or quality control program and 70 percent, the retention of insured sub-consultants as other areas for savings. A majority of insurers indicated they would apply premium credits to having a high percentage of repeat clients, as well as to fees attributable to abandoned projects.

Some insurers plan policy enhancements. Even as most insurers are planning rate increases in 2021, none indicated they are planning to impose any additional coverage restrictions this year. In fact, three insurers revealed they will offer updated policy forms in 2021 that will include some coverage enhancements. In addition, one insurer has announced plans to introduce an admitted excess policy for small-to-midsized firms.

III. Closing Commentary

In 2020, the construction industry proved resilient even in the face of the pandemic. A/E firms and contractors faced shortages of experienced workers, the challenge of retaining high-performing teams, as well as supply chain issues that threatened to trigger project delays. Despite the challenges, a positive outcome from the pandemic has been an accelerated reliance on technology to help facilitate project development and delivery.

As noted in our survey, competition among the A/E PLI market remains strong, which is a benefit to insurance buyers. However, 2021 could be a year where rates will have a greater impact on premium than in years past due to continued claims trends.

As they carefully monitor these trends, insurance companies are trying to balance their need to increase rates with their desire to maintain and grow their business. Included in the mix is economic uncertainty and its potential impact on the construction industry.

In this environment, we recommend A/E firms maintain a strong focus on sound risk management practices, including but not limited to mindful client and project selection, quality control measures and proper contractual risk allocation to support a positive risk profile.

We hope this survey report provides insight into your insurance coverage and strategy for this year and beyond.

ABOUT AMES & GOUGH

Ames & Gough, founded in 1992, has established itself as a committed, superior resource for design professionals, law firms, consulting firms and professional organizations and associations in need of insurance and risk management assistance. The firm has offices in Boston, Orlando, Philadelphia, and Washington, DC.

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