# PLI Market 2022: A/E Firms Face Headwinds Due to Adverse Economic Factors

## Ames & Gough Architects & Engineers Professional Liability Insurance Market Survey

## I. Introduction & Overview

As the construction industry navigated a second year of the Covid-19 pandemic, leading insurers providing professional liability coverage for design firms saw significant premium growth. In looking ahead to 2022, insurers see the need to counter the impact of continued deteriorating claims experience along with multiple issues related to the pandemic, including worker shortages, supply chain disruptions, elevated cyber exposures, and the effect of inflation on claim costs and the overall economy.

With the start of the new year, Ames & Gough (A&G) is focused on all of these issues in addition to new and continuing developments in the professional liability insurance market. We are pleased to provide the 12th edition of our annual survey, which offers insight, analysis, and perspective on the following topics:

- 2021 market review
- Insurer strategies on risk appetite, premium rates, and limit availability
- Claims activity
- 2022 market outlook
- Emerging trends affecting design firms including mergers & acquisitions, worker shortages, and inflation

This year's survey includes responses from underwriting executives at 16 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 2022 survey were: AIG/Lexington, Beazley, Berkley Design Professional, Berkshire Hathaway Specialty Insurance, Everest, Great American Insurance Company, Hanover Insurance, Markel, PUA, RLI, Riverton/Hudson Insurance, Ryan Specialty Group, Sompo International, The Hartford, Travelers, and Victor Insurance.

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

## II. Survey Findings
## Cost of Doing Business Continues to Escalate

Insurers saw substantial premium growth in 2021, with a majority hitting double-digit percentage increases. Altogether, 81 percent of survey participants reported their professional liability written premium grew in 2021, while the remaining 19 percent experienced flat premium levels. Among insurers reporting premium growth, more than half achieved growth above 15 percent. Nearly a third of the firms with premium growth in 2021 had growth levels above 20 percent, 23 percent had increases of 6 – 10 percent and the same number had modest growth of up to 5 percent.

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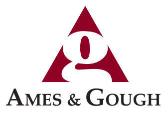


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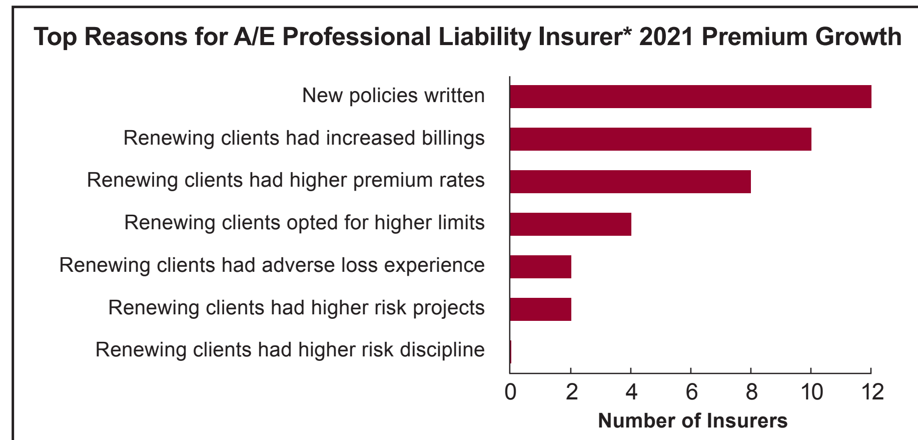
The good news for design firms is that the substantial premium growth of the insurers was aligned with the robust increases in revenues achieved by A/E firms across the U.S. Of the insurers that experienced premium growth, 92 percent attributed it to new policies written while 77 percent pointed to their policyholders' increased billings.

A majority (62 percent) of insurers surveyed also attributed growth to higher premium rates and 31 percent saw their clients opt for higher limits. To a lesser degree, premium growth was due to the insureds' adverse loss experience (15 percent) and higher-risk projects (15 percent). A/E firms are growing – and with that growth comes increased risk, such as the risk associated with larger, more complex projects.




*Note: Based on 13 insurers reporting 2021 premium growth*

**Insurers reported sharper rate increases in 2021.** Against the backdrop of deteriorating claims experience and uncertainty surrounding the COVID-19 pandemic, all insurers participating in this year's survey implemented rate increases in 2021. Among them, the majority (56 percent) had modest rate increases of up to 5 percent. The remaining 44 percent, however, achieved rate hikes of 6 percent or more, including 13 percent with rates that rose by more than 10 percent.

**Claims severity remains an issue.** While half of the insurers surveyed indicated their overall claim experience in 2021 was the same as the prior year, the remaining insurers were equally divided between those reporting better experience and those with worse claims experience. That stated, 63 percent pointed to an increase in claims severity last year and only one in five found no measurable difference in severity from the prior year. Along with the overall increase in severity, 31 percent saw a rise in the frequency of claims and the same percentage of insurers pointed to higher expenses as driving up overall claim costs. One survey participant shared his perspective:

"The past 10 years has seen substantial claims inflation in the A&E space, probably in the range of 3-5 percent per year," said Jim Schwartz, A&E Focus Group Leader, Beazley. "During the same time period, premium rates have been stagnant, and rates charged by A&E firms have not grown at nearly the same pace as claim costs. The expectation should be that premium rates across the sector need to increase in order to keep pace with claims inflation."

**Insurers rocked by multimillion-dollar claims.** When asked to reveal the amount of their largest single A/E PLI claim payout in 2021, 38 percent of the insurers reported paying a claim of between $1 million to $4.9 million. One in four paid a claim of $5 million or more, including 13 percent that made staggering payouts between $10 million to $19.9 million.

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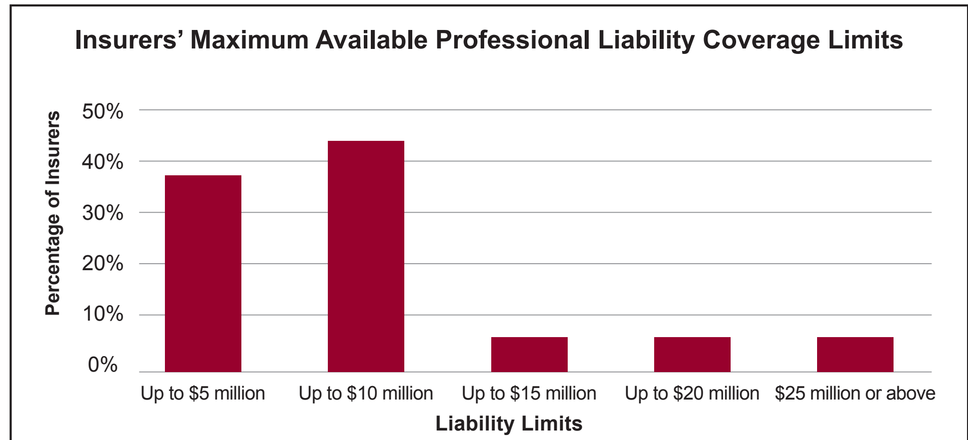
When asked about lessons learned from the large losses that might translate to advice for A/E firms, several insurers pointed to the need for appropriate contractual scrutiny, including having a clearly defined scope of service, meaningful limits of liability protection, and a careful review of indemnification provisions. They also cited the need for design firms to be more thorough in their selection of projects, clients and subconsultants, and to review their quality assurance and quality control measures.

**For A/E firms and their brokers, obtaining adequate capacity may require creativity.** Among insurers surveyed, the availability of professional liability limits is consistent on a year-over-year basis as indicated in the chart below. However, while over half of the insurers surveyed can offer limits of $5 million and above, obtaining higher limits continues to require greater underwriting review. Thus, while there is capacity in the market, in many cases an insured will need to seek multiple sources to meet increased limit requirements.




**Planned 2022 PLI Rate Actions: Insurers Seek Larger Rate Hikes.** The movement among insurers to seek increases in their professional liability insurance rates that became evident in last year's survey is continuing in 2022. Accordingly, 81 percent of insurers in the 2022 survey are seeking rate increases this year with the remaining survey participants planning to hold rates steady.

Unlike in past years, when insurers overwhelmingly targeted rate increases to accounts with adverse loss experience, 69 percent of those participating in the 2022 survey plan such actions. The more significant focus this year appears to be on accounts with what underwriters consider to be high-risk projects or disciplines. This year, 77 percent of survey participant plan increases related to high-risk projects and the same percentage will target high-risk disciplines.

**Are you in a state with rates on the rise?** A significant number of insurers surveyed (38 percent) intend to target increases on firms operating in states either historically considered higher risk or with generally adverse loss experience. Specifically, some insurers pointed to California, Florida, New Jersey, and Texas as states where rate hikes may be implemented.

Additionally, 31 percent plan to raise rates across their entire book of business. In this environment, A/E firms need to 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.

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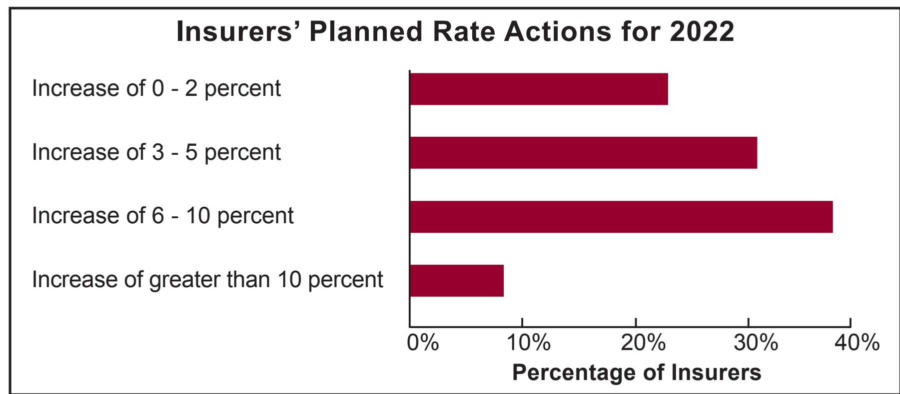
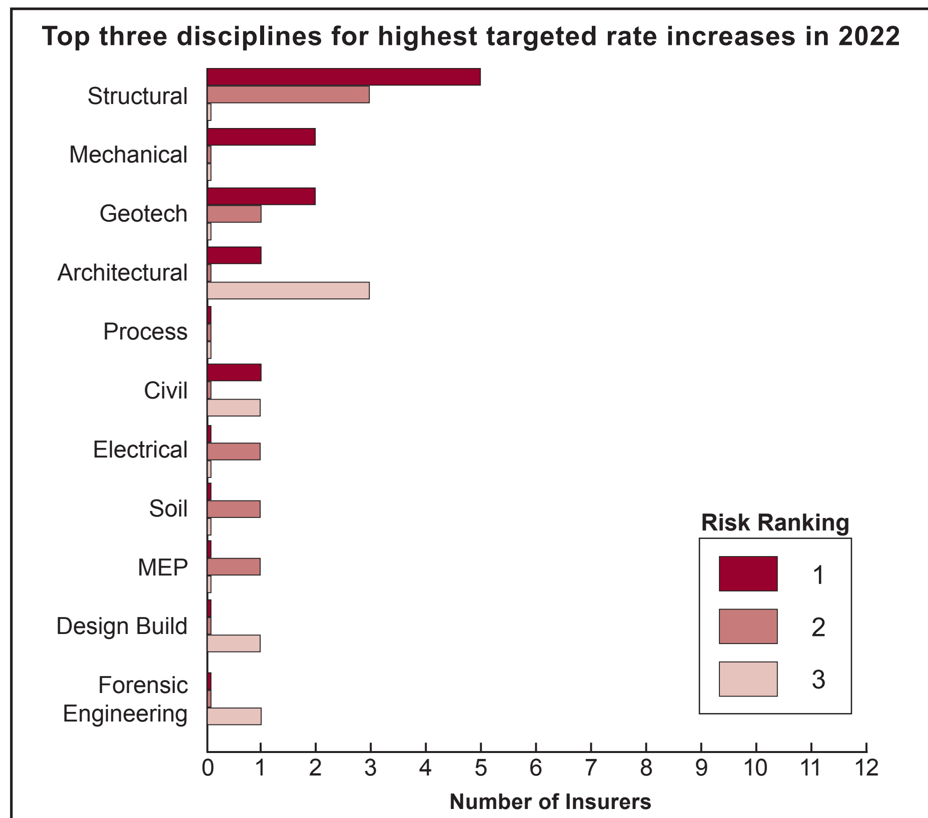



**Underwriters targeting high-risk disciplines for rate increases.** Based upon high claim frequency and severity in the past year structural engineering, architecture and geotechnical engineering continue to be disciplines which underwriters view as higher risk. Consequently, half the insurers surveyed placed structural engineering in the top three disciplines they plan to target for rate increases in 2022, followed by architecture (25 percent), and geotechnical engineering (19 percent).




**A&G Spotlight: Cyberattacks lead to greater insurer scrutiny.**

2020 and 2021 saw a rapidly hardening cyber insurance market. Moreover, across industry lines, cyberattacks have surged in both cost and frequency. The increase in attacks has, in turn, resulted in a rise in cyber liability claims and subsequent underwriting losses. In light of these market conditions, it is predicted that most insureds will experience higher cyber liability insurance rates in 2022, with many insureds seeing 15 - 50 percent increases.

Besides increased premium costs, insureds may also encounter coverage restrictions, further scrutiny from underwriters regarding cybersecurity practices, and exclusions or sublimits for losses stemming from specific

types of cyber incidents. If firms fail to demonstrate proper cybersecurity protocols or have experienced cyber incidents in the past, coverage will be increasingly difficult to obtain.

**Key developments to watch:**

**Tightened underwriting standards** — With cyberattacks surging, cyber insurers have adjusted their underwriting practices to help mitigate the risk of costly claims. In particular, insurers are now requiring more substantial documentation from their insureds. This may include detailed information related to workplace cyber policies, incident response planning, employee training and security software capabilities.

**Elevated ransomware concerns** — Ransomware attacks have been steadily increasing. This increase is likely tied to cybercriminals becoming more sophisticated and developing further avenues for launching these attacks (e.g., ransomware-as-a-service and remote desk protocol). This is concerning because ransomware attacks often carry higher costs than other types of cyber events.

**Heightened business email compromise (BEC) risks** — BEC scams entail a cybercriminal impersonating a legitimate source within an organization to trick their victim into wiring money, sharing sensitive data, or engaging in other compromising activities. According to the latest data from the FBI's Internet Crime Complaint Center, BEC scams continue to be among the most expensive types of social engineering losses.

**Are you managing your cyber exposure properly?**

- Take advantage of loss control services offered by insurers to help strengthen cyber measures.
- Focus on employee training to prevent cybercrime from affecting your operations. Employees should be aware of the latest cyber threats and ways to prevent them from occurring.
- Establish an effective, documented cyber incident response plan to minimize damages during a cyberattack.
- Consider supply chain exposures when establishing the firm's cybersecurity policies.

**Unprecedented consolidation gives insurers pause.**

With approximately 400 M&A transactions involving A/E firms in 2021, insurers surveyed expressed mixed views on any related implications.

"We have firms we've lost to M&A and some we've picked up, but of concern is how this activity impacts our exposure over time," said Larry Moonan, executive vice president, chief operating officer, Berkley Design Professional, a Berkley Company, a participant in this year's survey. "Culture clash, breakdowns in quality assurance and talent management can all lead to more claims. We are closely monitoring this continued activity."

Insurers caution A/E firms making acquisitions to practice careful due diligence, particularly in assessing the target firm's legacy exposures. Among the many factors to consider, insurers noted the two most critical involve addressing employee concerns and conducting a thorough insurance program review.

**A&G Insight: Navigating potential M&A exposures**

To make sure the firm is not blindsided by surprise liabilities after a merger or acquisition transaction, perform the following review:

- Ensure all of the seller's existing policies have sufficient limits and adequate coverage for its main risks.
- Determine whether the seller has any potential liabilities that are not insured. To do this, review the seller's claims history and existing policies.
- Take note of the seller's existing contracts guaranteeing indemnification, or agreeing to additional insured status for suppliers, customers, or corporate affiliates of the seller.
- Review existing contracts to look for any indemnities or insurance that may have been presented to the seller from other parties.
- Pinpoint new exposures that could pop up if operations are added or moved to locations unfamiliar to the firm. New coverages may need to be purchased or old policies may need to be updated to make sure these operations are covered.
- Address any circumstances or conditions that could generate claims that would fall under the seller's coverage.
- Address any differences in the way the seller reported claims with the way the buyer reports claims and the reporting requirements stipulated in the policy.

Additional uncovered liabilities are often discovered in the due diligence process, and the purchase price can be adjusted, accordingly, or the buyer granted applicable indemnification.

**Inflation may drive future premium increases.** When asked about their biggest concern that could impact the professional liability insurance market in 2022, many insurers cited the potential for the uptick in inflation to lead to another round of premium increases. Respondents also cited another type of inflation – social inflation – as fueling claim severity. Insurers also expressed concern about the pandemic-driven backlogs in courts increasing the claims cycle time and related costs.

**A&G Insight: Understanding drivers of social inflation**

In general, social inflation refers to the rising costs of insurance claims that are a result of societal trends. Trends such as increased litigation, broad insurance policy interpretation, plaintiff-friendly legal decisions and larger jury awards all drive social inflation in the insurance space.

As the insurance market changes, it is important for firms to understand what's currently driving social inflation. Doing so not only provides firms with a better understanding of the issues that affect insurance costs, but it can also help firms take proactive steps to protect the business in the face of litigation.

**Increased litigation** – One of the factors driving social inflation has to do with increased litigation or, more specifically, litigation funding. Litigation funding is when a third party provides resources to attorneys to finance a lawsuit. In exchange, the third party receives a portion of the settlement.

**Tort reform** – Refers to laws designed to reduce litigation. Specifically, tort reforms are used to prevent frivolous lawsuits and preserve laws that prevent abusive practices against businesses. Many states have enacted tort reforms over the past several decades, leading to fewer claims and caps on punitive damages. However, in recent years, states have modified tort reforms or challenged them as unconstitutional.

**Plaintiff-friendly legal decisions and large jury rewards** – Juries are increasingly likely to sympathize with plaintiffs, especially if a firm's reputation has been tarnished in some way in the past. As a result, plaintiff attorneys are likely to play to a jury's emotions rather than the facts of the case.

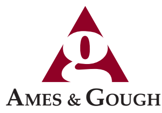
**Responding to social inflation** – Social inflation can introduce a level of uncertainty when it comes to a firm's risk management and claims prevention practices. While it's impossible to completely eliminate the threat of litigation, it's important to take the proper steps to ensure the firm is prepared for a lawsuit. This is increasingly crucial as social inflation continues to drive up the cost of claims.

## Other Key Findings:

- **COVID-19 having varied impacts on A/E firm risks.** Even though the insurers surveyed unanimously indicated that the COVID-19 pandemic did not give rise to claims for their companies in 2021, they remained concerned about the impacts the pandemic might have on the industry over time. Specifically, 94 percent of the insurers anticipated that supply chain interruptions will lead to potential claims for the A/E industry. They envision these disruptions leading to higher material costs, project delays, unavailability of critical materials, and higher costs ultimately driving up inflation and leading to higher overall claim costs.

- **Concerns over the impact of the "great resignation."** Sixty-three percent of the insurers surveyed expressed concern about the so-called "great resignation" – a trend that gained momentum during the pandemic – exacerbating employee shortages and claims. Among the most significant potential impacts insurers cited are an increased risk of design and technical errors, shortage of workers leading to project delays, and loss of institutional knowledge required to keep projects on track and to anticipate and address potential issues.

- **Insurers favor design firms' use of independent contractors.** In light of the challenges associated with potential staff shortages, 75 percent of the insurers surveyed view the influx of independent contractors (in the gig economy) as having a positive impact on the professional liability insurance market. Hiring an independent contractor offers employers many advantages. Unlike a traditional employee, an employer does not pay an independent contractor a wage or salary, federal and state payroll taxes on his or her earnings, social security tax, federal unemployment insurance tax, state unemployment insurance, workers' compensation premiums, benefits, or overtime. Employers do, however, pay for office space, along with supplies and equipment for the independent contractor to use. Employers can often save 30 to 40 percent by using an independent contractor versus hiring an individual to do the same job.



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- **Insurers eye benefits of technology investments.** Among insurers surveyed, 75 percent see making investments in technology as improving their ability to assess risk at a more granular level. From adding new risk management capabilities to enhance their underwriting and provide tools for their insureds to revamping their pricing models and improving data/analytics capabilities, insurers generally expressed enthusiasm about the potential benefits of the next wave of technology investments to their enterprises. Additionally, 63 percent of the insurers surveyed are planning new investments in technology to enhance their claims process, including some who plan to offer online portals or apps to their insureds for reporting and tracking claims.

## III. Closing Commentary

In 2021, even as the construction industry remained resilient despite the continuation of the pandemic into a second year, insurers are concerned about the continued deterioration of their claims experience and what some consider to be unsustainable rates driven by ongoing competition. For the second consecutive year, the majority of insurers are seeking to raise rates, with many now targeting high-risk disciplines and projects, as well as states with adverse loss experience.

Although the insurers reported no direct claims from the pandemic, they are concerned about related issues, such as worker shortages, remote work arrangements, supply chain disruptions, and the increased potential for project delays. They also are keeping close tabs on M&A activity involving A/E firms and elongated claim resolutions while maintaining careful underwriting discipline.

Even though fewer insurers than in the past indicated they plan to apply rate increases to firms with poor loss experience, it is worth emphasizing that A/E firms need to maintain a strong focus on sound risk management practices. This includes, but is not limited to, mindful client and project selection, quality control measures and proper contractual risk allocation to support a positive risk profile. In this environment, as always, firms involved in M&A transactions should practice careful due diligence in evaluating any potential deals.

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

**ABOUT AMES & GOUGH**

With more than 1,700 architects, engineering firms, and other construction professionals of all sizes as clients, Ames & Gough is the leading specialty insurance brokerage and risk consulting firm serving the needs of these professionals. Ames & Gough also has established itself as a committed, superior resource for law firms and associations and nonprofit organizations in need of professional liability, management liability, property/casualty insurance, risk management, and employee benefits assistance. Established in 1992, the firm has offices in Boston, MA; Philadelphia, PA; Orlando, FL; and Washington, DC.

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