Perfect Storm for Litigation: How Does Your PL Carrier Measure Up?

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External and Internal Forces Affecting Risk

Architect and Engineering (A/E) firms are in the mist of a very litigious periods, a slow economy combined with a credit crisis. Industry surveys have shown that in a down economy, claims and litigation increase. A recent Los Angeles Times headline read "*Economic Crisis, Boom Time for Law Firms".* With the slow economy, many A/E firm's are struggling to obtain work and stay afloat. Compounding the problem is reduced revenues, account receivable and cash-flow, turn-over and reduced staff, layoffs, senior management retiring, mergers possibilities, changes in business strategy and pursing alternative market segments. All realities in today's market conditions. However, any one of these items heightens risk for firms. When you combine the external forces of the credit crisis, economy downturn with the internal challenges for firms, liability and the potential for claims increases dramatically.

Based on all the external and internal risk factors, A/E firms are in a "perfect storm" scenario for potential claims. The external forces of the credit crisis and economy create concerns for; project financing, increased budget and scheduling pressures, product selection driven by cost instead of quality, low-bid selection of services and team members in lieu of quality based selection (QBS) process. All items lead to increased risk on projects for A/E firms.

Make Risk Management a Priority

As A/E firms consider belt-tightening measures, this is not the time to reduce risk management efforts; reducing insurance coverage's or increasing insurance deductibles putting your firm at higher risk. Firms should be increasing efforts in risk management and making it a priority. When firms focus on risk management strategies, the natural fallout improves performance and profitability. Risk management strategies not only address contract and insurance issues, it incorporates efficiencies into every aspect of practice and project management. This "holistic risk management" approach addresses strategies protecting the financial viability of a firm.

Professional Liability (PL) Insurance

A significant part of any risk management program is professional liability (PL) insurance. Insurance pays a key role in managing risk and providing a safety net when things go wrong. Insurance carriers obtain a profit in two ways: 1) underwriting strategy and/or 2) investment income. If investments income is positive, carriers can become more aggressive with underwriting approaches resulting in reduced premiums for insured's. This is a balancing act and can be a slippery slope if risky investments have negative outcomes combined with an aggressive, unprofitable underwriting strategy.

The credit crisis and economic downturn has had a negative affect on certain insurance carriers. Insurance carriers' surplus have been strained by significant investment losses, both realized and unrealized, as well as declining net investment income due to losses from limited partnership and other investments. These losses are the same as the banks and financial institutions with sizeable investments in mortgage and asset-backed securities. The results seriously affects carrier's liquidity levels. This combined with increased claim reserves result in negative outlooks and ratings.

Annually, a survey is conducted by ACEC, AIA and NSPE of A/E PL insurance providers. Sixteen (16) carriers participated in the survey this past year, the most ever involved in the survey process. Since the survey was conducted in October 2008, two additional carriers have entered the A/E PL insurance market. How does that affect A/E firms? It creates an enormous amount of insurance capacity (amount of available insurance) and selection options for A/E firms. Each PLI provider has what I call their "strategy and culture" of products and services. Each provider specializes in the A/E PL insurance market. However, each varies is coverage options and services offered. Certain carriers can be considered low cost providers with no or limited services. Others offer a wide variety of services and training options. Other variances include coverage features, underwriting experience, claims handling, risk management, training options and financial rating.

Each PLI provider, except one, indicated "gaining market share" for 2009. That is going to be a challenge for each provider. The number of A/E firms has not increased, most likely decrease based on economic conditions with more PLI providers offering insurance than ever before. The majority of providers indicated PLI rates going forward for years 2009 and 2010 shall remain flat or decrease.

Changes in how A/E firms practice should be followed by coverage features offered through insurance policies and endorsements. Changes such as BIM, IPD and Green Projects are occurring in A/E practices. Half the insurance providers indicated their PL insurance policy have been updated within one to three years. Five updated policies within the last four to five years. Two greater than five years and one had no response.

With the heightened potential for claims and litigation, A/E firms should carefully consider the selection of their insurance carrier. There is a great difference in coverage and service options. During the selection process, I recommend firms not select on price alone. Look carefully at offerings:

- Are they an advocate for the industry and A/E firms?
- How and what actions are taken supporting the industry and firms?
- Do they provide only insurance coverage with minimal value-added services or are they a full-service provider?
- If they offered minimal services, is their rate lower than the other providers?
- Do they have dedicated A/E specialists as claim handlers?

A great resource in help making a decision is your specialized A/E agent or broker. They are knowledgeable regarding the insurance market and carrier options.

Recommendations When Selecting a Carrier

When A/E firms are selecting an insurance carrier, I recommend providers that offer insurance coverage features consistent with services and services assisting in mitigating risk and liability exposures. This is especially important in this heightened litigious and claims period. From my perspective, this is a win-win situation for all parties. When carriers help mitigate risk for A/E firms, it helps them as well, improving the performance and profitability of accounts and book of business.

Key Categories When Considering PL Insurance Carriers:

- Experienced A/E Underwriting Staff: The number of carriers has increased. There is a limited pool of experienced, knowledgeable underwriters available in the market today.
- Claims Management: Experience in the A/E market is very important for claims managers and the selection process used for panel counsel. Inquire into claim management experience and practices used. Example; use of Reservation of Rights letters. Majority of carriers rarely used, however others delivered at higher frequency.
- Pre-Claims Assistance: Service that assist firms when things "may" be going wrong or need assistance/guidance but no formal claim filed. This service should be at no cost to insured's. Service and quality vary greatly with carriers being lenient while others offered very limited service options and provided at their discretion.
- Risk Management Program: Indicates commitment, knowledge and interest in mitigating risk. Training and topics relevant to today's A/E market including; contract review, firms and industry seminars on a regular basis. Certain carrier offer extensive programs, others do not see the value offering limited or no services.
- Length of Time in the Industry: Important but not a vital component. Newer carriers may have hired experience personnel from competitors. Indication of track record, abilities, commitment and performance.
- Industry & Insured's Feedback: Inquire and obtain feedback from other A/E firms; does the carrier have a positive reputation on services and claims handling? What is the renewal rate for the carrier with firms that have had a claim? Excellent indication of claims handling satisfaction. One resource is ACEC's Annual Professional Liability Survey of insured's. The survey inquires into satisfaction with carriers risk management programs, pre-claims and claims handling process.
- Carriers Financial Stability: Vital factor in today's economic environment; evaluating and confirming the carriers' financial stability. What impact has, or is the financial crisis having on the insurance carrier? Is it affecting their debt and financial strength such as AM Best, S&P, Fitch and Moody's? Is the carriers rating under watch, review with positive or negative implications?

Conclusion

This is a challenging period for many A/E firms just trying to obtain work and keep employees working. Adding to the challenge is the heightened potential for litigation and claims. The economic and credit is also having a negative effect on insurance carriers and their financial stability adding pressures to premiums. This is at a time when many A/E are having cash flow problems and least able to take on an additional expense. Firms should make risk management a priority and not just view it as a line-item business expense. The natural result when firms focus on minimizing risk is improved performance and profitability. A very important aspect of any risk management program is the selection of the PL insurance carrier. There are many aspects in the evaluation and selection process and specialized A/E insurance agent or broker is an excellent resource for guiding firms through that process.

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