PLI Market 2016: Insurers' Drive for Stability Facing Headwind of Competition

Ames & Gough Architects & Engineers Professional Liability Insurance Market Survey

I. Introduction & Overview

While professional liability insurers for architects and engineers (A/E) collected more premium in 2015, most of their growth stemmed from an overall increase in the revenues of their insureds. Meanwhile, after three consecutive years of modest rate increases, most insurers saw their rates flatten in 2015.

With the U.S. economy continuing its gradual recovery, design firms have enjoyed several years of growing backlogs and billings, which in turn helped generate more business for professional liability insurers. Notably, premiums for individual design firms are affected by their prior year revenues, which generally have been growing for the past 2 - 3 years. As these insurance companies look ahead in 2016, most now are seeking to stabilize rates in the face of ongoing competition. Meanwhile, claim activity, as measured by frequency, has been flat, helping to sustain the profitability of this specialized line of business for underwriters.

The A/E business sector continues to draw attention from insurers seeking to enter the professional liability marketplace, creating new competitors and holding premium rates down. This has forced existing insurers, many of which want to increase their market share, to sharpen their pencils as well. Despite the competitive drive, insurance companies continue to approach the underwriting of A/E professional liability insurance with great care and discipline. In particular, they continue to focus on recent and historic claims experience and carefully evaluate changes in A/E risk profiles and participation in high-risk projects.

In the Ames & Gough *2016 Architects & Engineers Professional Liability Insurance Market Survey*, we examine key pricing and coverage trends and offer perspectives to help design firms manage their professional liability exposure, which continues to be among their most significant risks. We recently surveyed senior underwriting executives responsible for the architects and engineers professional liability insurance lines at 14 of the leading insurance companies providing this coverage. This is the sixth consecutive year we have conducted this study.

The insurers that participated in the 2016 survey were: ACE (now Chubb), AIG (Lexington), Arch (PUA), Aspen, AXIS, Beazley USA, Berkley Design Professional, CNA, Liberty (LIU), Markel, Navigators, One Beacon, RLI, and Travelers. They account for over 75 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 2015?

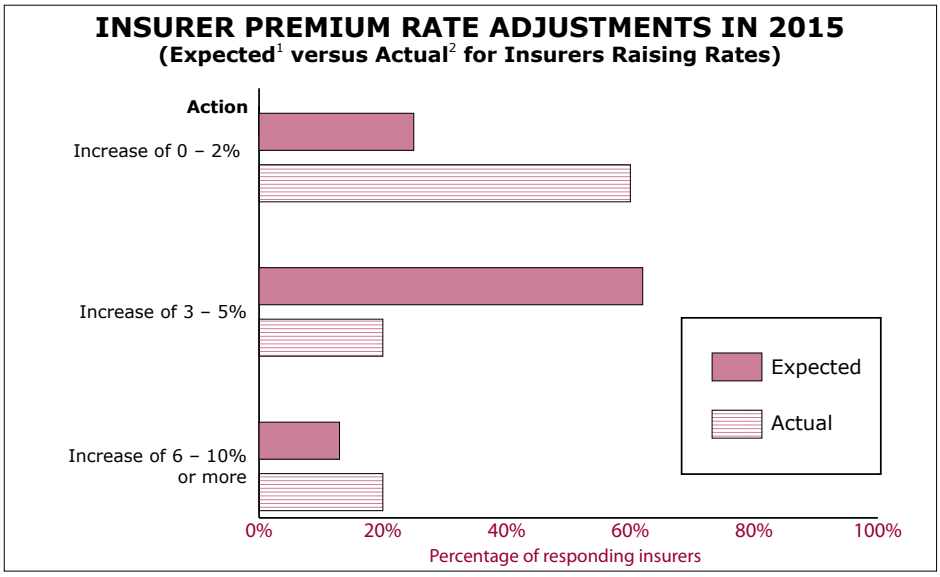
New business and exposure changes drove overall premium growth

As many design firms continued to benefit from a rebounding economy, the majority of insurers (85 percent) in the survey reported that their professional liability insurance business, in terms of written premium, grew in 2015. One insurer indicated its premium volume decreased and one insurer reported its premium volume remained flat.

For the second consecutive year, all the insurers experiencing an increase in premium attributed the growth to new business. Most (67 percent) also pointed to clients renewing with a combination of increased exposures (i.e., business grew, project mix changed or adverse loss experience). One insurer specifically cited higher premium rates as one of the factors for its growth in premium volume. Nonetheless, the insurance marketplace remained competitive in 2015: the one insurer whose business shrank cited the loss of clients to competitors as well as lower premium rates as the contributing factors.

Overall, premium rates remained flat in 2015, as claim experience stabilized or in some cases improved. Fifty-seven percent of the insurers surveyed indicated their professional liability insurance rates were flat in 2015, while 36 percent saw rates increase and one insurer lowered its rates. Notably, the magnitude of any rate increases achieved in 2015 was significantly lower than insurer expectations at the start of that year (a finding also reported in A&G's 2015 survey).

Among the five insurers achieving rate increases in 2015, 20 percent had an actual increase of 3 - 5 percent, versus 62 percent of the insurers in last year's survey expecting such increases at the start of 2015. Meanwhile, 60 percent reported increases in 2015 of up to 2 percent (versus 25 percent expected). Only one insurer in the survey achieved increases of 6 - 10 percent, the same number anticipating this rate hike at the beginning of 2015.



Notes:
1. *Expected* rate action based A&G's 2015 survey results of those expecting to increase rates (eight insurers).
2. *Actual* findings based on A&G's 2016 survey results of those reporting increased rates (five insurers).

Claim experience steady: The majority (79 percent) of the insurers surveyed reported no change in their overall claims activity in 2015 compared to prior years; 14 percent saw their claim experience improve and 7 percent had worse experience.

When asked if a specific geographic location experienced an increase in claims activity, most insurers (71 percent) responded there was not. However, of the 29 percent responding affirmatively, 50 percent indicated it was the Northeast region, 25 percent cited the Mid-Atlantic and 25 percent, the West Coast region. Only one insurer saw a regional decrease in claims activity (the Mid-Atlantic).

What's Behind 2016 PLI Rate Actions?

Rate inadequacy, claim experience remain key elements in 2016 rate decisions

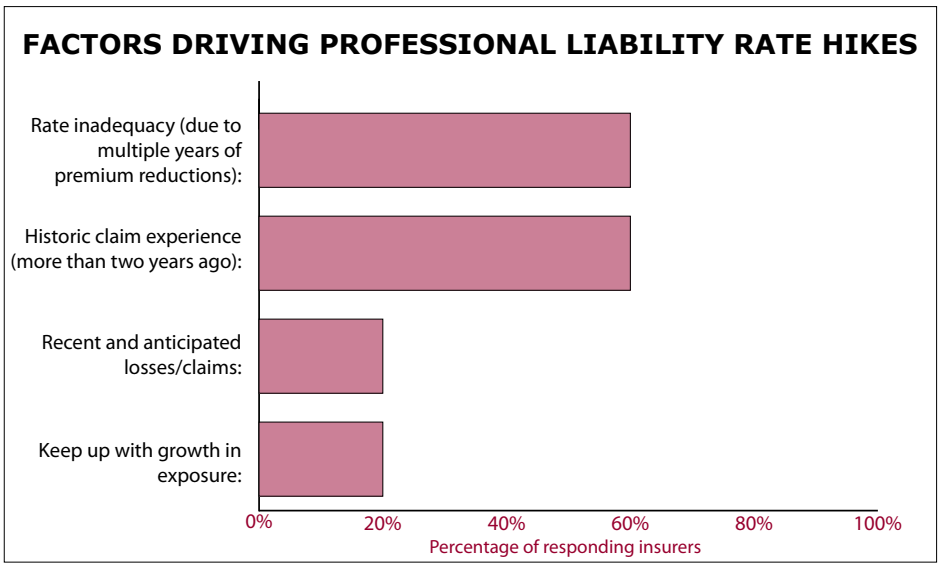
The majority of the insurers surveyed (64 percent) indicated that their plan for 2016 is to keep professional liability insurance rates flat. The remaining 36 percent of the insurers are looking to increase overall rates this year. Among those looking to increase rates, three insurers (60 percent) cited rate inadequacy (unrelated to claims/losses), which is primarily due to several consecutive years of premium reductions. While most insurers had modest rate increases from 2012 - 2014, the overall industry rates still have not increased over the long term due to years of rate declines during the long soft market cycle that lasted through 2011.

Historic claim experience (losses more than two years prior) was also cited by 60 percent of those planning to raise rates. One insurer indicated recent loss experience (last two years) was a factor, while another reported the need to keep up with what the insurers consider an increase in the overall exposure.

Among those planning rate increases in 2016, 60 percent will target the hikes to a specific discipline, such as structural engineering and geotechnical engineering. Meanwhile, the same percentage of insurers surveyed plan to target increases for specific types of projects, including residential construction and schools. One insurer is planning an across-the-board rate increase.

When asked if there were any claim patterns or trends observed, 43 percent of the insurers reported an increase in claim severity and the same percent cited an increase in defense costs impacting overall claim payments. Only 7 percent saw an increase in frequency of claims. This trend is similar to our 2015 findings. In addition, 35 percent indicated specific project types, such as single- and multi-family residential, schools, roads/highways (including bodily injury type claims) and parking structures, as causing a greater number of claims.

Only one insurer surveyed paid a network security and cyber-related claim related to a firm's professional services. However, in terms of an A/E firm's overall exposure to cyber-risks and related protection, this finding may be misleading. While few network or cyber incidents may have surfaced as claims under a professional liability policy, these losses are occurring with greater frequency for A/E firms and construction professionals. What's unclear is that these losses may be either uninsured or addressed by stand-alone cyber insurance, crime or other insurance policies; consequently, they fall outside the scope of this survey.



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

Insurers responded with the following data with respect to their largest single claim payment in 2015. The majority (57 percent) paid a claim of $1 million or higher, including one insurer that reported its largest claim was between $5 million - $9.9 million and one that paid between $10 million and $19 million.

A&G Insight: Ames & Gough's own experience is that in addition to the potential for large claims and ever-increasing defense costs, contractual compliance is also driving a move to higher limits. More often, design firm clients are requesting limits of $5 million or even $10 million.

What Can We Expect in 2016?

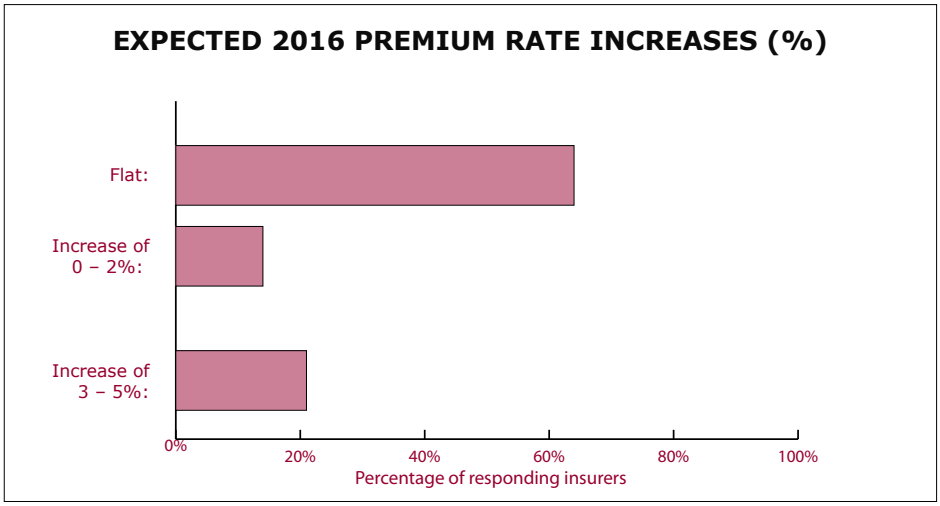
Professional Liability Insurers Seek Rate Stability in Competitive Environment

As more insurance companies are enhancing their presence in or re-entering the A/E professional liability marketplace, many existing A/E insurers are looking to maintain steady rates this year. Some are even looking to obtain only slight premium rate increases. This desire to maintain stability reflects an understanding of just how competitive the A/E professional liability insurance market is.

In previous years, we saw the trend of increased competition primarily affecting smaller firms; we are now seeing this competition affecting all size firms. Nine of the 14 insurers participating in this year's survey expect to maintain professional liability rates at 2015 levels; the remaining five plan to increase rates. Among the five insurers surveyed that are planning rate increases, all expect rates to go up by 5 percent or less.

Although insurer profit pressures are pushing most insurers to want to raise premium rates, the market realities (excess capital, new market entrants, etc.) will work to dampen these increases. In particular, incumbent insurers may well face aggressive efforts by those seeking new business to fuel growth.

For 2016, this will likely result in renewals in the flat to up 2 - 3 percent range for growing firms with good loss experience and less risky disciplines.



A&G Guidance: Reducing the cost of professional liability insurance by changing insurers can be an attractive option for many A/E firms to consider. At the same time, in evaluating insurance company relationships, A/E firms should recognize the value of longevity. When an incumbent insurer has an ongoing relationship with an individual design firm, it may be more flexible on unique coverage requests and "grey area" claims. This is not to say A/E firms should shy away from considering alternative options from other insurers every three to four years, but in contemplating any change A/E firms need to consider:

- The value of risk management and claims service provided by their incumbent insurers
- The financial strength of the potential replacement insurer
- The length of time the insurer has been in the A/E market and its commitment to the market
- Any differences in policy terms and conditions offered by competitive insurers that could adversely impact their business

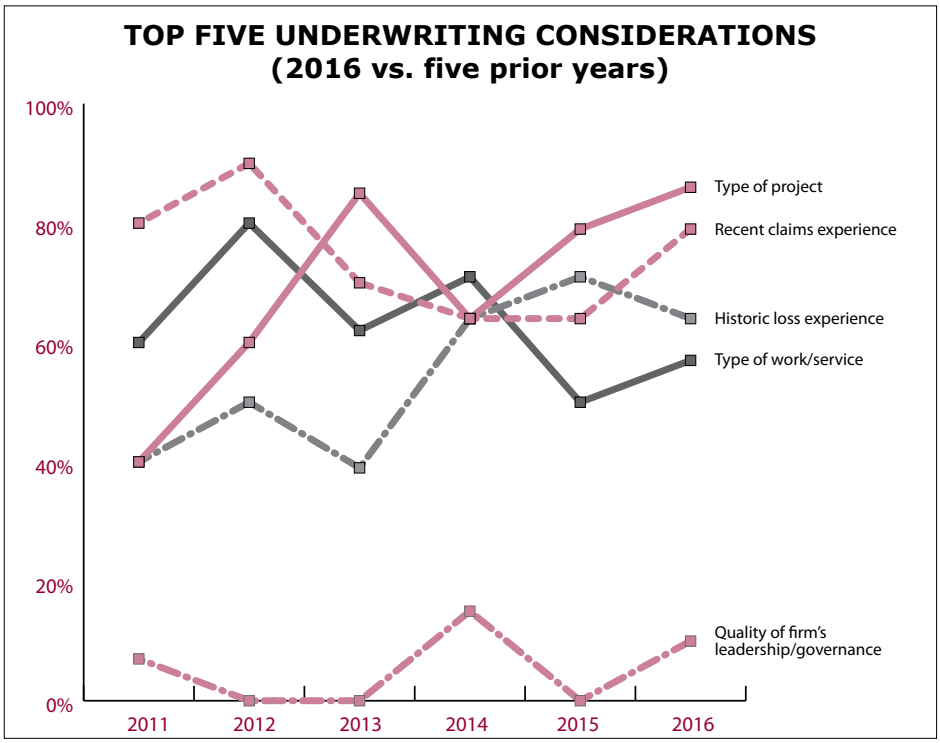
While some initial premium savings may be attractive, A/E firms should try to determine whether the potential new insurer will be able to maintain reasonable pricing over time.

How Do Insurers Set Premiums For Individual A/E Firms?

Insurers watch high-risk projects, claims experience

From an insurance underwriter's viewpoint, rate changes for an individual risk are driven by a number of factors. In 2016, the insurance companies surveyed cited type of projects (86 percent), recent claims experience (79 percent), historic claims experience (64 percent), and type of work/service (57 percent). Although their ranking may have changed slightly on a year-over-year basis, these factors have been consistently ranked as the top issues in each the past several years.

With respect to projects: residential, schools, and highway/road projects have the highest risks from an underwriting standpoint. Of note, while a design firm's risk management program had been a consideration in the past, none of the insurers in this year's survey included it among their key underwriting criteria. This may reflect a steady uptick in design firms' commitment to risk management during the past several years. For the second consecutive year, no underwriters cited the overall need for a higher rate as a driver for increases on individual accounts. Perhaps, this is another affirmation of the overall flattening of the professional liability market and the importance of individual risk underwriting.



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

A&G Insight: Underwriters continue to evaluate a variety of risk factors to determine an appropriate premium rate for each insured. In addition to overall revenues (keep in mind that many underwriters utilize some form of revenue averaging for rating purposes), underwriters will look at type of projects, historic loss experience (five to 10 years), recent claims (within last five years), and type of work/services performed. In addition, the percentage of work actually conducted by an insured's subconsultants and the firm's overall internal risk management practices play a part in developing premiums.

Other Key Findings: Emerging Risks; Stable Capacity; Insurers Stress Service; Calm Before the Storm?

Underwriters monitor emerging issues: In response to a question about the top three emerging issues that are most prominent from an underwriting perspective, 79 percent cited evolving project delivery methods, such as the increase in design-build and public-private partnerships; 71 percent cited innovation, including use of BIM and technology and new construction materials/methods, and 57 percent of the insurers indicated international exposures. Other issues getting the attention of some underwriters included: sustainable design, increase in condo projects, and the rising costs of design errors, including widened negative exposure associated with these claims exacerbated by social media.

Stable capacity: There remains stable capacity for A/E professional liability insurance coverage with significant excess limits available for even the largest firms through the participation of multiple insurers. Three of the insurers surveyed will provide limits of up to $5 million. Seven will provide up to $10 million in limits; one will provide up to $15 million, and three will provide up to $25 million in limits for A/E professional liability coverage to qualified firms. In response to higher limit requirements, many underwriters will participate as an excess insurer for larger programs while maintaining their capacity restrictions on individual placements. Total limits for an individual insured of $50 million - $100 million or more are available in the marketplace.

Insurers continue to stress claims service: In the competitive marketplace, insurers continue to emphasize capabilities, services and other measures that bring added value and differentiate themselves from the pack. Claims service was most prevalent, cited by 79 percent of the insurers; next was longevity/stability/commitment, noted by more than half of the insurers (57 percent); breadth of coverage was noted by 50 percent and 36 percent of respondents cited risk management support. Several insurers included competitive premiums, ability to offer project-specific policies, ability to provide creative solutions, and one-stop shopping as other differentiators.

Calm before the storm? When asked about potential issues related to the state of the A/E professional liability insurance market, some insurance companies raised concerns that the combination of a lack of underwriting expertise in dealing with A/E firm exposures, market overcapacity, and unsustainable pricing levels ultimately may lead to a shakeout with some insurers withdrawing from the marketplace altogether. While it might take a combination of factors for those developments to occur, it does point to the need for A/E firms to take great care in evaluating their relationships with insurance companies and in opting to make any changes.

III. Closing Commentary: Sound Risk Management Remains Key for A/E Firms

Even as professional liability insurance rates are leveling off and the marketplace remains competitive, insurance companies are maintaining strict discipline in their underwriting practices. With respect to individual accounts, they are watching for changes in risk profiles associated with participation in higher risk projects, mergers and acquisitions and claims experience, among other factors.

What should firms do? A/E firms seeking to capitalize on the current state of the professional liability market should remain committed to internal risk management protocols, including:

- Careful client selection
- Ongoing review and management of contract terms
- Effective project management
- Proactive client communication
- Complete and accurate insurance applications

Firms should also be proactive in identifying and promptly reporting potential claims and practicing sound claims management. In addition, it remains important to provide a complete and accurate underwriting submission for the insurance underwriters' consideration.

The professional liability insurance marketplace continues to evolve with insurance company mergers and acquisitions, changes in their risk appetite, and an increasing number of start-up operations. In this environment, an experienced A/E specialist insurance broker can be a valued partner in helping A/E firms assess their insurance needs, obtain appropriate coverage and strengthen their overall risk management program.

ABOUT AMES & GOUGH
With more than 1,100 architects, engineering firms, and other construction professionals of all sizes as clients, Ames & Gough is the leading 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 non-profit organizations in need of professional liability, management liability, and property/casualty insurance and risk management assistance. Established in 1992, the firm has offices in Boston, MA; Philadelphia, PA, and Washington, DC