Professional Indemnity Update for Contractors

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Speakers

David Isherwood
Account Executive
Lockton Professional & Financial Risks

Shanna Renaud
Account Executive
Lockton Professional & Financial Risks

About Lockton

Lockton is **a global professional services** firm with over 7,500 Associates who advise clients on protecting their people, property and reputations.

Lockton has grown to become the world's largest privately held, independent insurance broker by helping clients achieve their business objectives.

For nine consecutive years, Business Insurance magazine has recognised Lockton as a 'Best Place to Work in Insurance'.

Our **96% client retention** rate speaks for itself.

Over 7,500 associates

Exceptional client retention rate (96%)

Over $29 billion premiums placed

Clients in over 125 countries

Over 52,000 clients

Over 95 offices worldwide

10.3% annual organic growth since 2000

$1.72 billion revenues

90% reinvestment due to our private ownership

Our Philosophies

Demand highest standards of excellence

Promote ethical and caring culture

Recognise associates as most valuable asset

Encourage associates to achieve potential

Respect and value clients and carriers

Recognise and reward exemplary performance

Provide innovative solutions

Show passion for unparalleled service

Maintain independence and private ownership

Sustain meaningful corporate social and civic responsibility

Be fiercely competitive

Agenda

1. What is PII?
2. Market Conditions
3. What are we seeing in the market
4. COVID-19
5. What can you do?

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What is Professional Indemnity Insurance (PII)?

- Indemnifies the Insured against claims made against them by any third party for financial loss suffered by the third party due to the provision of the Insured's professional services
- The PII policy will protect the Insured against third party claims for the cost of direct and/or consequential losses suffered by the third party as well as costs of bringing the claim against the Insured
- PII also indemnifies the Insured for the costs associated with defending the Insured for that particular loss
- PII is a 'claims made' policy meaning it is the policy in force at the time a claim is notified that will come into effect i.e. a claim notified in 2019 for work conducted in 2015 will be settled under the 2019 policy. Other policies are 'claims occurring'
- Traditionally, PII is purchased by architects, engineers, solicitors, accountants, surveyors, contractors, IFA's, insurance brokers and a number of other professions
- It is mandatory for many – SRA; ARB; RICS etc.

Why would a PII claim arise?

- Allegation of wrongdoing in the course of your professional services
- Design or specification error
- Late delivery
- Statutory duty to prevent the spread of fire at a building and obligation to make the building 'safe'
- Generic issues on site tend to prompt letters of claim from solicitors to all parties
- Vicarious liability for sub-contractors/sub-consultants

...to name a but a few...

The market cycle

The PII market is cyclical in it's nature enduring both 'hard' and 'soft' market conditions over a period of time.

A **Soft Market** is where insurer capacity is high, competition for business is fierce and premiums/rates low. A Soft Market is good for the insurance buyer and places you in a strong negotiating position. A Soft Market is often brought about by consistently profitable underwriting results, good loss ratios and high interest rates where insurers earn a fair return on their investments.

A **Hard Market,** which we are in now, and has existed since early/mid 2018, is where the insurance buyer faces premium increases, reductions in insurers capacity, narrower coverage being available and even refusal of renewal terms to some insureds. Hard markets are usually the direct result of difficult economic conditions and a loss making portfolio.

What caused the hard market?

Grenfell Tower

The Lloyds' Report

Economic Factors

Post-Grenfell changes in the PII market

14th June 2017 – Grenfell Tower tragedy

- 72 people died and over 70 were injured in the deadliest structural fire since Piper Alpha in 1998
- September 2017 – public enquiry opened

December 2017 / January 2018 - dramatic change affecting all construction PII renewals

- Broad Insurer concern of systemic / catastrophic consequential losses
- Insurers view that they faced increased liability due to very broad insurance policy terms (civil liability)
- Withdrawal of insurers from construction PII market / reduction of insurer capacity on renewals

June 2018 to present – concern that worse is not yet over

- First formal third-party "claims" for non-ACP cladding – fire compartmentalisation detailing and combustible insulation
- Insurer concern that pre-2018 renewals only had limited cladding endorsements → more notifications to be made
- Non-UK claims – class actions in Australia
- Insurers considering additional exclusionary language broadening "ACP/Cladding" definition or "per building" self-insured excesses

The Lloyds' Report

Lloyd's of London: 5-year summary (combined ratio prior to full development);

	2017	2016	2015	2014	2013
Gross written premium	$43,332	$40,314m	$40,836m	$41,677m	$39,959m
Combined ratio	**114.0%**	**97.9%**	**90.0%**	**88.4%**	**86.8%**
Result before tax	- $2,701m	$2,613m	$3,119m	$4,705m	$5,320m
Return on capital	-7.3%	8.1%	9.1%	14.1%	16.2%

The Lloyds' Report – Performance Review Headlines

- 83% of Lloyd's syndicates reported an underwriting loss for 2017 up from 49.5%
- Lloyd's ran up an underwriting loss of £3.4 Bn in 2017 – combined ratio of over 114% (previous slide)
- Non-US PI in bottom ten performing classes of business
- > 100% loss ratio at end of 2017 (PI long-tail business which usually takes time for development)
- Backdrop of some very large PII claims globally
- Direct results include many PII syndicates no longer writing this class - China Re, Accapella, Vibe and Neon

Economic Factors

- The economy has been growing very slowly through the period of austerity and there have been significant mergers and failures in the construction industry

- Interest rates have remained at historically low since the financial crash in 2008. Investment income has always been a significant source of income for insurers, and this has compounded the effect of an otherwise poor financial performance and has led to greater underwriting discipline.

- As Brexit looms, some insurers deem that increased operating costs are going to inhibit business going forward

- The soft PII market has been in place for over ten years which has meant that premiums were at an all time low for many construction firms. Many insurers had been trying to redress this balance since 2012 but with limited success

The PII policy structure

There are three possible PII placement strategies to achieve a Limit of Indemnity;

i) Any one claim (also referred to as 'each and every claim') and unlimited in the aggregate

The insured has available a limit for any one claim with the number of claims being unlimited. The liability of insurers is to the maximum of £x for any individual claim but there is no overall limit on the number of claims. We believe this type of cover is becoming unachievable in the current market

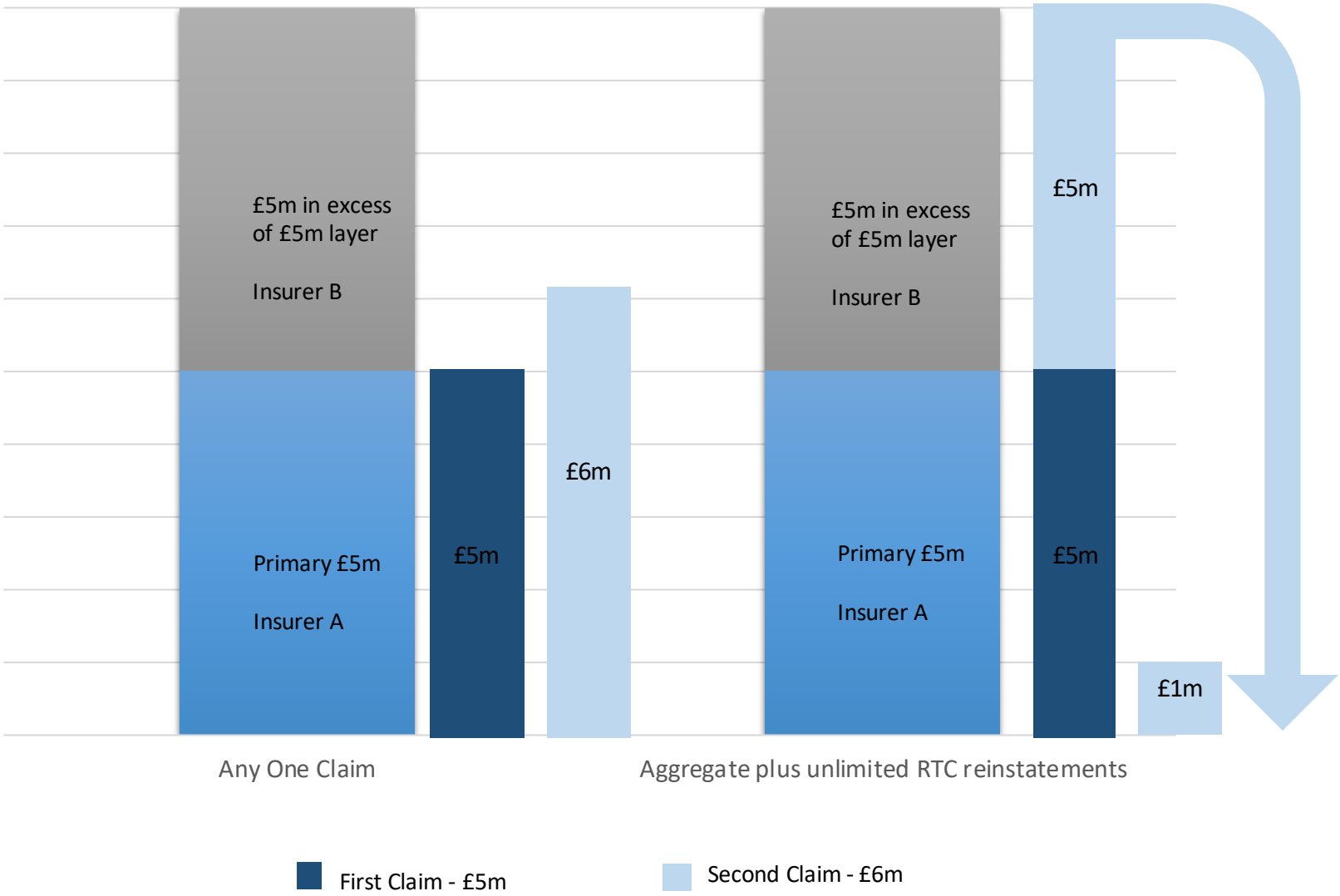
ii) Any one claim and in the aggregate

The limit of indemnity is to the maximum £x in any one policy year, no matter how many claims are made. This is the most common form of limit for contractors currently

iii) Any one claim and in the aggregate plus unlimited 'round the clock' reinstatements

As per (i) above, the limit of indemnity is still in the aggregate. However, the limit of indemnity reinstates for any 'new' claim meaning that the insured is able to evidence cover on an 'any one claim basis'. The benefit to insurers of this approach is that the primary insurer does not have potential liability for a number of small claims that don't exceed their own layer. The total sum of claims must exceed the full limit before the tower 'reinstates'

Any One Claim vs Aggregate RTC Reinstatements



What else have we seen?

- A global engineer experienced a premium increase from £70k to £1m for their £5m xs £5m layer alone at renewal in October 2018. They also only had £10m cover in place at renewal opposed to their £100m expiring limit (not a Lockton client!)
- We are seeing many contractors only being able to purchase their PII limit on an 'aggregate' basis as opposed to the prior 'any one claim' limit basis
- Insurers are increasingly ceasing to write PII at all including VIBE, Neon, Acappella (syndicates in run-off) in the last few months. This adds to the already extensive previous list
- Where primary layers are concerned, insurers are generally looking to reduce their capacity to a maximum of £2.5m; each renewal is taking significantly longer and will involve more insurers
- Whilst the 'cladding endorsement' is now market-standard, we have seen several insurers impose additional language and actively exclude <u>any</u> claim to do with the combustibility of cladding and impose a sub-limit for 'fire safety' claims
- We are witnessing the majority of contractors met with rating and self-insured excess increases at renewal

What else have we seen? COVID-19

- Insurers are increasingly asking questions around an Insured's BCP and how they are managing turnover during this time

- In addition to any BCP, we are also seeing the following questions be asked around contracts;
  - *Has the insured undertaken a full review of the current contracts for delays & fines? Has the Insured responsibility for these under contract?*
  - *Do all contracts include a Force Majeure provision?*
  - *Does the Insured limit their liability within their contracts?*

- Insurers are also likely to want to understand more about an Insured's supply chain – have any of your sub-contractors gone into liquidation?

What else have we seen? COVID-19

In addition to the questions outlined previously, we are seeing several insures impose exclusions as follows from renewal;

This Insurance does not cover any claim in any way caused by or resulting from:

a) Coronavirus disease (COVID-19);

b) Severe acute respiratory syndrome coronavirus 2 (SARS-CoV-2);

c) any mutation or variation of SARS-CoV-2;

d) any fear or threat of a), b) or c) above.

BUYERS BEWARE!

What can you do?

- Unfortunately, increasing premiums, excess and reducing limits are unavoidable. The hard market means that insurers hold all the cards. This is all about damage limitation;
- Get the renewal info in early (ideally 6 weeks before renewal)
- Meet with your insurer if you can. If they hold your other liability insurances, this can mean a more beneficial outcome
- How are you limiting liabilities in contract? Are you excluding any con. losses? What about financial caps?
- Does your supply chain all buy PII? To what limit?
- What risk management procedures does the firm operate?
- If you have had claims, why won't that scenario happen again? What steps have been taken?
- The soft market was a time for alternatives. The hard market is a time to build & utilise the relationship you have with your current insurer as that is always going to be the best option

Any questions?

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Registered in England & Wales at The St Botolph Building, 138 Houndsditch,
London EC3A 7AG. Company No. OC353198.

www.lockton.com