

Preparing for a Professional Liability Insurance Renewal

BY JOSEPH NAWA

When it comes to renewing professional liability insurance, contractors often feel like no time is the right time. With too much else in the pipeline—new proposals to submit, multi-million-dollar projects to finish and a multitude of other logistics to handle—most business owners just sign the paperwork and move on.

Unfortunately, this mistake has cost numerous contractors and architects millions of dollars in lawsuits—and even resulted in bankruptcy for others. Having the proper form of professional liability insurance in place when challenges arise can make all the difference between remaining solvent and facing financial ruin.

While it is rarely fun to evaluate the percentage of revenues needed to estimate the proportion of risk to liability, this annual process remains very important in not only guarding corporate assets and the balance sheet, but also protecting the company's credibility in a skeptical and unforgiving marketplace.

Today's professional liability sector remains soft by definition, but is beginning to harden. New carriers are continuing to enter the marketplace with more alternatives available than ever before. In addition, many buyers have access to new and enhanced coverages that previously were only open to a few firms.

Why Keep Professional Liability Insurance?

In the construction industry, professional liability insurance provides protection from third-party claims

alleging professional negligence as a result of acts, errors or omissions in rendering professional services. The rationale for its purchase is driven mostly by contractual requirements. Based on the size and complexity of the project, contractors and other design professionals often are required to purchase limits ranging from \$1 million to \$10 million.

Beyond contractual obligations, contractors enlist this type of coverage to protect themselves from claims related to subcontractor mismanagement; errors in construction means and methods; improper cost estimates; poor communication among contracting parties; non-timely project completion; and vicarious exposures resulting from at-risk delivery methods during the design-build and construction management processes.

Professional liability insurance also commonly is purchased for balance sheet protection, given that it is a low-frequency, high-severity line of insurance. While claims do sometimes surround negligence resulting in bodily injury or property damage, the purchase of such insurance is mainly driven by claims associated with the loss of economic damages. One of the most common claims involves contractor negligence resulting in project delays, such as the stalled opening of a sports arena and the resulting loss of potential revenues.

Costs to Expect From a Renewal

When pricing an account for professional liability insurance, underwriters are trained to concentrate on the

potential risk of exposures, historical data, claims statistics, and a central rating variable or exposure base determined by annual or projected revenues. With revenue fluctuations being common in the current state of the construction industry, revenue decreases often lead to a drop in premium. This usually results in a rate increase because the rate is typically inversely proportionate to revenue.

Keeping with that logic, if revenue were to increase, then the rate would decrease. (Note: It is usually an implied rate and not an actual rate, as nearly all policies are non-auditable.) This assumes there are no changes in the contractor's work, such as an increase in design-build revenue or new service ventures.

Beyond revenue swings, other factors need to be considered when analyzing the exposures of contractors and design professionals, including:

- material changes in services rendered;
- exposures associated with the projects normally performed by the contractor;
- professional liability exposures relative to the historical claims of similar service providers;
- propensity to report claims from a frequency and severity standpoint; and
- the history of claims reported in the past and during the previous policy term.

How to Keep Premiums Reasonable


Not much can be done to prevent claims from happening given the

litigious nature of the industry. Subsequently, carriers are more receptive to offering competitive terms and conditions to firms competing for lower-risk services and projects. However, numerous protocols and procedures can be instituted to mitigate the exposures of potentially higher risk firms. These include:

- employing a dedicated risk manager or outsourced risk management firm to assess insurance coverage needs and reduce the firm's overall risk;
- preparing an in-house quality control manual updated on an annual basis to keep up with the latest trends in managing and regulating best practices;

- developing procedures designed to prevent the counter-claims of negligence by past clients;
- including "limitation of liability" provisions in client contracts;
- using industry-standard contracts with detailed indemnity and scope of services provisions;
- having certified legal counsel perform detailed contract reviews;
- providing in-house continuing education programs for all professional staff; and
- having evidence of adequate levels of professional liability insurance for all subcontractors

that offer design and engineering services.

Budgeting to subsidize professional liability insurance can be burdensome for construction firms in the short term, especially if they have never reported a claim. That said, the revenues needed to protect against potential risks is minimal in relation to the financial pitfalls and ramifications that can plague companies in the long term. 

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