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PLI Market 2018: Insurers Maintain Growth, Profitability Against Headwind of Competition

Ames & Gough Architects & Engineers Professional Liability Insurance Market Survey

I. Introduction & Overview

Despite unrelenting competition, the majority of architects and engineers (A/E) professional liability insurers surveyed this year saw their premium volume grow in 2017. These positive results were largely due to a combination of new business and increasing exposures as their insureds grew their revenues, took on more risk and had expanded coverage needs.

For the most part, individual A/E firms continue to benefit from favorable insurance market conditions. Among most insurers surveyed, overall claims activity has been flat on a year-over-year basis, helping to sustain the coverage line's profitability. Along with the competitive market conditions, this helped keep a downward pressure on insurers' premium rates. Consequently, many A/E firms saw their overall premium rates level off or slightly decrease in 2017. As these trends continue into this year, A/E firms with favorable claims experience may likely see flat or only slightly rising premium rates in 2018.

Even under the stress of competitive market conditions, underwriters generally have continued to prudently evaluate exposures. Indeed, underwriting factors, such as project mix, services and loss experience, are carefully examined by insurers to determine premium rates. They are also monitoring emerging exposures, such as design-build project delivery, new construction materials or methods and judicial rulings, among other key issues for A/E firms.

The Ames & Gough *2018 Architects & Engineers Professional Liability Insurance Market Survey* reviews 2017 market results and what insurers anticipate this year in terms of rates, capacity and coverage trends. We offer insights to help design firms manage their overall professional liability risk, which remains one of their most significant insurance costs. Our eighth annual survey reports on responses from senior underwriting executives at 17 of the leading A/E professional liability insurance companies which represent a significant percentage of the overall marketplace. While some insurers offer excess professional liability, more than 80 percent of their premium is from primary placements.

Participants in the 2018 survey were: AIG (Lexington), Arch (PUA), Argo Pro, Aspen, AXIS, Beazley USA, Berkley Design Professional, Berkshire Hathaway, Chubb, CNA (Schinnerer), Everest, Great American, Liberty/Ironshore, Markel, Navigators, RLI, and Travelers. We are most thankful for their participation and are pleased to share the findings in this report.

Washington, D.C. (headquarters)
8300 Greensboro Drive
Suite 980
McLean, Virginia
22102-3616
Phone: (703) 827-2277
Fax: (703) 827-2279

Boston
859 Willard Street
Suite 320
Quincy, Massachusetts
02169-7469
Phone: (617) 328-6555
Fax: (617) 328-6888

New York
200 Willis Avenue
Mineola, NY 11501
Phone: (703) 827-2277
Fax: (703) 827-2279

Philadelphia
1781 Hunters Circle
West Chester, Pennsylvania
19380-6643
Phone: (610) 547-0663
Fax: (703) 827-2279

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II. Survey Findings

What Happened in 2017?

New business, heightened exposures sparked premium growth

The majority of insurers surveyed (76 percent) reported an increase in their professional liability insurance written premium in 2017. Premium volume remained flat for 18 percent, while one insurer reported a decline last year. The percentage of insurers experiencing premium growth in 2017 represents an increase from 63 percent reported for 2016.

For the fourth consecutive year, all insurers that had premium growth indicated their increase was partly due to new business. More than half (54 percent) of these insurers also indicated clients had larger exposures as measured by increased revenue, adverse loss exposure and/or project or service changes. Half indicated that renewing clients opted for program enhancements, such as higher limits or added coverages that contributed to premium growth. The one insurer whose premium volume declined reported the reason as a restructuring of its portfolio and greater selectivity of its clientele.

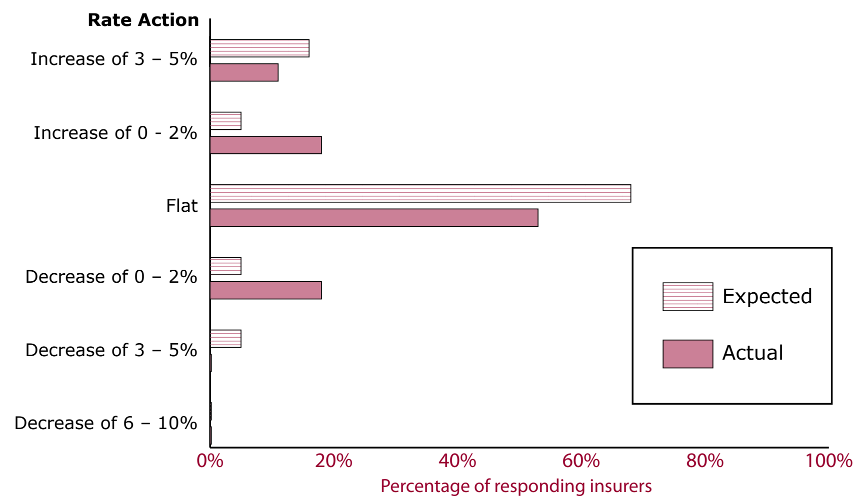
Rates flat for most insurers but show a slight upward tick. Professional liability insurance rates remained steady in 2017 for 53 percent of the insurers surveyed while 18 percent had a rate reduction. On the other hand, 29 percent experienced rate increases. By contrast, in 2016, 16 percent of insurers surveyed reported higher rates and 32 percent reported rates had decreased. This does suggest a trend, albeit relatively weak, toward rate increases.

The significant number of players in the A/E professional liability arena no doubt played a part in keeping premium rates stable as insurers endeavored to maintain existing business while at the same time win new clients. Stabilized claims experience, reported by 76 percent of the insurers surveyed and better claims experienced by 12 percent, enabled insurers to be more comfortable keeping rates steady.

The current state of the insurance marketplace can be examined by comparing insurers' expected 2017 rate actions (as reported in last year's survey) with actual results. As illustrated in the table below, insurers generally did not achieve the rate increases they expected in 2017.

Any rate increases insurers achieved in 2017 were moderate. Indeed, only three insurers surveyed this year saw an actual rate increase of 3 percent or more and two insurers reported an increase in 2017 of up to 2 percent. Worth noting is that no insurers in the 2018 survey attained overall increases above 5 percent, nor did any insurers surveyed last year expect to see such increases at the start of 2017.

INSURER PREMIUM RATE ADJUSTMENTS IN 2017
(Expected[1] versus Actual[2] for Insurers Raising Rates)



Notes: Expected rate action, based A&G's 2017 survey results (19 insurers).
Actual findings, based on A&G's 2018 survey results (17 insurers).

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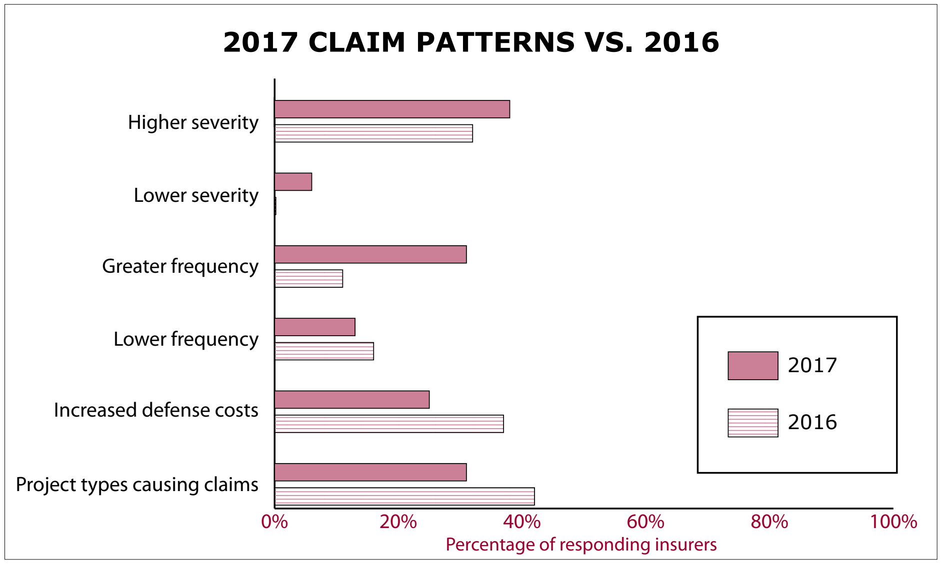
Claims experience steady: In 2017, 76 percent of the insurers surveyed reported no change in their overall claim activity compared to prior years; meanwhile, 12 percent saw their claims experience improve while the same percentage saw it worsen.

With respect to individual insurer claim patterns or trends, 38 percent of insurers noted an increase in claim severity, while 31 percent experienced an increase in claim frequency. An identical percentage reported certain types of projects causing more claims. At the same time, 25 percent pointed to increased defense costs as contributing to greater claim severity. On the flip side, 13 percent saw lower claim frequency and 6 percent, lower claim severity.



Notes: In both years, insurers provided multiple answers, so the responses sum to over 100%. 2017 results based on 17 insurers; 2016 results based on 19 insurers.

While the majority of insurers (59 percent) indicated that no specific geographic location experienced an increase in claim activity, 41 percent responded that they had increased claim activity in specific geographic regions. These responses were skewed with 29 percent citing increased claims in the Northeast and West Coast, and 14 percent reporting more claims in the Mid-Atlantic, Southeast and Southwest regions. None of the insurers surveyed experienced greater claim activity in the Central U.S. On the other hand, one insurer saw a decrease in their West Coast claim activity.

When asked to provide the amount of their largest single professional liability loss paid in 2017, insurers gave the following responses: The majority (59 percent) paid a claim of at least $1 million or higher, including two insurers that reported their largest claim paid was between $5 million and $9.9 million and two that paid a single claim between $10 million and $19 million.

Given this potential for larger claim payments, it is becoming more common for A/E firms to purchase higher limits. This trend is also being reinforced by rising defense costs and more widespread higher contractual requirements. Whereas in past years the requirements were for $2 million or $3 million limits, design firm clients are increasingly requiring limits of $5 million or $10 million.

As in last year's survey, three insurers in the 2018 survey indicated they paid a cyber-related claim under their professional liability insurance policy. Given the reports of increasingly sophisticated cyber-crimes affecting businesses in all industries and the public sector, this continues to be an area that requires constant monitoring by A/E firms. Additionally, more insurers are facing greater cyber liability exposures from endorsements for this coverage added to their professional liability policies.

A&G Insight: While many insurers are expanding coverage for cyber-related claims under their design firm professional liability policies, the coverage provided tends to be somewhat restricted with some coverage for third-party claims and only limited coverage for first party losses. Often, there is an additional requirement that the cyber claim must arise from the provision of professional services. This has caused more and more firms to opt for stand-alone policies, which provide an expanded breadth of coverage and typically can be purchased at reasonable premiums. In addition, securing a separate policy can help preserve the limits under a design firm's professional liability insurance policy.

Planned 2018 PLI Rate Actions Appear to Aim for Stability

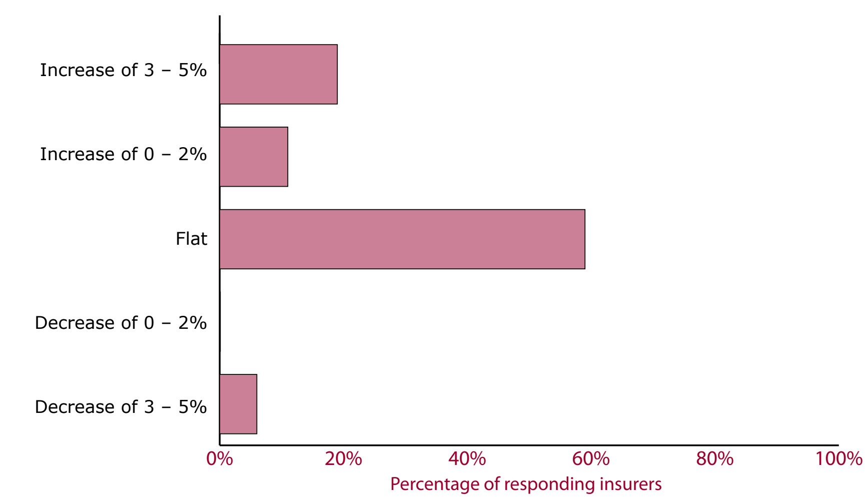
Most insurers still seek flat rates as some plan modest hikes

The unyielding competition in the marketplace is continuing to affect insurer plans with regard to their rates. The majority of insurers surveyed (59 percent) reported their plan for 2018 is to maintain current professional liability insurance rates. Meanwhile, 6 percent plan a modest rate decrease.

That stated, this year, 30 percent plan a modest rate increase of up to 5 percent; these insurers are basing their decisions on continued rate inadequacy, as well as historic claim experience and an increase in claim severity.

For those seeking rate increases in 2018, 67 percent will focus the hikes on high-risk projects, such as residential and schools. Half plan increases targeting those in high-risk disciplines, such as structural and/or geotechnical engineering, and the same percentage are planning increases across their entire book of A/E business. Meanwhile, 33 percent are targeting a specific geographic region for rate increases.

INSURERS' PLANNED RATE ACTIONS FOR 2018



Note: One respondent did not specify the amount of the insurer's planned increase.

Even with the modest uptick in rates anticipated from some insurers, a positive note for design firms is that the A/E professional liability insurance marketplace continues to have a wide selection of insurance companies offering this coverage. For 2018, this will again enable firms with favorable loss experience and less risky disciplines to renew coverage with flat or only modest increased premium rates. In some cases, firms with increased revenues may be able to obtain some rate reduction to partially offset premium increases associated with growth.

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Value Added Coverage Extensions

As insurers look to differentiate themselves from the competition, some have added or are now exploring new endorsements for a variety of emerging risks. Among those surveyed, 76 percent are exploring new or expanded coverage for cyber-liability; 53 percent, for drone usage; 24 percent, for the duty to defend third parties where the insured agrees to do so by contract; 18 percent for public-private partnership exposures, and 12 percent, for design-build risks.

Some current examples of specific policy enhancements include:

- **Cyber risks**. Some A/E professional liability insurers provide a variety of cyber security coverages under their forms or endorsements, such as third-party coverage in the event of a cyber breach resulting in a network security offense or theft of confidential information of others, or limited first-party coverage for privacy breach response services. As noted, while cyber coverage under a professional liability policy is not designed to provide the depth or scope of protection available under a stand-alone cyber policy, having some limited coverage can be beneficial.

- **Supplementary payments**. Varying types and amounts of supplementary payments coverages are available under many A/E professional liability insurance policies. These may include coverage for crisis event expenses, loss of earnings reimbursement for attendance at a trial, deposition, mediation or arbitration, disciplinary or regulatory action expenses or pre-claim assistance.

- **Drone usage**. The majority of insurers surveyed reported their professional liability insurance policy has no exclusionary language for drones, while others reported coverage can be added by endorsement at no additional premium. Some indicated their policy covers professional services related to data collected from drones, but excludes bodily injury, property damage and invasion of privacy.

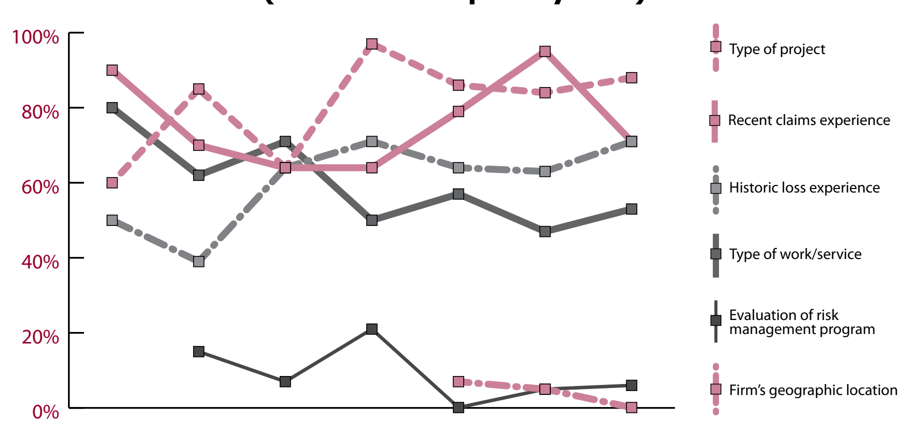
Underwriting Factors May Trigger Increased Rates for Individual Risks

Greater focus on higher risk project mix

Several factors come into play in underwriting a particular risk, although underwriters are now placing greater emphasis on an A/E firm's project mix. This year, 88 percent of those surveyed identified type of project (e.g., condominiums, schools, transit, tunnel, water/wastewater) as one of the top factors for raising a specific firm's PLI premium rates.

That's fairly consistent with last year's finding where 84 percent ranked projects among the top risks. Meanwhile, other top factors include: recent claims experience (past two years), cited by 71 percent of the insurers surveyed, down from 95 percent in 2017; 71 percent cite historic claims experience, up from 63 percent in 2017, and 53 percent, type of work/service, up from 47 percent in 2017.

TOP FIVE UNDERWRITING CONSIDERATIONS (2018 vs. six prior years)



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

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A&G Insight: In addition to the important underwriting considerations outlined above and, of course, a firm's revenue base, other factors come into play as underwriters evaluate a firm's overall risk profile. Factors that can help reduce premiums include: lower risk services, such as feasibility studies and agency construction management; international projects; or abandoned projects. In addition, highlighting fees paid to subconsultants can reduce premiums, as can confirming the use of contractual limitation of liability provisions.

Other Key Findings:

Underwriters tracking emerging issues: Those surveyed were asked to identify emerging risk trends they are monitoring from an underwriting perspective. The most prominent issues were: evolving project delivery methods (e.g., design-build and public-private partnerships), cited by 82 percent; judicial rulings that are eroding protections for design firms under state statutes, such as economic loss doctrine (76 percent); innovation, such as new construction materials/methods (47 percent), the use of BIM and technology (18 percent), the use of drones (6 percent) and international exposures (6 percent).

Capacity remains strong: For 2018, the availability of adequate capacity for A/E professional liability insurance coverage remains stable. Firms that want (or are contractually required) to obtain higher insurance limits may be able to obtain such limits from their current insurer or with the participation of two or more insurers. Those insurers surveyed have the capacity to provide the following limits: five will provide policy limits of up to $5 million; six can offer up to $10 million in limits; three, up to $15 million; and three, up to $25 million in limits for qualified firms. In any event, there is a robust insurance market for stand-alone excess professional liability policies to sit above the primary A/E PLI policy.

Insurer claims service, a key differentiator: Insurers are well aware of the continued need to emphasize their capabilities and offerings that will resonate with design firms. Quality claims service continues to be the most prevalent, cited by 71 percent of the insurers; next were longevity/stability and risk management support, each cited by 59 percent. Breadth of coverage was cited by 47 percent and competitive premiums, by 35 percent.

III. Closing Commentary

In general, the news is good for A/E firms that are reaping the benefits of continued soft market conditions. Even with a few insurers exiting the A/E professional liability market in 2017, others have come into the mix, ultimately placing continued pressure on the marketplace to hold the line on rates as well as to find innovative ways to stand above the crowd.

Such favorable market conditions will only continue as long as overall claim activity remains stable. Nonetheless, A/E firms are advised to remain vigilant in their risk control efforts to mitigate claim activity. Taking the steps to negotiate contracts that fairly allocate risk and limit uninsured exposures, and engaging staff to participate in risk management training through webinars or seminars are valuable tools to keep firms out of claims or, at the very least, mitigate the risk.