How to control professional liability insurance costs

Fill accurate applications, manage and monitor outstanding claims, invest in risk management, and utilize a specialty broker.

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GUEST SPEAKER

One of the largest expenses architects, engineers, and construction professionals bear is the cost of their professional liability insurance. After compensation, benefits and rent, PLI premiums are often the next most significant expenditure.

So, what drives the cost of design firm professional liability insurance? Generally, insurers use a design firm's billings or revenues as a basis for calculating premium levels. In effect, the multiplier for A/E PLI is billings (often per $100 of billings) multiplied by the premium rate.

Beyond that basic formula, however, several factors affect overall liability insurance premium rates, including:

- The state of the economy (a weak economy means companies have lower revenues and/or less payroll – both of which are key drivers in calculating premiums)
- The interest rate/investment environment (low interest rates mean insurers earn less on the premium monies they hold to pay claims)
- The environment for judicial action/tort reform

In particular, of late, the investment/interest rate environment is so weak that insurers seeking a reasonable rate of return on their invested capital must redouble their efforts to achieve an underwriting profit (defined as premiums collected less claims and claims expenses paid). This is driving overall liability premium rates higher as insurance company executives can no longer expect anything beyond limited investment returns.

Turning to professional liability insurance, and design firm professional liability, in particular, in addition to these "macro" factors, there are industry/risk specific factors affecting insurers' perception of premium rate adequacy. This includes the inflation in defense costs brought about by increased claim complexity and e-discovery. Simply, the cost to investigate and defend professional liability claims is up dramatically over the last five years or so. Secondly, the economic downturn and increased focus on public entity (e.g., school boards, turnpike authorities, etc.) transparency and budget management have brought more claims as project owners seek to recover losses from failed projects or cost overruns.

Again, these factors are pushing rates higher. Ames & Gough's 2013 survey of 13 leading PLI insurers (representing more than 70 percent of the market) quantified this trend – rates are moving higher for the second straight year with seven out of 10 insurers planning further rate increases averaging as much as 10 percent over expiring.

Firm-specific factors also affect premium. In addition to the more general factors driving PLI premium rates higher, there are several firm-specific criteria that affect premiums. According to the Ames & Gough market survey, these include: type of projects (cited by 87 percent of insurers surveyed as the biggest driver of rate changes); loss experience within the past two years (mentioned by 70 percent of insurers); and type of work or service (62 percent of insurers).

With regard to types of projects, tunnels, condominiums, and schools rank among the most risky in terms of claims experience. As to type of work, structural engineering, geotech, and cutting-edge architecture often are viewed by insurers as creating more claims, while civil engineering and construction inspection are considered less risky.

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Loss or claims experience definitely makes a difference. The typical measure is the so-called loss ratio, which is the result of the paid and incurred (meaning claims reserves) losses divided by premiums collected. Typically, insurers look at a five- or 10-year loss ratio (losses include monies expended to defend claims). A loss ratio below 30 percent is considered very good, with loss ratios of 30 to 60 percent typically considered acceptable and any loss ratio above 65 percent resulting in a debit (or premium rate increase).

Finally, growth or shrinkage and geographic locale also make a difference. A growing firm will often receive a credit on their premium (which may take the form of a lower premium rate increase rather than an actual reduction in premium) if their revenues are moving upward. Meantime, a firm with shrinking revenues may see a premium rate increase due to so-called "diseconomies of scale."

Conclusion. So how does an architect or engineer control costs? A few important steps are:

- Ensure a comprehensive, accurate application, including thoughtful allocation of billings among the various categories.
- Actively monitor and manage outstanding claims to assist your insurer in either defending the claim effectively or settling the claim, if appropriate.
- Invest in risk management, whether risk management training for project managers and other key leaders or contract review to avoid accepting risks that can increase claims and insurance costs.
- Utilize a specialty broker that is knowledgeable regarding the PLI underwriting process, has strong relationships with key insurers, and can assist with risk management training, contract review and claims management/advocacy.

Often, the only way to get a premium reduction today is to change insurers. However, design firm leaders need to be careful before making the leap to a new insurer. Insurance is still a relationship business and longevity with an insurer and the relationships built with underwriters and claims professionals alike can pay real dividends that are often hard to quantify at renewal time. In any event, it rarely makes sense to move to a new insurer unless the savings are at least 10 to 15 percent or more.

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and, finally, our CEO as we grew from a handful of people in a single office to 2,400 people in 25 offices around the world) those nightmares about being out of your depth can continue to haunt you.

A final observation: People who work "with," not "for" their organization are not bashful about noting what's working and what's not. They do, however, learn to walk that fine line between complaining to their pals (or even their superiors) about what's wrong and being able to engage in a meaningful conversation about what to do about it. Their point of view is consistently presented as, "These are some things we can be doing to make our enterprise better – for our clients, for the many people we rely on to accomplish what we do for our clients, and for the people in our organization."

Conversations that take this point-of-view are to be encouraged (and should be cherished) by leaders of any enterprise. Don't we all want to be part of an organization that we're proud of, that we thrilled to be a part of, that contractors, building officials, lenders and everyone else involved want to work with (and recommend to others), and a firm that clients seek out and tell their friends about? That's the performance difference between a command-an-control ("you work for me") attitude and a "we're in this together" partner relationship between people at all levels of the organization.

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When dealing with personality conflict on projects, Phillips seeks the advice of a psychologist.

"I have frequently asked Dr. David Hescheles for the right path to take with a stakeholder who is particularly difficult to deal with," he says. "After describing the dynamics of the group in question I am amazed by how accurate his predictions have been."

Pay it forward. Jeremy Wright, a business management consultant, notes that organizational leaders have a responsibility to give and seek advice within the industry.

"Part of receiving is the responsibility to give," he says. "Because others have extended their helping hand to you, you have a responsibility to make yourself available to others."

Mirroring this thought, Butler says, "One of the things that we do here at Butler, Rosenbury & Partners and have always done is to be open and generous with counsel when other architects (even our friendly competitors) call with a problem."

Acknowledging that this practice does not include much benefit for the company, Butler says that when these instances arise, as a firm, "You like to think that you should treat others like you would like to be treated."

Moving forward. Fostering an environment where individuals feel comfortable asking for advice in times of need creates a positive environment for personal and professional growth within the industry. Relying on colleagues to provide advice and resource sharing in times of need creates positive motivation for the creation of high performing workplaces.

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