

# Economics

## Keep a Watchful Eye on Liability Insurance Rates

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Rates for professional liability insurance offered to U.S. architecture firms are at their lowest levels in a generation. Stable claims levels coupled with a very strong performance of their investment portfolio have allowed carriers to continue to offer increasingly lower rates in recent years, while also attracting new competitors into the liability insurance market.

Nonetheless, the landscape in this industry is undergoing unmistakable changes. Key elements of the business climate for carriers have reversed themselves in recent months, which in turn have put pressure on them to raise rates. With the competitive market of recent years, architecture firms have become accustomed to a strong negotiating position. In addition, the favorable rates have helped offset what otherwise would have shown up as rapidly rising premiums given the strong growth in billings for design services at most firms.

Following is a summary of research conducted in January on the changing insurance market.

### A 15-year decline in rates

After a sharp upturn during the mid-1980s, rates for professional liability insurance have been steadily declining since 1987 for major carriers such as CNA/Schinnerer. In 2000, estimated rates were just 40% of their 1987 high and less than two-thirds of their 20-year average.

There are several reasons why rates have been favorable for such an extended period of time:

- Stabilization of professional liability claims filed against architecture firms
- In spite of larger and more complicated construction projects in recent years, the cost of an average claim when adjusted for inflation has hardly risen at all
- The boom in nonresidential construction activity during the 1990s
- Growth has encouraged more carriers to enter the marketplace
- The unprecedented increase in stock prices over this period.

The environment that has encouraged steadily lower rates is rapidly changing. The economy has shown unmistakable signs

of slowing in recent months, and even the aggressive reduction in interest rates by the Federal Reserve in recent weeks is probably not enough to completely reverse the slowdown in the short run. The sustained increase in nonresidential construction activity also has reversed itself recently. All members of the AIA Consensus Construction Forecast Panel are projecting slower growth, if not outright declines, in nonresidential construction activity in 2001.

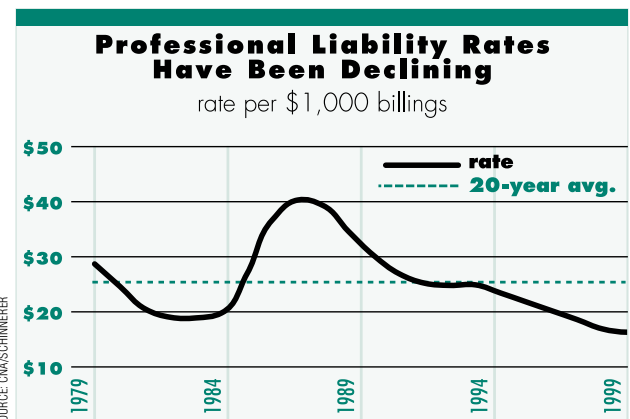
### Carriers look for increases and tighter underwriting

The result of the slowing construction sector and reversal of strong growth in stock market investments is the erosion of profits for professional liability insurance carriers. This situation is putting pressure on carriers to raise rates to improve their financial performance. Reports indicate that loss ratios for carriers—claims payments compared to total premiums—are at levels that make it difficult for them to achieve profitability, particularly now that they cannot supplement their revenue with investment returns to the degree that they have in recent years. Also, reinsurance rates have begun to rise because carriers that purchase insurance for the larger policies they cover also are having to pay higher rates. Most carriers state that they hope to raise rates 5–10% this year and reevaluate the situation toward the end of the year to see if further increases are needed next year.

### Firms review options

Architecture firms clearly have benefited from lower professional liability insurance rates, and many indicate they are not likely to be receptive to rate increases. Lower rates have

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encouraged many firms to purchase coverage. In 1988, an AIA survey of member-owned firms determined that over half did not purchase professional liability insurance. This figure slowly declined during the early 1990s and then fell even faster during the latter part of the decade when liability rates declined more rapidly. By 1999, just 27% of AIA member-owned firms were not purchasing professional liability insurance coverage.

Many firms are just beginning to feel the effects of a softer construction market and may need to implement cost-reduction strategies themselves. If the professional liability insurance market remains as competitive as it has been in recent years, carriers that attempt to raise rates may find themselves losing business as firms move to lower-cost carriers or reduce limits.

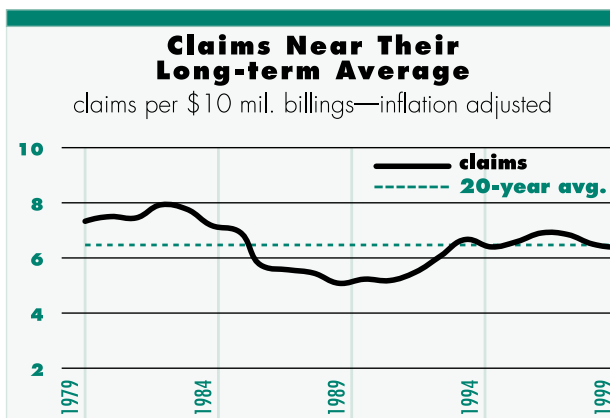
Still, it is evident that the professional liability insurance market will undergo substantial changes over the next several

years. Coverages, rates, underwriting standards, and carriers serving this market all may undergo significant modifications as the market sorts itself out and firms choose their best options for purchasing insurance.

### How this study was conducted

The Economics and Market Research department of the AIA Knowledge Center, with the cooperation of the AIA Risk Management Committee, prepared this report. It was conducted through the support of the AIA Trust. During January 2001, Monalco Inc., a private research firm, conducted the following in-depth telephone interviews with three key constituencies of the professional liability insurance market:

- Seven major insurance carriers offering professional liability products to architecture and engineering firms—CNA/Schinnerer, DPIC, Lexington (AIG), Kemper Professional, Zurich-American, Euclid (Professional) Managers, and SAFECO/Insight
- Four brokers representing the major carriers
- Twenty-one AIA member-owned architecture or architecture/engineering firms. Firms were selected based on their knowledge of the liability insurance process, as well as to ensure representation in all size categories and in each of the major regions of the country.



Among carriers, the primary AIA contact was interviewed. The brokers included two Schinnerer and two DPIC brokers. Among firms, the person interviewed was that identified by the firm as most knowledgeable about its professional liability insurance coverage.

To order the full report (one per member), call 800-365-ARCH; fax 800-246-5030; or email [aia@balmar.com](mailto:aia@balmar.com), and ask for #W908. 