

Risk Management

Why Are Our Professional Liability Insurance Premiums Going Up?

by Jim Harris, AIA

AIA Risk Management Committee

My understandings and observations of these issues are from a practicing architect's point of view. Therefore, my first piece of advice to you is to discuss the reasons for and the effects of any potential increases in your insurance premiums with your professional insurance broker.

With that being said, we are anticipating a groundswell of AIA members asking:

- "Why are our professional liability insurance premiums going up?"
- "What did we do wrong?"
- "Is it just our firm?"

Naturally, most of us try our best to practice "safe architecture," which may include:

- Checking a potential client's credit rating
- Avoiding clients who have a history of suing their architects
- Using AIA standard forms whenever possible and involving our attorney in the review of any nonstandard documents
- Hiring the best available professional staff to serve our clients
- Training and providing continuing education for our staff on all aspects of the projects and profession
- Implementing a quality-assurance program to increase our ability to provide complete and well-coordinated contract documents
- Building a strong relationship with our professional liability broker and considering him or her as one of our strategic business partners.

Following these practices should have a positive effect toward minimizing your claims history. However, your firm may still face an increase in its insurance premiums due at least in part to factors that are outside of your control, including:

- Natural and man-made disasters that have occurred throughout the world
- The decline in the stock market
- The repositioning of the insurance companies and their "reinsurers."

One of the primary reasons for the need to increase premiums is the excessive amount of losses that the insurance industry has experienced during the last few years. Catastrophic losses from natural occurrences such as earthquakes, floods, hurricanes, as well as manmade events such as fires, explosions, and building collapses (most poignantly, of course, the World Trade Center) have driven insurance companies' combined-loss ratios to unacceptable heights.

The combined loss ratio is the percentage that results when

the amount of the premiums taken in is divided into the total amount of claims and expenses an insurance company pays out. Theoretically, an insurance company breaks even when the ratio hits 100, and it makes money when the ratio falls below 100. In practice, insurance companies can be profitable at ratios slightly above 100 due to the interest and dividend income that they receive by investing the premium money. The insurance companies invest the premiums they receive in stocks and other securities between the times they receive the premiums and the time they need to pay the claims. We all know that our individual stock and bond investments have performed poorly over the last couple of years. The insurance company's investments have also suffered. Their investment income cannot offset the excessively high combined loss ratios, which may be running 115 percent or higher.

You may ask, "What does my professional liability insurance carrier have to do with losses incurred during natural disasters?" This brings us to the relationship between professional liability insurance companies and reinsurers.

Although the insurance companies that specialize in professional liability insurance for architects may not have a large exposure from natural disasters, the reinsurers do. A reinsurer is a company that agrees to accept a portion of the risk for a fee. Professional liability insurance companies may decide to keep only the first million dollars of risk on a multimillion-dollar policy. They transfer the remaining exposure to reinsurers who underwrite the risk should the insured's claim exceed a million dollars.

The reinsurers are involved with many types of insurance risk other than professional liability insurance, including life insurance policies and property insurance. It's the reinsurers who have been hit hard from recent worldwide catastrophic events. While insurance industry experts report that the reinsurers still have adequate capacity, the reinsurers are becoming more selective as to which lines of coverage they want to accept. At the same time, they are demanding higher fees to accept part of that risk. A portion of those increases must be passed along to the insureds—us.

So don't take it personally! We may all be asked to pay a higher premium for our professional liability coverage due to reasons outside our control. We do, however, have control over several processes and factors that can affect the amount of those increases, including selection of a professional liability broker, knowing how to complete the application process properly, and informed selection of coverage options. ■