Introduction & Agenda

- The Marsh London Professional Indemnity Team
- **Background to current market conditions**
- Restrictions in available insurer options and reduction in capacity
- Coverage restrictions & exclusions - cladding & fire safety, other exclusions & examples of language
- Changes in policy limit basis
- **2021 market overview**
- Capacity and appetite
- Continuing challenges
- What is Marsh doing to be more creative in the PI space?
- What can companies do?
- Questions

Construction Professional Indemnity Team

James Bainbridge
Senior Vice President and Head of Professional Indemnity for Marsh Construction in London

Dedicated team of 11 based in London and Norwich specialising in PII for contractors.

The team are:

- Martin Stubbs
- Stephanie Ormiston
- Jemima Bexley
- Ben Jackson
- Stuart Cullum
- Sophie Black
- Natasha Lochhead
- Oliver Swann
- Aaron Phillips
- Adam Elliott

Background to current market conditions

Construction industry losses

Issues specific to the construction industry itself have greatly impacted the specialist D&C PI market. In recent years the following issues have had a negative effect on the sector and its ability to insure construction risks:

- **Unproven technology**. The underperformance of waste to energy plants has resulted in massive P claims as owners seek redress. Whilst there are fewer new projects planned in this sector, underwriters reserves have taken a huge hit during the past five years
- **Building cladding**. The Grenfell disaster in June 2017 has highlighted the issue of defective cladding and other deleterious materials. Investigations are still continuing in 2020 as more and more issues in this space come to light.
- **Unreasonable contract terms**. As a result of the economic cycle contractors have been forced to accept and bid for projects with onerous conditions. Such as fixed price contracts, fitness for purpose obligations and high levels of liquidated damages.
- **Tight margins**, driving contractors to cut supply chain costs. Supply chain management has been impacted and uneven liability caps throughout the chain have resulted in unbalanced risk.

Background to current market conditions (continued)

- **Insolvency**. Insolvency of the company (or companies) to which the main contractor has transferred risk. Leaving the contractor with no rights or remedies when facing a claim from an owner.

Insurance market consolidation

There has been a trend toward consolidation in recent years, some of which has had a direct impact on the London insurance markets: Ace and Chubb, XL and Catlin and others.

Furthermore a raft of carriers have either withdrawn from writing D&C PI or withdrawn from PI entirely, including Brit, Aspen, Markel, Novae, Pioneer, Hamilton, Vibe, Chaucer and AXA XL.

Regulatory action

The effect of these issues being that construction PI has been underperforming for many years. This has drawn the attention of the Lloyds Performance Management Division (LMPD). The LMPD is seeking to address unprofitable underwriting in Lloyds and the message is clear that unprofitable areas must demonstrate a realistic route to profitability or portfolios must close.

Non US PI is one of the eight worst performing lines of business and therefore in the spotlight commercially and from a regulatory perspective.

Restrictions in capacity

As highlighted in the previous slide, a significant number of carriers withdrew from the market. Those still writing D&C PI have drastically reduced appetites:

- Minimum premium requirements for capacity. In some cases as much as £250,000 in premium for a £2.5m line (QBE);
- Majority of carriers have cut their maximum capacity back to a maximum of £2.5m (or even less). This means the number of insurers required to complete a co-insurance tower has increased dramatically. Those new carriers to a risk are then pushing premiums and coverage restrictions further;
- The emotive approach to underwriting has lead to incredibly selective underwriting:

a) Lack of willingness to compete against peers;

b) Greater willingness to walk away from business as no longer writing for premium income;

c) Underwriters are taking a more global view to create consistency in pricing with their international offices;

d) Ventilation – in prior years insurers would be happy to deploy capacity on consecutive layers. Ventilation dictates there should be no participation on adjacent layers. This complication makes programmes even more a challenge compounded by reduced capacity

Aggregate cover vs Any one claim

True “any one claim (AOC)” cover for many contractors has largely been unavailable for years with the majority of contractor PI programmes being placed on an aggregate limit of indemnity. In order for contractors to meet contractual requirements for AOC limits of indemnity they will have provisions in their policies for unlimited “round the clock” reinstatements, either across the board or where required by contract.

Whereas AOC cover can result in the primary layer of cover suffering repeated losses before any excess layers are engaged, aggregation spreads those losses through the tower of the programme meaning the primary is no longer exposed once it has been fully eroded.

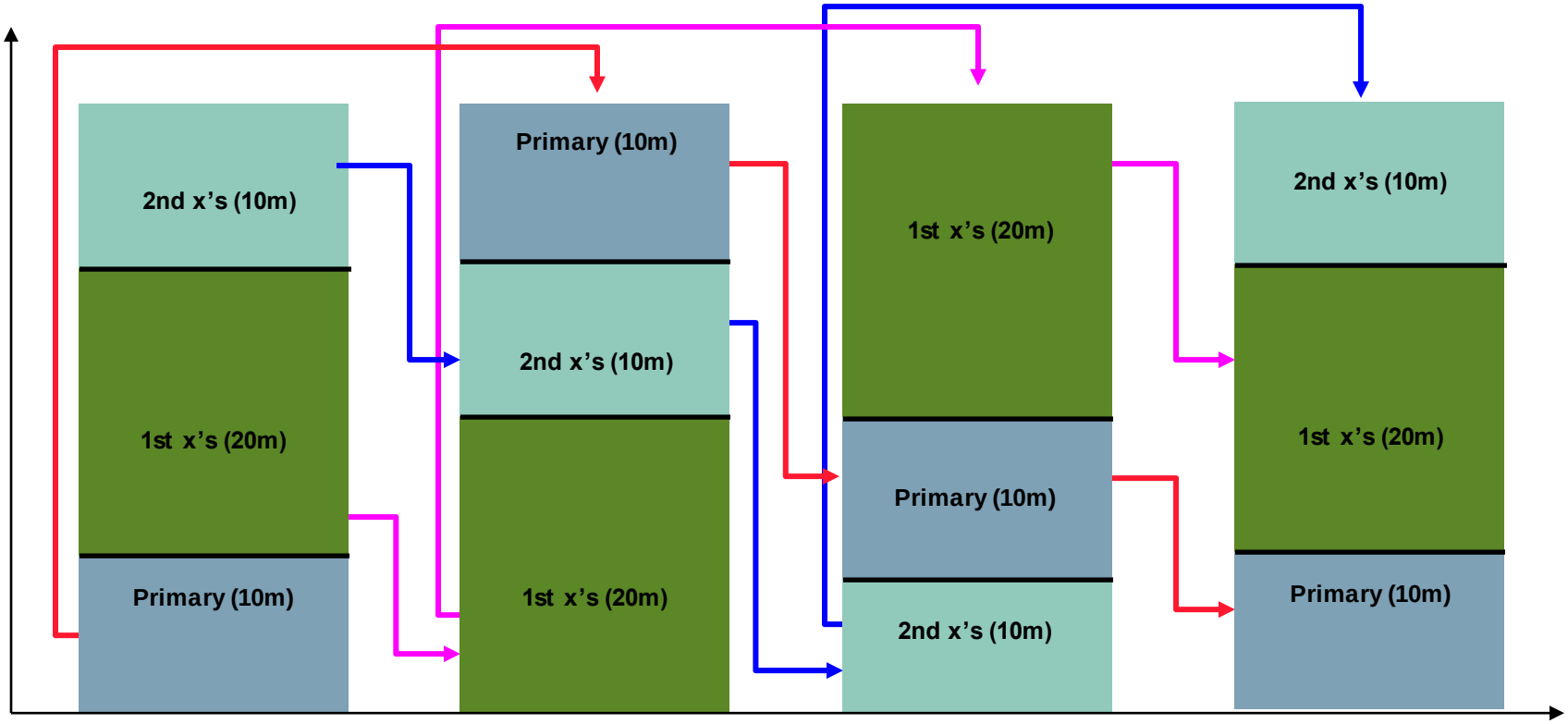
Whilst London insurers have, in most cases, only provided aggregate limits of indemnity to contractors PI, that has not been in the case in the regions. A number of insurers in the UK regions had been continuing to quote AOC cover for SME risks at hugely unsustainable premiums. This has resulted in huge losses in the UK insurance market and a major clamp down on AOC cover being offered across the board (including internationally).

Those contractors lucky enough to have had their limits placed AOC will now have had that cover adjusted to aggregate. Not all will have unlimited reinstatement provisions included in their wordings either because insurers will not offer it to them, or they cannot afford the premiums quoted for the increased limits of indemnity needed to give insurers comfort to agree reinstatements. This is not market standard cover.

The next slide has a demonstration of reinstatements in practice.

How do Reinstatements work?

'Round the Clock' Reinstatement Based on $40m limit (Primary $10m, 1st Excess $20m xs $10m and 2nd Excess $10m xs $30m)



After $10m loss exhausts the primary limit, the excess layers "drop down" and the primary $10m reinstates in excess of the "dropped down" excess layers, effectively reinstating the limit back to $40m. The first excess layer now becomes a primary $20m limit

After a second $20m loss exhausts the "primary" limit, the "excess" layers "drop down" and the "primary" $20m reinstates in excess of the "dropped down" excess layers, effectively reinstating the limit back to $40m

After a third $10m loss exhausts the "primary" limit, the "excess" layers "drop down" and the "primary" $10m reinstates in excess of the "dropped down" excess layers, effectively reinstating the limit back to $40m. At this stage there has been one full "round the clock" reinstatement of limit

Cladding and Fire Safety

- **How has cover been restricted for cladding and fire safety?**

For those contractors who still have an element of cover under their policy, cover will have been restricted to:

- Rectification costs only;
- Single aggregate limit (no reinstatements);
- Excluding all consequential losses;
- Punitive excess for each and every building and each and every site;

Please see following slide for a coverage example;

Given the sheer volume of claims and circumstances notified post-Grenfell, in many cases total exclusions have been applied by insurers as they are no longer accepting further exposures of this kind

Coverage Example for Cladding & Fire Safety

Fire Safety Claims and Cladding Claims – Specific terms and conditions

Notwithstanding anything contained to the contrary the following specific terms will apply to Fire Safety Claims and Cladding Claims:

1. Insuring Clause

The indemnity provided by Insurers under the Insuring Clause (a) and (b) will be limited to actual direct losses, costs and expenses incurred in respect of rectifying any part of the works where such losses, costs and expenses are incurred as a direct result of any negligent act, negligent error, or negligent omission in the conduct by or on behalf of the Insured of the Professional Activities and Duties as herein defined.

2. Aggregate Limit

Notwithstanding the provisions of this policy, the total liability of Insurers (including Defence Costs and Claimant's Costs) for all Fire Safety Claims and Cladding Claims will not exceed in the aggregate the sum(s) insured expressed in the Schedule which will not be reinstated.

3. Excess

The Excess in respect of Fire Safety Claims and Cladding Claims will be £XXX and will be applied to each and every claim for each and every building on each and every site.

Definition

For the purposes of this endorsement it is agreed that the following definitions will apply:

Cladding Claims will mean any claim directly or indirectly arising from or in any way connected to the combustibility of any composite panels and/or external wall systems and any associated core/filler insulation material and/or any ancillary fixing systems.

Fire Safety Claims will mean any claim in any way related to the fire safety of a building.

Exclusion

For the avoidance of doubt the Insurer shall not be liable to indemnify the Insured for any liability, loss or damage resulting directly or indirectly or as a consequence of negligent advice, design or specification, including but not limited to waking or walking watch costs, loss of profits, loss of use, loss of rent, loss of production, loss of contracts, liquidated damages or for any cost of decamping or rehousing or bodily injury.

Cladding & Fire Safety (continued)

The reality for many contractors, particularly in the SME and mid-market space, is that the example of cover in the previous slide is no longer available. Total exclusions for cladding (combustible or otherwise) and fire safety are now far more prevalent in the market.

Those clients who still have an element of cover do so because of long-standing relationship with their insurers and relatively healthy claims records in that regard.

Any insured considering moving insurers in the current climate runs the risk or losing any cover at all with total exclusions now being applied by many insurers on new business enquiries.

Differing factors such as size, specialism and claims history play some part, but the reality is insurers are blanketing this approach across their portfolios.

Capacity and appetite

Market Capacity

- Withdrawals - numerous markets exiting construction space in 2018, but much more stability since with only AXA XL withdrawing in August 2020.

Market Appetite

- Number of new markets have opened construction PI portfolios since 2020, including Convex and HDI Global, with further carriers due to join this year.
- Number of legacy insurers have begun to actively grow and pursue new business given the amendments imposed by the markets.

Effect on Rates and Premiums

As a result of the improving appetite of insurers there has been noticeable improvement on rate and premium increases since the turn of the year:

- 2019 average rate increase 40%
- 2020 average rate increase 20%
- 2021 year to date average rate increase 10%

Continuing challenges

- However, there are some continuing challenges for which selective underwriting is apparent:
- Companies with on-going claims concerns.
- Companies operating in sectors which are of specific concern for insurers.
- **Cladding & Fire Safety**
- Cladding and fire safety circumstances and claims continue to be notified in 2021.
- Due to the volume of notifications made post-Grenfell many insurers will now insist on imposing exclusions in respect of these works, particularly on new business enquiries.
- This concern continues and at the time of writing there is no suggestion that insurers' attitudes toward this sector will relax.

What is Marsh doing to be more creative in the PI space?

- **Maintained and grown the markets available under our D&C PI facility** – maintained broad cover during this challenging period. Successfully renewed all placements on time.
- **Established a global PI committee** – truly joined-up global team approach for clients to explore all markets, all options, leverage across our portfolios and share innovative ideas. To help create and access more capacity for clients.
- **European PI team** – building upon our global PI committee, we have also established a European PI placement team, to best access key markets within Europe and coordinate our activities for clients across multiple territories.
- **Embed ourselves in our clients business and their claims** – to fully understand them and articulate their risk in the very best light to differentiate them to PI markets.
- **Benchmarking limits / deductibles / covers across various regions** – taking a global approach to data and benchmarking, to stress test our placements and benchmark our clients against markets and industry peers.

What can companies do?

- Continue to engage with your broker early in the renewal process to mitigate any challenges.
- Insurer meetings remain vital for enhancing both old and new relationships and for insurers to see beyond the underwriting submission.
- Virtual meetings in the current climate are just as necessary as face-to-face.
- Companies must take every opportunity to demonstrate:
  - Their understanding of current market developments and concerns.
  - Robust risk management practices in place to mitigate and manage these issues.

QUESTIONS?