

PI INSURANCE FOR CONSTRUCTION

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INTRODUCTION

With Design and Build becoming the most common contractual arrangement for UK construction, an increasing number of design elements are performed by Specialist Contractors and integrated into the overall design produced by or for the tier 1 contractor. As a result, Professional Indemnity (PI) insurance is now required by a significant number of businesses in the construction supply chain and a minimum level of cover is a condition of many contracts.

Whilst the insurance market has always fluctuated, PI insurance was available at reasonable rates and for the majority of activities until relatively recently. However, since the fire at Grenfell Tower in 2017, companies that undertake any aspect of construction work have found it increasingly difficult to secure appropriate and affordable cover.

The introduction of large excess payments, exclusion clauses particularly for cladding and fire safety, and the high cost of many policies is resulting in certain types of work becoming unviable as businesses find obtaining PI insurance cover unaffordable or impossible altogether.

This guide has been produced by Build UK to provide an explanation of PI insurance, including what it is, why it is needed, and how it can be obtained in the current market.

PI insurance and design liability are complex subjects and any business providing design services and offering PI insurance is strongly advised to seek specialist professional advice as to what their obligations are and how they can protect themselves.

WHAT IS PI INSURANCE?

PI insurance protects businesses that provide professional services to their clients against claims arising out of professional errors or omissions in the provision of those services.

Most commonly, the insurance deals with the consequences of errors and omissions in design services but it can also extend to other disciplines, such as specification, supervision, project management, feasibility study, technical calculations and surveying.

CLC PI Insurance Survey

The **PI Insurance Survey** undertaken by the Construction Leadership Council (CLC) in March 2021 revealed that average premium rates were nearly four times higher at last renewal compared to the year before and almost 50% of respondents had been declined cover by three or more insurers.

WHAT DOES IT COVER?

In broad terms, PI insurance covers legal costs and expenses incurred in your defence, as well as any damages or costs that may be awarded against you, if you are alleged to have provided inadequate professional services that cause your client to suffer a loss.

This includes cover for defects and damage that appear in buildings which are caused by a deficiency in the design of the structure, or part of it, as opposed to poor workmanship. For example, in the event that a concrete beam begins to fail, if it has been constructed exactly as specified but fails nonetheless, then there is probably a fault in the design. However, if the beam has been built with understrength concrete, or the wrong reinforcement, the failure is more likely the result of a workmanship issue.

Where workmanship is the cause of the defect, it would usually be covered by Public Liability (PL) insurance, rather than PI insurance.

Every policy is different and you should always take specialist professional advice from insurance experts with experience in construction PI insurance.

DO I NEED PI INSURANCE?

Whether you are a design professional such as an Architect or an Engineer, a Contractor providing a full or partial Design and Build service, or a Specialist Contractor providing design for just one part of a project, your contract will almost certainly require you to have PI insurance and to maintain it for a period of time, usually 12 years.

This means that any company which has signed a contract or warranty in the last 12 years that requires it to maintain PI insurance probably already has a legal obligation to secure PI insurance if it is possible to do so.

If your contract is strictly for supply of labour only or supply and install, you probably do not need PI insurance as you are not offering a design service. **However, care should be taken.** Whilst many Specialist Contractors do not consider themselves designers, they make decisions on matters that might be construed as design. For example, the selection of fixings and secondary framing for a cladding system could, in some circumstances, be considered a design function.

It is advisable to speak to your insurance broker in detail about the scope of the services you provide and, where you do not carry PI insurance, to make sure all of your activities are covered by either your Public or Product Liability cover.

WHY DO MY CLIENTS WANT ME TO HAVE IT?

Errors in the design of a building can often remain undiscovered until several years after the building has been completed and is in use. It is also not uncommon for the consequences of a design defect to cause costs and losses far in excess of the value of the design work that led to them.

For example, the cost of performing the design service for a foundation system or a building frame may be no more than a few thousand pounds; however, the cost of putting issues with these elements right in a completed, occupied building can be many times that and potentially more than the value of the company that carried out the design.

Building owners and occupiers want the comfort of knowing that, on the rare occasion that a building suffers from a design failure, there are sufficient funds available to cover the costs and losses involved, and this comfort is provided by the PI insurance policy.

As issues might not become apparent until after the building is in use, PI insurance is generally required for the period for which the designer is legally liable for any negligence, typically 12 years from completion of the work.

WHY IS PI INSURANCE MORE DIFFICULT TO GET?

PI insurance works in a different way to most other construction insurances and so presents a different risk profile for insurers. The key difference is that PI insurance policies are underwritten on a “claims made” basis, whereas most other liability policies are underwritten on an “occurrence” basis.

For example, if an employee has a fall on site and the employer is considered liable, it would be the employer’s liability policy that was in force *on the day of the incident or “occurrence”* that would respond, not the policy in force at the time the claim was made. However, with a claim for negligent design, it would be the PI insurance policy in force *at the time the claim is made* that would respond and not the policy that was in force at the time the design work was done.

For underwriters, this means that they are potentially taking the risk on every negligent act or omission that you may have made for the preceding 12 years (sometimes longer) in addition to any that you might make during the period of insurance.

With other policies such as PL, insurers are only liable for the mistakes you make during the period that they insure you, even though claims arising from those mistakes can be made for several years after the policy ends.

In order for insurers to underwrite these extended periods of activity, they need to understand the following:

- What your business does
- How much professional work is involved
- What processes you have in place to minimise the risk of professional errors occurring
- How you limit your liabilities
- Whether you have had any claims made against you in the past

The less able you are to provide this information, the greater the risk for insurers and therefore the higher the premium and the more restrictive the basis of cover – if they are willing to provide cover at all.

WHAT IS THE CURRENT STATE OF THE MARKET?

The insurance market has always been subject to a cycle between a buyer's "soft" and a seller's "hard" market. Historically, "soft" markets have lasted longer than "hard" markets. The most recent "soft" market, up to 2018, lasted for about 15 years, and it remains to be seen how long the current "hard" market is going to last.

During the 15-year "soft" market, insurance companies competed aggressively for business which led to falling premiums and a lack of underwriting discipline among many insurers.

The inevitable outcome was growing losses and unprofitability, culminating in several insurers reducing the amount of business they were prepared to take on or withdrawing from the market altogether. The Grenfell Tower fire has also had a significant impact on insurance in the construction sector, especially in terms of fire safety and cladding coverage.

Adding COVID-19 into the mix, along with other technical changes within the insurance industry, has created a perfect storm for more onerous terms.

These onerous terms include:

- Higher premiums
- Lower limits of indemnity
- Higher excesses/deductibles
- More onerous restrictions and exclusions

The effect of all this has made PI insurance completely unavailable to some companies, and for those that can secure it they will almost certainly not have the cover they once had. If the policy will not respond except in the narrowest (and least likely) of circumstances, or the deductibles are so high that the insured cannot meet its financial contribution to a claim, then it is of little value not only to the insured but employers and end users as well.

CLC PI Insurance Survey

Almost one in three respondents to the CLC PI Insurance Survey undertaken in March 2021 were unable to buy the cover they want or need. Over 60% had some form of restriction on cover relating to cladding or fire safety, with one in three having a blanket exclusion for cladding claims and one in five a blanket exclusion for fire claims.

WHAT CAN BE DONE ABOUT IT?

The challenges in obtaining PI insurance affect the whole supply chain as the industry needs to have suitable and sufficient cover to protect against genuine examples of professional negligence. The “claims made” nature of PI insurance means that if a company cannot achieve cover in the current market it is not covered for previous work undertaken. Therefore every stakeholder has an interest, and a part to play, in ensuring that appropriate insurance cover is available to the sector.

Clients

Clients can choose to use alliancing project arrangements. Whilst they do not suit every project, where they are appropriate, they create the opportunity to use **Integrated Project Insurance (IPI)**. This is a single policy, taken out by the Client, which covers the project for all events that would normally be covered by one or more of the multitude of policies held by the supply chain. Although the Client bears the cost of this, it should recover most or all of the cost by not having to pay the supply chain for their insurances.

Alternatively, it may be possible for Clients to obtain **single project PI insurance**, which covers all the parties providing design services on a project and runs for the latent defects liability period. Insurers will take a more direct interest in the selection of contractors and sub-contractors which will be covered by the policy but this should benefit the Client and the project as the selected participants will have satisfied insurers as to their competence.

Contractors

Some large Contractors are able to limit premiums by effectively **self-insuring** and using their own balance sheet. Alternative risk transfer vehicles, such as captives, can be used as an alternative to traditional risk transfer.

Contractors can also relieve some of the burden on the supply chain by **being selective in whom they seek PI insurance from** and by keeping the insurance requirements proportionate to each Specialist Contractor’s input. They should avoid asking all sub-contractors for PI insurance by default and only ask for it where there is genuine design input. Where a Specialist Contractor is not providing design, the Contractor should ensure their sub-contract does not say that they are.

Specialist Contractors

Many small Specialist Contractors do not directly employ designers but use sub-consultants. In such cases, a **collateral warranty** should be sought from the sub-consultant to the higher tier parties so that their PI insurance is protecting both them and the project.

Specialist Contractors should **only sign contracts that contain design liability obligations where they are undertaking design work**. If the design input is very limited or specific, this should be clearly stated in the contract. If an insurer can see they are exposed to limited and specific risks, they are more likely to offer cover.

Beware that some contracts may make the holding of PI insurance cover a condition precedent to other unrelated actions such as payment which means if your current policy expires during a project or contract term and cannot be renewed you could be held in breach of contract.

HOW CAN I GET BETTER TERMS?

Whether you are taking out a new PI policy or renewing an existing one, you need to prepare the submission of information with as much care as you would a new tender for an important client. There are no short cuts if you want to get the best terms. You will have to complete a proposal form and take care to do this clearly and in full.

Demonstrate good risk management

- Written procedures for designs, including checking and sign off by senior members of staff
- Details of qualifications and experience of designers
- Contractual risk management procedures, such as limitations on liability, exclusion of “fitness for purpose” obligations, clear statements of the scope and extent of design work undertaken, and express statements on which information and documents you have relied upon in performing design works
- Identification of contracts that did not include a design element or were covered by project-specific insurances, which present little or no risk to potential insurers
- A breakdown of the nature of your work: public/private sector, residential, high/low rise, industrial, commercial, retail etc. It may be possible to secure cover at reasonable cost for the part(s) of your business not considered high risk
- Agreements with external design consultants confirming their liability to you for professional negligence and evidence of their own PI insurance.

Be open about your claims history

- If you have had claims, give details of what you have learnt from the incident and any measures you have taken to prevent a recurrence. You are obliged to give insurers a fair presentation of the risk and failure to do so would allow them to avoid paying any subsequent claim in full or in part.
- The question on the proposal form about claims will usually include words such as “AFTER FULL ENQUIRY” when asking about circumstances that might lead to a claim, so it is important to understand what their definition of “circumstance” is.
- Be aware of the claim reporting condition on your existing policy as you may have an obligation to report it prior to expiry of the policy. If you fail to do so, you may end up with no cover.

Keep good records

- Potential claims could arise months or even years after the work was completed and good documentary evidence on all aspects of a project will be vital to defending any claim. If you can demonstrate to insurers that you maintain good records, it may help to improve the terms on offer.

This will take time so you should start the process well in advance of renewal. How far in advance will depend on the size of your business so discuss this with your broker. Set deadlines but be prepared to be flexible. What you really want to avoid is getting terms 48 hours before renewal and having to make hasty decisions.

CAN MY INSURANCE BROKER HELP?

Your insurance broker should be helping you throughout the process of obtaining cover so make sure you talk to them.

There are a lot of good commercial insurance brokers who may not have much experience of PI in the construction sector and as such may not have access to all of the markets and required expertise. Ask your broker about their experience in this field, for example, how many construction clients do they have, which insurance companies do they have access to, and what will their strategy be for presenting your submission to insurers?

Building a Safer Future Charter

The [Building a Safer Future Charter](#) contains five commitments designed to realise the positive culture and behavioural changes required for a safer built environment. Becoming a signatory can help companies demonstrate that they take a proactive approach to risk management and prioritise safety. They also receive access to a learning and excellence hub providing best practice information.

This publication is issued by Build UK Group Limited in order to give general guidance only on what it considers to be best practice; if you require guidance on a specific issue, you should seek your own independent professional advice.

WILL CLAIMS STILL BE PAID?

For the foreseeable future, it is likely to be very difficult to insure against certain types of claim. There may also be more subtle changes in policy wording that will increase the risk management obligations of the insured.

It is important that you review the policy wording so that you can understand exactly what is expected of you and put in place processes to meet your obligations. There is a greater risk that claims will not be paid if the insured cannot prove that they took all the steps required by the policy to mitigate their risk.

It is also important to be aware of when a claim should be made and you must read the claims reporting conditions in your policy. If you wait for a formal claim to be made against you by your client before you submit the claim to your insurance company, it is likely to be in breach of the claim reporting conditions on your policy and will create problems with the claim being paid.