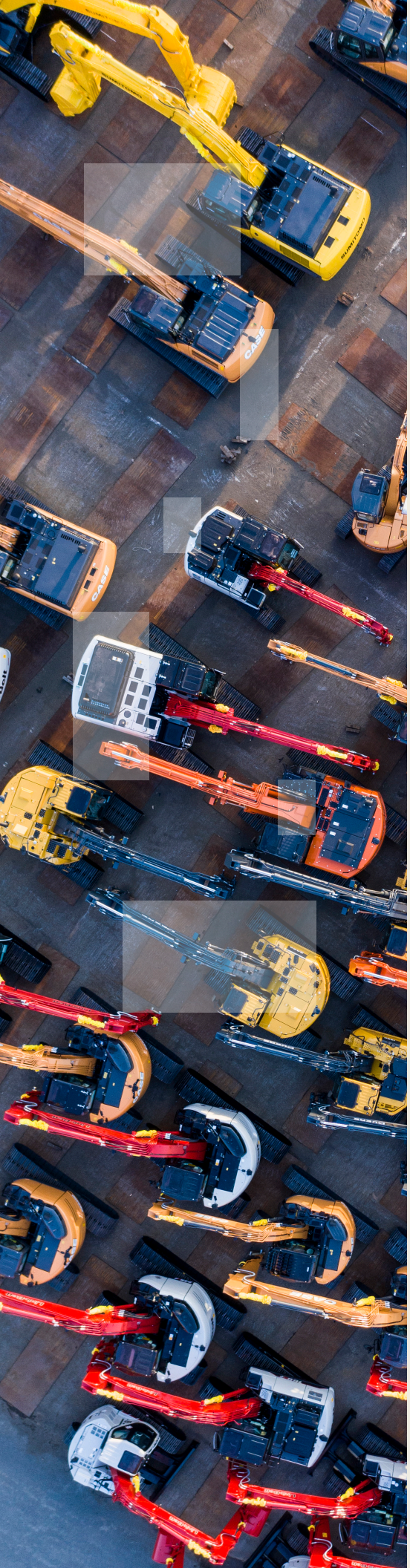
Construction Marketplace Realities

March 2019

Willis Towers Watson



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Introduction

Welcome to our Spring Construction Marketplace Realities. In this edition we hope you notice our renewed focus on providing more than just market updates but also giving insight around what it means from a strategic standpoint and what the most important points are from each line of coverage. The depth of material and expertise contained in this edition are a direct result of our connected teams and our collaborative approach in delivering the very best insights to our clients.

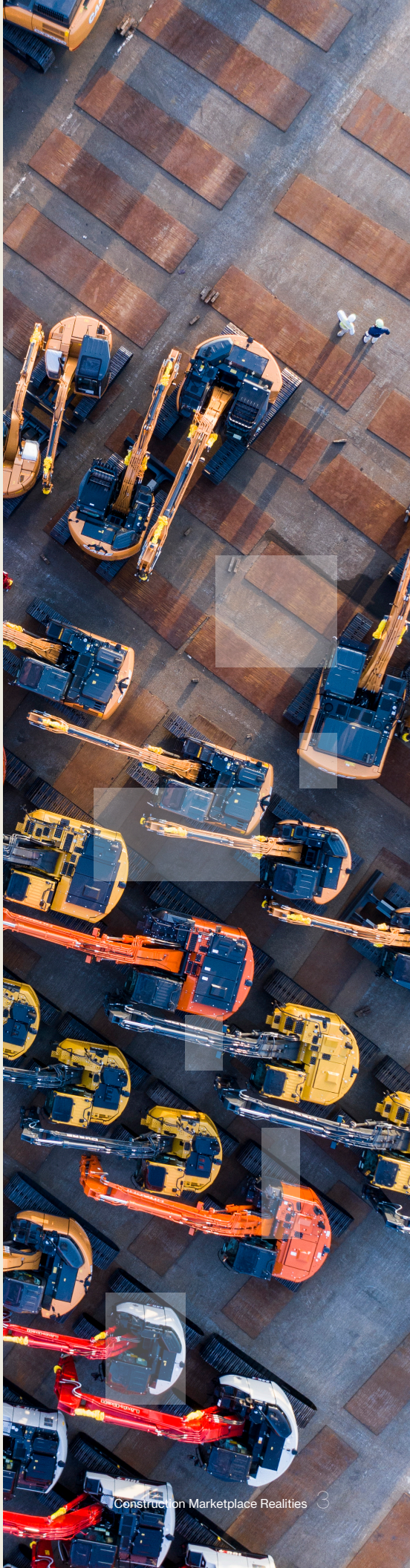
The construction industry is experiencing a myriad of evolving risks that do not preclude opportunities for our clients but can make the route to them more complex for the unprepared. Contractors are faced with broadening contractual requirements while, at the same time, being driven to evaluate the handling of risk transfer within a changing insurance marketplace. You will read about aspects of the market that can significantly impact a project's margin if ignored or not understood early in the project process. Examples of these include significant challenges around *auto liability* and how *wildfire* exposures are addressed as many markets seek to exclude cover.

These challenges can be met by strategic planning early and by heightened focus on the quality of information being supplied to an increasingly discerning underwriting community. In addition, it is imperative to evaluate new approaches such as integrated risk placements or the use of *alternative risk transfer* techniques, including parametric solutions for addressing project risks stemming from extreme weather events. Creativity and innovation will now be essential in building leading-edge approaches to risk management.

We hope you find this overview valuable and encourage you to help guide us further in how we deliver our insight to you.

Bill Creedon
North America Construction
Industry Leader

Kelly Kinzer
North America Construction
Broking Leader



Rate predictions

Flat to +10%

General liability (GL)

Carriers are becoming vocal about the sleeping giant that is GL and beginning the push for rate. Emerging trends in loss activity demonstrate an adverse shift in premises and operational risk results, which have typically been overshadowed by those of traditional "long tail" completed operations. Accordingly, carriers are beginning to tighten their respective appetites, pushing for best-in-class risks as well as extensive underwriting data and engineering information.

- **Combined ratio results remain top of mind as underwriters evaluate rate adequacy. Well-publicized challenges in auto liability have made general liability subject to several cycles of suppressed pricing to help offset. However, during this time, legal expenses have continued to rise, plaintiff verdicts are reaching unprecedented outcomes and CAT losses are putting pressure on carrier portfolios. The window to discount GL is closing, and we can expect closer scrutiny ahead.**
- Construction companies are diversifying operations more than ever with mergers and acquisitions activity on the rise in tandem. Whether it is a push for vertical integration, offering turnkey solutions or expanding capabilities to include design-build services, construction firms are exploring ways to fortify client relationships. Insurers are cautiously receptive to these broadened operations, actively seeking greater understanding of their scope. Without proper due diligence with a carrier, insureds could face policy restrictions, change in risk retention or perhaps the need for stand-alone coverage.
- Comprehensive underwriting information is more critical than ever to success in the renewal process – including but not limited to thorough descriptions of newly formed and/or acquired entities, loss experience and historical exposures. Carriers are increasingly employing predictive modeling technology to drive underwriting decisions, thus making accurate exposure data imperative to achieving the best results.

Disruptors on the horizon:

- *Court decisions:* Case law continues to produce land mines for general liability as states vary on fundamental coverage interpretations within the CGL policy form, including the trigger of an occurrence. In October of 2018, Ohio joined the fluid list of states to bar coverage arising from a subcontractor's faulty work, even in the event a clarifying endorsement was purchased by the policyholder.
- *Wearable safety devices:* Technology advances in "wearables" demonstrate tremendous potential to protect the workforce and ensure safe habits. However, these devices open the potential for new claims scenarios on the fringe of privacy infringement. Traditional GL policies have not truly been tested yet on this front.

New York update

The New York marketplace continues to harden for subcontractors, due to the increased size of payouts on Labor Law claims. Some carriers with historical experience in New York have either pulled away or restricted their overall program offering. In 2018, we experienced significant movement in the E&S space with new markets entering and others exiting the New York market for trade contractors.

Overall, there is no shortage of capacity, namely coming from the GL-only marketplace and less traditional companies, including E&S carriers and Lloyds of London.

The standard markets remain opportunistic by picking and choosing where they are going to play. Overall, carriers continue to seek mid to high single-digit rate increases on their books of business. Certain standard markets continue to aggressively pursue "best in class" risks which can still obtain favorable terms on renewal. Regarding loss sensitive business, it will depend heavily on experience and loss information of the contractor. Contractors seeking a low deductible program continue to find themselves in the challenging landscape of the E&S space.

Rate predictions

+5% to +20%

Auto

Auto liability remains the most challenging line in primary casualty for insureds. Underwriting results have been sharply deteriorating since 2015, without a plateau in sight. While there is indication that repeated auto rate increases year after year are having an impact on carrier profitability and rate strategy, we don't expect underwriters to "take their foot off the gas" just yet. Combined ratios for auto are well in excess of 100 for most carriers. Increased loss activity is not just in the frequency but also severity of claims.

- The robust economy is putting more vehicles on the road than ever before and, as we would expect, increasing the frequency of accidents. With unemployment rates categorically low, this translates into driver shortages for many firms, most notably transportation and construction firms, especially since these often require CDL certifications. As a result companies are hiring less experienced drivers, and insurers are seeing a rise in accidents.
- More claims are being litigated, with verdict outcomes consistently in the seven- or eight-figure range. Common high value verdicts are stemming from traumatic brain injury claims (TBI), negligent entrustment/driver selection, and distracted driving. Furthermore, a rise in third-party litigation finance is encouraging the jump to file suit.
- Insureds with historically adverse auto loss experience and a heavier fleet exposure are likely to receive even more significant rate increases than average:
  - Little to no loss activity and low fleet hazard – up to 5% or more
  - Moderate loss activity and moderate fleet hazard – up to 10% or more
  - Significant loss activity and high fleet hazard – up to 20% or more
- Auto physical damage pricing is also encountering challenges. Comp/collision claims can escalate quickly due to the increased technology in vehicles – a bumper is no longer just a bumper, it's also a sensor and camera. In addition to auto physical damage rate increases, auto physical damage deductibles for comprehensive and collision are also on the rise. For private passenger and light trucks, a $1,000 deductible may be the norm, but deductibles escalate much higher for large vehicles, $2,000 or more for heavy to $5,000 or more for extra heavy vehicles.

If performing well, carriers have been willing to reduce WC rates modestly to help offset auto rate increases. Due to the growing concern on GL, carriers are less likely to reduce GL rates to offset the auto rate increase, as done in recent years. Poor experience in other casualty lines (GL and/or WC) may exacerbate overall program pricing increases as carriers are unable to offset auto pricing increases in the other lines of business.

Disruptors on the horizon:

- *Expectations in fleet safety programs:* Telematics, driver selection/training and formalized fleet safety programs are becoming a more standard expectation in the marketplace. Buyers are challenged to be more engaged and proactive than ever in managing their fleet exposures. However, a plan in writing but not in practice can be just as detrimental in a claim as no plan at all. The same can be said of telematics. If the data is being tracked but not reviewed or acted upon this could pose legal implications for a defendant. It's critical that fleet safety initiatives are deployed thoughtfully and thoroughly.
- *Defining vehicle use:* Vehicle usage data (miles driven, location, etc.) is now often required submission information. Data on vehicles "laid up" (not used for significant periods of time) or used only within the boundaries of a large construction project (limited public road use) can help mitigate concerns and costs.
- ***Primary, buffer or umbrella:*** **There has been disruption to the traditional program structure on primary auto and its attachment to the lead umbrella. Fleet size, irrespective of loss experience, has become a significant component of umbrella underwriting. Insureds with large fleet schedules may be forced to increase primary auto limits or obtain an auto buffer layer to satisfy new umbrella/excess requirements. $2M primary limits are becoming the minimum primary combined single limit (CSL) standard. Buyers who currently purchase a $1M primary CSL limit should seek a $2M primary CSL option. Large fleets (> 500 power units) may see $5M underlying limit requirements from some carriers.**

Rate predictions

-4% to +2%

Workers compensation

Workers compensation continues to exhibit positive results, serving as a pressure valve to persistent challenges in auto liability and emerging trends in general liability.

- The line-of-business combined ratio has continuously improved to the lowest level in over half a century, despite investment income remaining below long-term averages for private carriers.
- NCCI has reported countrywide reductions in advisory rates, loss costs and assigned risk rates for five years running – most recently decreasing further from -5.4% off expiring in 2017 to -9.6% in 2018.
- The most recent state filings resulted in decreases for all but one NCCI state (LA).
- Even with state base rate reductions, most carriers are holding steady on discretionary credits and use of deviated filings for renewals and further, offering competitive discounts to win on new business when marketed.
  - Exceptions remain for California and New York, where carrier appetites (and historical results) still cause heartburn for buyers in the private marketplace. In New York, some of the standard markets continue to look beyond loss cost rates and at rising medical costs. Indemnity may be a little less in New York than some other states but, due to Labor Law, there will be additional medical surgeries associated in the build-up of a Labor Law case.

These results are attributable in part to the marked increase in both the insurer and insured's stake in managing risk, including use of managed care, enforcement of return-to-work programs, nurse triage, fee schedules and telehealth.

Disrupters on the horizon:

- *The aging workforce:* The U.S. construction workforce is aging, putting a strain on the pool of skilled workers. This manifests in workers compensation results/trends by way of increased severity and duration of care on the road back to health.
- *Independent contractors/on demand economy for labor:* Now, more than ever, individuals are engaging in freelance work as opposed to steady 9 to 5 jobs. The construction industry is not immune to the gig-economy phenomenon. This trend carries benefits and risks; independent contractors can exercise complete flexibility in their schedules and workload; however, ambiguity in medical coverage for injuries occurring "on the job" comes with the territory. Who is really going to be responsible?
- *Opioid epidemic:* Per the CDC, opioid overdoses claim more than 40,000 lives each year in the United States, and the numbers are rising. With workplace injuries that often result in some degree of chronic pain, a typical starting point for relief and treatment of construction workers is prescription opioids. State governments and insurers are becoming increasingly proactive in mitigating abuse and monitoring for red flags; however, there is still a disparity in governance from one geography to another.
- *The legalization of marijuana:* Already legal for medical use in most states in 2019, nine states have legalized it for recreational use as well despite remaining a Schedule I substance under the Controlled Substances Act. This generates challenging scenarios for insureds and policyholders when it concerns use in the workplace.

Source: NCCI State of the Line; NAIC's Annual Statement Statutory Page 14 Values reflect changes in average premium levels between years, based on approved changes in advisory rates, loss costs, assigned risk rates, and rating values, as of 5/10/2018.
Source: International Risk Management Institute, Inc. "The New Normal: Fundamental Changes in the Construction Market," Hank Harris.

Rate predictions

Umbrella: +5% to +10%
Excess: 0 to +5%

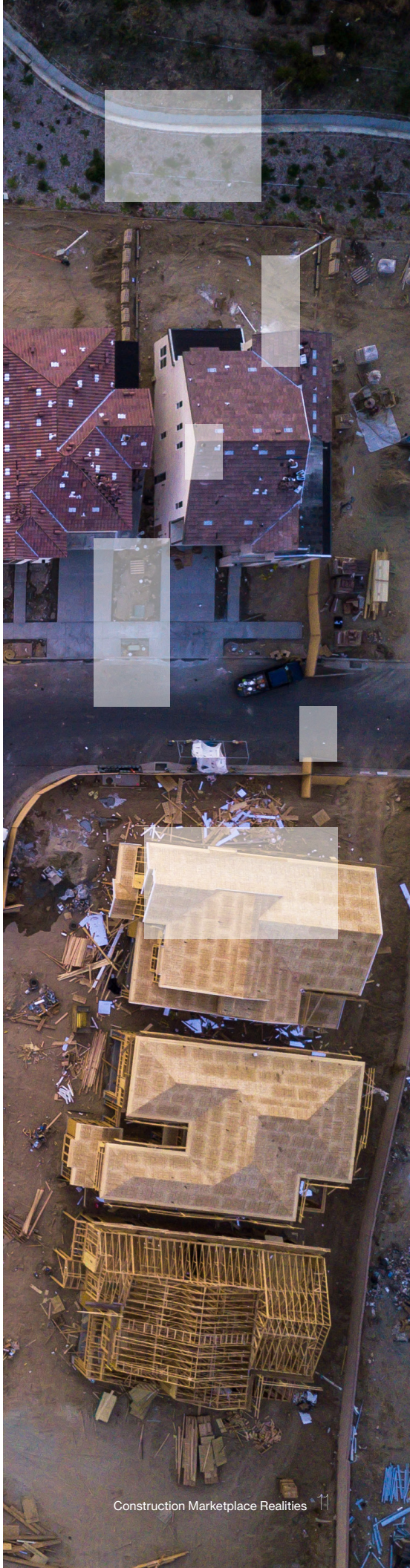
Umbrella/Excess liability

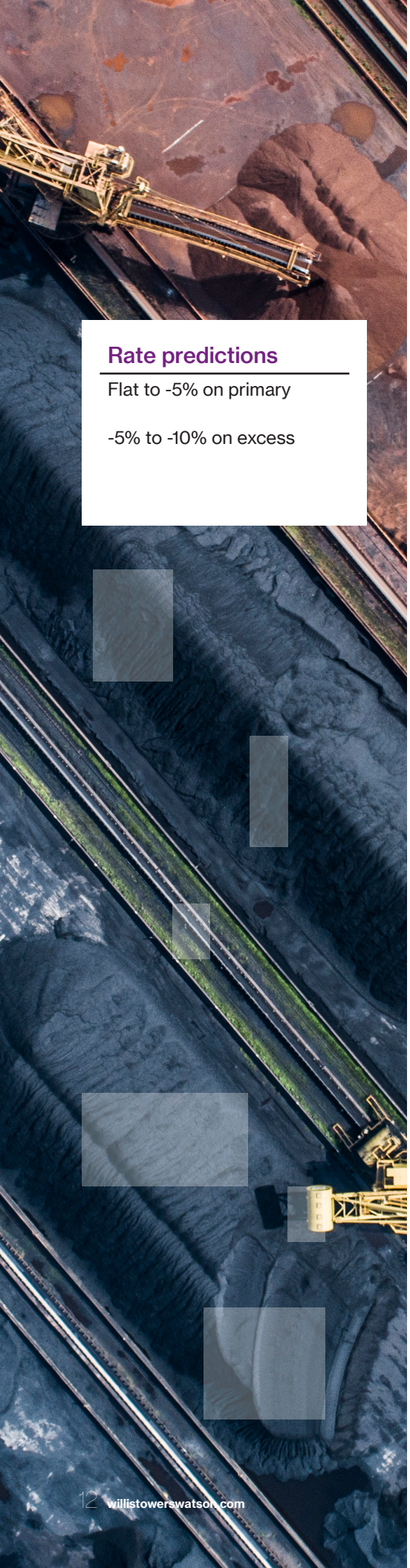
Construction umbrella and excess liability placements are expected to encounter challenges in 2019. As with the umbrella marketplace across industries, construction underwriters are increasingly scrutinizing rate, capacity and attachment points and often adjusting one or more of those parameters, resulting in disruption to existing program structures and pricing. Generally, market appetites for umbrella carriers are narrowing. We expect these market challenges to have a greater impact to programs with unsupported umbrella programs (e.g., where the umbrella market does not also write the primary casualty program).

- **Auto liability fleet exposure and attachment points have been a focus for umbrella underwriters for some time. While the construction umbrella market has been slower to respond (in part due to the lower per-unit mileage exposure), changes are happening to underlying attachment points and pricing, and this is expected to continue.** It is essential for underwriting submissions to present fleet details, usage and, where possible, mileage figures, to put this exposure in the right perspective versus true transportation risks. Minimum underlying limits for fleet sizes over 100 units have generally moved to $2M. As fleets approach 1000+ units, we are experiencing pressures to increase to $5M. Fleets in excess of 5,000+ may be forced to look at $7.5M or even $10M, without regard to loss experience. In response, buffer auto liability programs are an avenue to fill gaps, if the primary carrier is unable to address; however, the buffer marketplace is highly limited and pricing is rather uniform, passing on reinsurance costs effectively.
- Typical capacity deployed in the lead umbrella position is decreasing. Many carriers prefer to offer limits of less than $25M in the lead position, as has been customary in the past. Shorter umbrellas of $10M or $15M are common and $15M xs $10M and $25M xs $25M are seeing increased competition. This phenomenon is in direct correlation to the increase in severity on primary auto and general liability losses – carriers view a $10M hit as much easier to absorb across a portfolio in comparison to $25M.
- For New York risks, excess capacity remains limited below $5M per occurrence with only a select number of carriers willing to participate. Higher excess liability capacity remains plentiful with carriers from New York, London and Bermuda pursuing excess business.

Disruptors on the horizon:

- ***Wildfire — a "burning" issue.*** **In 2018, several areas of the western U.S. were burned by historic wildfires for the second year in a row. Estimated insured losses from the 2018 Camp Fire could be between $7.5 billion and $10 billion. This is not just an attachment or pricing concern, but rather anxiety around complete vertical exhaustion for those carriers exposed to construction operations that support utilities in the Western and Southwestern geographies of the United States. As reinsurance treaties are being negotiated, whatever capacity carriers are willing to extend will be offered with discretion and monitored closely to avoid stacking of limits. This translates into intense underwriting data requirements, a need for formalized fire prevention/mitigation strategies, and ultimately the risk of wildfire exclusions in the lead umbrella or excess tower.**
- *A contracting domestic marketplace.* Some key U.S. insurers with significant market share are walking away from umbrella renewals or are expected to significantly reduce capacity – all done with intent to right the course on underwriting profitability. One major lead umbrella market in particular shifted their platform to only entertain construction risks via non-admitted paper or through alternative access points overseas. Another insurer that distributes through both a traditional and specialty channel is carefully managing the capacity available on any given risk. It is important to note that the total capacity available from incumbent markets on umbrella/excess program may be reduced.
- *London and Bermuda.* The London and Bermuda marketplaces remain a key source of capacity for the construction industry on umbrella and excess and will be essential to solving capacity challenges, particularly on large excess placements. However, these markets are placing increasing value on excess liability capacity, so replacing capacity may come at a cost. With more than 20 markets and $800M in capacity to lean upon, direct engagement overseas will be imperative to ensuring effective renewal outcomes.
- *Aggregate exposure versus premium.* Carriers, even in high excess positions, are placing increasing value on their total aggregate limit exposure. This is resulting in a push for rate across excess programs above what has been customary over the last several years, particularly where per project aggregates are required on practice placements and per project and/or annually reinstating limits are required on project business.





Controlled insurance programs

Rate predictions

Flat to -5% on primary

-5% to -10% on excess

The controlled insurance program (CIP) marketplace continues to produce competitive rates and broad coverage for both owners and contractors. Growth expectations in habitational, manufacturing and mixed use continue to pave the way for competitive pricing, as well as some recent industrial projects. Warehouses, office buildings and data centers are some of the types of projects that stand out in recent pipelines.

GL-only low retention CIP programs offer an alternative to the traditional WC/GL large deductible CIP programs that usually require clients to post and tie up collateral for several years. With regard to pricing, there remains capacity in the market, especially for non-residential. Rolling programs continue to be popular, and more creativity and flexibility have helped sell these types of programs. Some examples of flexibility are “pay as you go” (enroll) options and subscription programs. The volume in these types of programs helps attract more competitive rates.

Overall, carriers remain hungry for project business and often want to save their capacity in the contractor space for these programs to avoid anti-stacking issues when participating in both project and practice. Pricing in the excess liability CIP space continues to soften. Splitting up the lead $25M (10/15) continues to be common. As premium dollars decrease higher in the tower, quota shares can help provide more competitive options and avoid minimums.

New York update

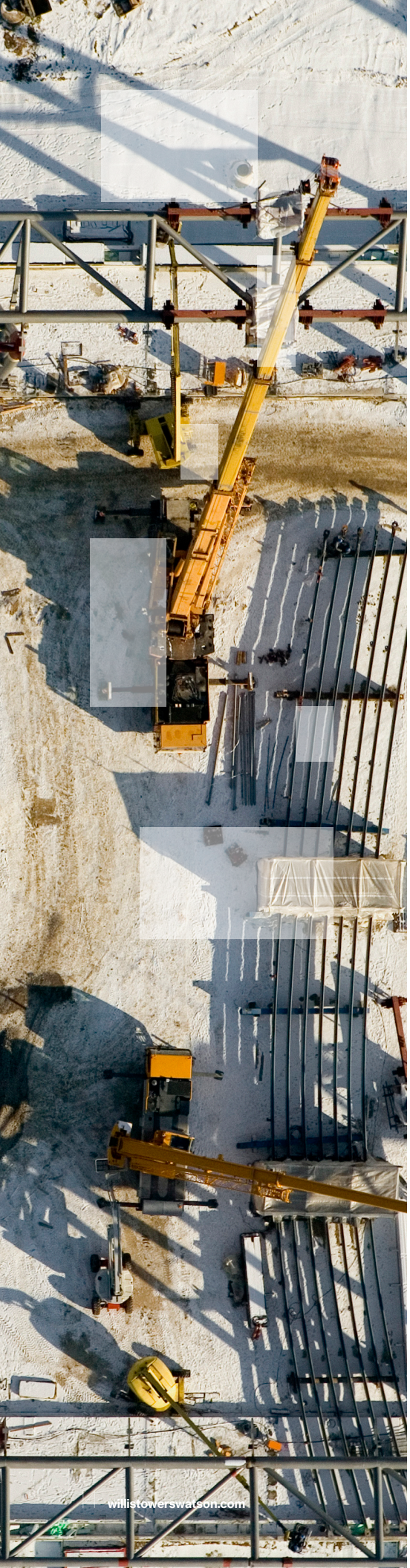
CIPs remain a popular solution to reduce costs and ensure coverage certainty, but GL retention levels continue to rise. The standard markets which have historically been competitive have either pulled away or require increased retentions and large collateral outlays from the client. Their concerns are no longer just erosion of the "maximum program aggregate" but also paying out defense dollars on GL Labor Law claims that settle above the retention. The minimum GL retentions in New York have risen to the $2M – $3M deductible range.

Accompanied by premium increases for any risk transfer, carriers are essentially funding to limit. Therefore, many CIPs are now structured with a $5M per occurrence retention, which allows the client to fund the risk and realize potential savings via risk management.

The cost of entry to undertake a CIP has increased as carriers expect significant internal oversight from the sponsor. The focus is on the sponsor to put forth risk management, loss control and claims management services with appropriate staffing. While these requirements are enhanced from your broker partnerships and their experienced services and capabilities, there is a need to actively participate in overall program management.

The entrance of new GL markets has led to more stand-alone GL CIPs in New York, which can provide a lower overall cost for the program, including "pay as you go" collateral and reduced completed operations exposures. The standard markets continue to support a stand-alone CIP for the workers compensation component which can be paired with the GL CIP.

With GL retention levels on the rise, matching deductibles and fronted programs have become a standard on large construction projects in New York. The program sponsors now take on most, if not all the primary GL limit. Therefore, the use of captives is a popular discussion point to explore a more cost-effective way to structure a CIP given the minimal risk transfer options in the market.



Surety

The surety market continues to be quite competitive from a rate and capacity perspective with the ability to support multi-billion-dollar jobs.

Sustained industry profitability has increased surety appetites for carriers to provide larger lines of credit and attract new markets. We expect this to result in a favorable marketplace for surety for the next several years.

For the contract bond segment, growth should increase as more robust government infrastructure funding attracts support along with increased use of alternative funding models including P3.

Beyond the underlying superior underwriting results, the industry continues to exhibit discipline from an underwriting standpoint, including how it evaluates the financial strength of its clients. There is some debate that the strong construction economy could result in less financial rigor by contractors leading to losses once the construction market eventually cycles down. As such, we expect surety companies to continue focusing on core financial measures. This key discussion around the financial measures should be a focus of all contractors as they balance the need to make investments to support growth while maintaining financial discipline, but this will become an even bigger issue as the underlying construction markets begin to plateau. Now would be a good time to review business strategies and challenge spending in light of a likely market downturn in commercial construction in the next two to five years.

In addition to the traditional use of surety for infrastructure needs (including alternative project delivery approaches), the ability of the industry to support emerging technologies is strong. Initiatives to reduce carbon-emitting sources will increase investments in renewable sources for power generation, including solar, wind, hydro, nuclear, etc. These types of investments will likely increase the demand for surety which will also drive growth in the industry.

The surety industry faces the same talent issues as the construction industry as a whole with a significant number of underwriters, managers and claims professionals retiring in the next five years. To effectively compete in the marketplace, finding the next generation of talent is significant. We expect that this will result in increased movement of people in addition to significant investments in training, which is an area that has lagged over the last decade.

In summary, we expect the contract surety market will:

- **Have more than enough capacity to support the needs of the construction industry**
- **Continue to be rate competitive for its better clients**
- **Attract new players while at the same time consolidating via mergers and acquisitions**
- **Need to focus on underwriting discipline as the commercial construction economy matures**
- **Grow as the hope for sustainable infrastructure investment will result in the need for surety while at the same time challenging it to bring new surety solutions to the market to support alternative procurement methods.**

Rate predictions

+5% to +10% at program renewal

Subcontractor default insurance

The subcontractor default insurance (SDI) market continued to expand in 2018, and carrier discussions point to further market entrants in 2019. Currently, there are six markets providing this coverage, with varying appetites and capacity of up to $75M per loss. We expect the increase in capacity seen through numerous market entrants over the past eight years to continue to support a competitive market from both a pricing and terms and conditions basis.

Industry losses for the product were not outside expectations in 2018, with losses continuing to be led by residential risks and generally high backlogs subcontractors are holding – which are placing strain on subcontractor's ability to perform from a labor and cash flow basis. These trends are expected to impact placements with residential exposures or, especially, adverse loss history.

The other significant trend is the increase in the cost for tail coverage. Over the past 12-18 months, most of the carriers' coverage for tail in particular has been shortened on a year-over-year basis from inclusive of 10 years to programs inclusive of two or three years post-substantial completion. We have seen pricing increases of up to 10-20% on an additive basis, to maintain tail coverage of 10 years with some markets declining to entertain (even at a price for the full 10 years the market historically enjoyed).

Outside of these trends, coverage for mega projects is also a dynamic market, with variability in pricing across markets. Due to the number of carriers now in the marketplace, these risks have more options for coverage than historically experienced, as long as they do not contain adverse risk profiles. Placement with appropriate limits and tail coverage is still an involved process, necessitating individual project underwriting by market and risk mitigation efforts by the contractor to meet the carriers' expectations. Often the largest subcontracts, over $100M, or the most unique subcontracts where few have performance experience, are being removed from the subcontractor default program due to selective bonding, carrier appetite or owner requirements.

Overall there is now a robust subcontractor default marketplace, which provides contractors with multiple options for carrier partners offering programs to suit their needs. Obtaining coverage continues to require an extensive underwriting process, with carriers paying more attention than ever to not just financial prequalification procedures, but also quality management and operational controls in place. While we expect rates to remain fairly stable, unless a client has not yet renewed their program under the new tail pricing structures being seen, the competitive landscape provides a good opportunity for clients to broaden terms and conditions.

Builders risk

The North American builders risk market has started to exhibit signs of firming. The recent shift in market conditions can be attributed to poor loss experience, globally, coupled with a fixed/operational property market that is quickly hardening.

In 2017 and 2018, the global builders risk marketplace experienced a rash of major insured losses. While the majority of these were the result of natural catastrophe, many stemming from HIM (Harvey, Irma and Maria), others were the result of fire. We also experienced several large losses relating to paint protection in connection with liquid natural gas (LNG) facilities in Australia.

Loss experience, in concert with the past decade of eroding marketing conditions, has resulted in a reduction of builders risk capacity in the London marketplace. Lloyd's, for example, has seen several syndicates, including Brit, Beazley, Talbot and CNA Hardy, exit the construction marketplace entirely, equating to a loss of $202.5 million of probable maximum loss (PML) capacity. The reduction in capacity, which is currently estimated at $4.5 billion, has resulted in a surge in rates, as well as a restriction in coverage terms and conditions overall in the London marketplace.

The builders risk loss experience, globally, coupled with record losses for the fixed property/operational marketplace in 2017 *and* 2018 (estimated at $230 billion total), has caused firming that our project owners, developers, contractors and subcontractors, are just now starting to experience in North America. The shift in market conditions is starting to be seen and felt in a number of different ways: increased underwriting scrutiny, a reduction in carrier appetite for projects with a heavy exposure to natural catastrophe, and/or unique means and methods (e.g., modular construction), an increase in rates, as well as tightening of terms and conditions (e.g., increased scrutiny regarding request for "the defective part" via LEG 3, requirements for higher water damage deductibles, etc.).

It's critical to understand that the builders risk market is very much in a state of transition and is starting to firm. As you prepare for your master builders risk renewals and/or budget your builders risk costs for an upcoming bid, it is imperative to factor in the additional rate/surcharge that will likely be required at the time of binding. It's also important to start considering alternative program structures, to ensure optimization of risk transfer at acceptable levels of cost.

Now, more than ever, it's critical to partner with an insurance broker that has successfully navigated through various market cycles and possesses a deep understanding of the shifting builders risk marketplace. Our North American Builders Risk Broking Team is comprised of dedicated brokers that specialize exclusively in CAR and EAR. Their deep level of expertise, coupled with their strong market relationships, position them to design and deliver comprehensive and competitive programs, regardless of market cycle.

Rate predictions

+5% to +10%

Professional liability

Rate predictions

Flat to -5%

Contractors and owners can take advantage of a competitive marketplace to procure policies with higher limit structures and better terms. Construction professional indemnity/liability has remained competitive into 2019. There continues to be more than a dozen carriers offering primary forms and several others which provide either primary or excess coverage. Total U.S. capacity is now in excess of $300 million with an additional $150+ million available through London, Bermuda and other international markets.

Contractors' professional

Consistent with 2018, we anticipate rates for 2019 contractors' annual practice renewals to remain flat to -5% or more, assuming good loss experience. Many contractors have taken advantage of market conditions and increased limits with favorable terms given the aggressive environment.

Due to competition in the marketplace, coverage terms continue to expand as carriers try to differentiate themselves in a crowded market. Product enhancements are consistent with the evolution of technology, delivery methods, and contractual terms and conditions. Protective indemnity and rectification coverages are now inclusive in standard forms offered by the key carriers, but terms and limits need to be carefully analyzed as they can vary considerably from market to market. Technology services have become a defined coverage component in the market in response to the changing exposures technology has presented from a professional liability perspective. Additional notable expansions include a few carriers offering sub-limits for "defense outside the limit," and even one carrier offering per-project aggregate limits – both traditional general liability coverage capabilities.

Owners' protective professional

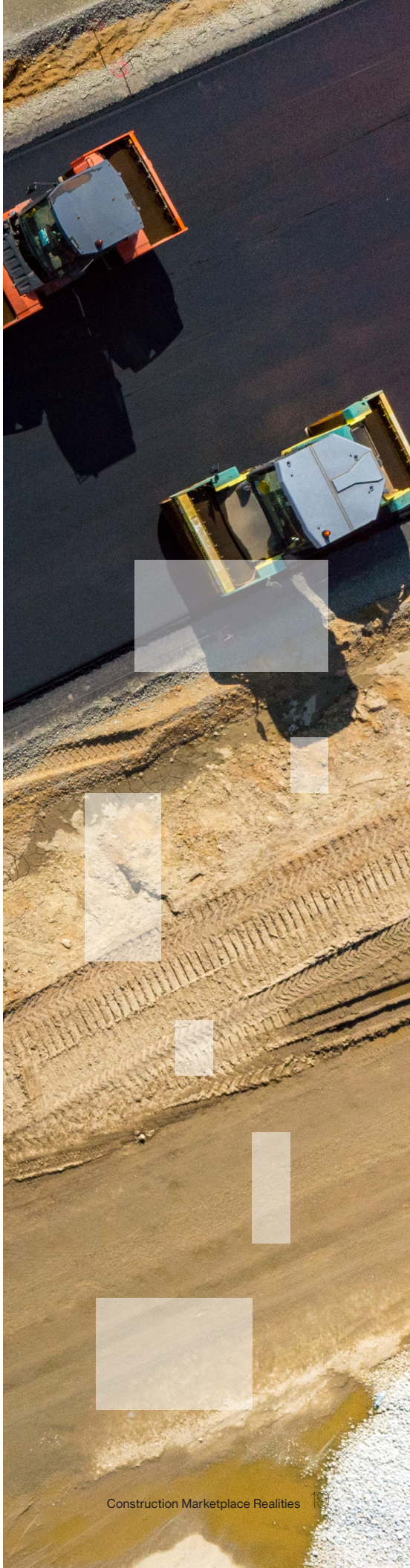
As project values continue to increase ($500M to $1+ billion-dollar projects becoming common), the corresponding risk of professional liability losses arising from construction and design professionals increases as well. Construction owners are very focused on this risk. Many contractors and design professionals do not carry limits which adequately address these now larger exposures and, as a result, owners are routinely purchasing owners' protective professional indemnity (OPPI) policies to allow for further project protection.

The marketplace for project-specific OPPI provides limits which attach above those contractually required of contractors and design professionals. This is a cost-effective way to build significant project-specific professional limits and has become the main alternative to expensive project-specific A/E policies. Traditional project-specific professional liability policies which cover all design risk on the job, can still be obtained, but typically are not put in place given the cost efficiency the protective products provide. Interestingly, while project values trend upward, we are also seeing increased interest in owners' protective professional for much smaller projects (down to $50M), driven primarily by market capacity and the product's cost effectiveness. In addition, there continues to be increased interest in rolling programs for owners engaged in regular construction activity.

Additional notable trends

- Late notice/reporting continues to be the leading cause for denial of claims, and it is important for clients to do an internal claim sweep at each renewal for any known circumstances or claims to avoid coverage impacts.
- Often rectification coverage requires carrier approval prior to action; it is important that clients recognize that these costs cannot be incurred prior to such approval, in order to preserve coverage.
- Residential projects continue to be the loss driver for professional liability insurers. This has created a small market of carriers willing to offer project-specific products to contractors, design professionals and owners. Condominiums are particularly challenging.
- Claims associated with civil engineering, such as firms providing geotechnical and structural professional services, are emerging as a significant concern of professional liability insurers.
- Professional claims in general are on the rise as the product matures, driven partially by the litigious environment in the U.S. and the adoption of the product by many more construction firms and owners over the last 15 years.
- Project-specific policies can now offer 10-year extended reporting periods post-substantial completion of a project. This takes the reporting period out through, or close to, the statute of repose in most states. At this point, it is unknown what impact these longer coverage periods may have on losses or market stability, as it takes years for these long tail placements to fully develop or establish any pattern of predictability.

In summary, construction professional indemnity/liability is very competitive with a growing product suite and aggressive underwriting. This year continues to offer opportunity for contractors and owners to take advantage of the competition to procure policies with higher limit structures and better terms to protect their balance sheets from the complicated claims associated with professional negligence losses.



Environmental liability

Rate predictions

Flat to +10%

With environmental insurance claims on the rise and the marketplace still offering ample carrier choice and appetite, insuring a business from a possible pollution condition at a job site is now seen as a business essential for all types and sizes of construction contractors and projects. The construction industry has experienced elevated exposures for both project/job site owners as well as for the contractor actually performing the work. This is largely due to differences in risk management perspectives, appetites and related controls from one project to another and an increase in claims/loss activity (such as those associated with pollution exposures during work and after completion, indoor air quality, Legionella, mold- and water-related issues, emergency remediation expenses, contractor-owned locations and "beyond the boundaries" scenarios, transportation and disposal of construction debris).

Being fueled by more than 40 environmental carriers competing for business in this space, market conditions are still generally considered "soft," which has inspired many to differentiate themselves by expanding coverage and competing on price in some instances. Carriers have also been thinking more holistically and strategically by joining forces with other lines of business to offer quotes for builders risk, professional, wrap-up, or even blanket practice programs where appropriate. In addition, site pollution and contractors pollution wrap-up products are being coordinated to address both pre-existing and construction-related exposures of project sites. In other exposure-based instances, rate predictions vary from flat to +10%, and the market is "hardening" in areas where carriers have less of an appetite and employ coverage restrictions based upon the type of work being performed, such as redevelopment projects (due to the high potential for the discovery or exacerbation of pollution conditions) and heavy habitational, hotel, hospitality and hospital risks (due to an increase in indoor air quality, mold, MRSA and Legionella-related claim activity).

The environmental insurance markets have become more adept at providing protection against the risk of uninsured or underinsured pollution losses and continue to provide viable and cost-effective insurance options and products to ensure more certainty and comfort around construction and contractor exposures.

Cyber liability

The cyber insurance market remains competitive with over 100 markets offering some form of coverage, and more than $600M of capacity available in the marketplace. Many carriers have released revisions and/or updates to their existing primary forms, in an effort to maintain a competitive advantage in the marketplace. While the cyber market remains competitive, carriers are beginning to push back on price decreases and some expanded terms, in particular relative to business interruption coverages.

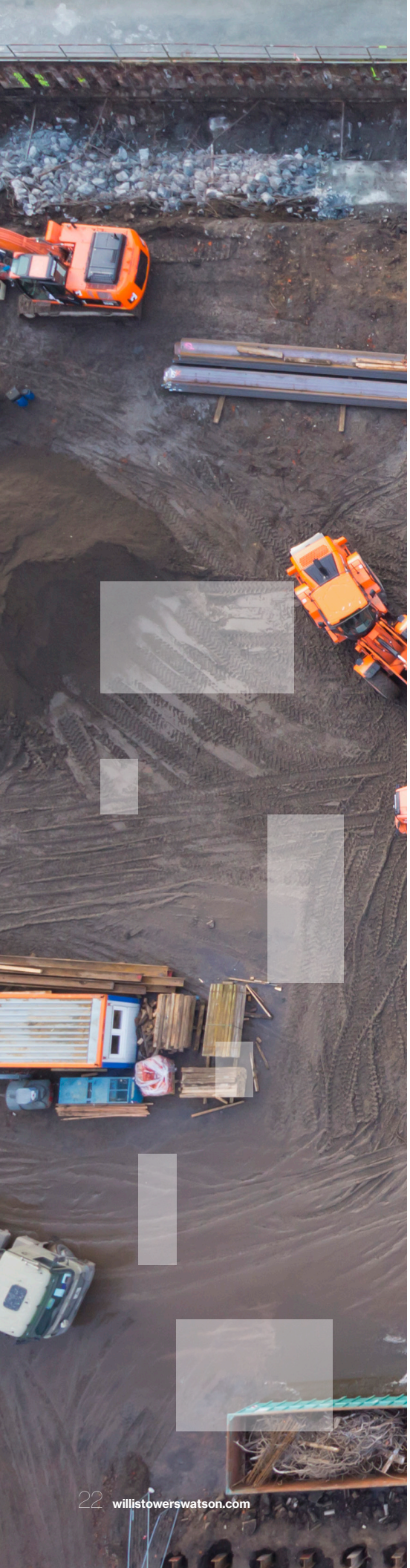
Expanded coverage, such as voluntary shutdown of a computer system, reputational damage and coverage for forensic accountants in the event of a business interruption event, remains available in the marketplace, as well as coverage for construction and engineering risks that include privacy claims due to drone usage, contingent bodily injury and property damage due to a cyber event, downstream contractual penalties, and missed bid/RFP coverage. As construction and engineering firms incorporate technology into projects, such as building information modeling (BIM), project management and design software, the exposure to cyber risk increases.

According to the 2018 Cyber Risk Outlook, cyber risk is becoming increasingly international, with cyber losses being reported in almost every country. The human element continues to be the leading cause of cyber risk, representing 61% of the claims included in Willis Towers Watson 2017-2018 Reported Claims Index. Insurers are observing two to three business interruption claims a year, with losses exceeding the waiting period.

Pricing in the cyber marketplace is expected to remain stable in 2019, with gross written premiums continuing to rise. A key question has been whether cyber should be a stand-alone product or included in other coverages such as property or general liability. While the issue has yet to be resolved, some carriers are taking a clear position regarding physical loss and how a cyber event could affect an insured's other policies, including property and general liability.

Rate predictions

+3 to +5%



Global construction
Marketplace update

Risk financing has become globally integrated over the last few years. Insurance companies are continuing to consolidate (AXA/XL for example) as they seek scale and market balance to offer true global solutions for the biggest companies. At the same time, the commoditization of core insurance products is driving innovation and new ideas for both traditional and non-traditional risks. This offers brokers and buyers the opportunity to look at risks differently and think of ways to finance risks that have not been widely used in the past.

Examples of where this global footprint is driving discussions of new ideas include:

- *Wider use of parametric solutions:* These products are based on financing events which can be measured as opposed to focusing on more traditional hazard-based coverage triggers. These include weather insurance triggered by rainfall amounts rather than provable delay or damage to a project.
- *Inherent defect insurance:* IDI addresses construction defects for up to 10 years after project completion and grew out of decennial liability coverage in France, which is mandated by law. Not surprisingly, IDI insurers are concentrated in Western Europe and particularly in France.
- *Impact of capacity for mega jobs for builders risk:* Builders risk is truly a global market; capacity remains very high in most markets, including Western Europe (Swiss Re, Allianz, Mapfre and others), Bermuda with major reinsurers who remain quite flexible even as other markets pull back from capacity and of course London. Builders risk and CAR facilities often follow global contractors wherever they have jobs and as a result it is not uncommon to have a non-U.S. market take the lead on a U.S.-based project. These global programs routinely have broad terms, including LEG 3 and broader design cover than U.S. lead placements, but that gap is narrowing as the U.S. market responds to be more competitive on terms. As this is being written, the impact of Brexit and major losses in the London market continue to create market uncertainty, but we expect that this will normalize over the next year.
- *Integrated casualty excess:* These programs have multiple lines of coverage (often general liability, auto, professional, environmental and employers liability as starting points) continue to be sought by large construction firms but are not widely put in place. There are active markets both domestically in the U.S. and globally that can offer terms for these types of programs, but there are few programs that are put in place. The positives are obvious with catastrophic protection across multiple policy lines, which should reduce coverage gaps and litigation across policies. In addition, there is the promise of efficiency of purchasing to drive down costs. On the other hand, the process of integrating the coverages can be cumbersome and expensive, so adoption of these programs is still not widespread.

- *Alternative covers for delay:* The global market tends to be more flexible in areas previously thought of as force majeure events. Recent examples of offerings include cover for cost increases and delays due to protests of certain types of jobs, inability to obtain permits and labor unrest. These remain fairly rare in the construction industry due to cost concerns but continue to attract attention from owners and contractors.
- *Efficacy and performance coverage:* These types of coverage have grown particularly in the energy space with the growth of renewable energy projects such as solar and windfarms. The coverage addresses the output of the project if it falls short of promised performance due to weather conditions as well as power demand. These have not been widely accessible for the commercial market or infrastructure to date but questions arise routinely about the availability of the products, so we expect more interest in the future.

Summarizing global market conditions, there continues to be significant capacity for most areas of insurance with many carriers pushing this capacity into local markets from the traditional centers of London or New York. This trend has accelerated with the recent uncertainty in the London market and offers alternatives which we expect will encourage innovation and a competitive environment long term.

Captives

U.S. construction's use of captive insurance company programs remains strong and crosses the insurance gamut from project-specific lines to core (practice) property and casualty into the less traditional, such as contractual warranty and self-insured medical stop-loss. Alternative risk transfer strategies are gaining a modest foothold in the construction industry. Acceptance and use of alternative collateral arrangements remain steady. With the hardening of certain casualty lines, carrier financial underwriters are imposing more restrictive collateral terms respecting LOC amounts and durations. We see insureds under high deductible or fronted casualty programs pushing against legacy collateral levels and also exploring other options, including carrier-approved reinsurance trusts, special escrows and security deposits.

Captives

Group captives (groups): Interest in group-based casualty captive programs has increased in recent years, driven largely by middle market-sized contractors wanting to consider market alternatives. Contractors transitioning from low deductible or guaranteed cost practice programs view groups as potential stepping stones toward risk assumption. Due diligence must include consideration of:

- Premium underwriting, buy-in capital and additional loss contingency assessments
- Adverse loss scenarios and pool performance
- Adequacy of coverage, terms and conditions (especially for homogeneous groups)
- Policy year closeouts and exit requirements

Potential participants are encouraged to partner with competent risk professionals in vetting these opportunities, as groups tend to be longer-term commitments.

Single-parent captives: Contractor-owned, single-parent captive programs remain strong and recent innovations are impressive, as owner-insureds tailor underwriting and risk assumption programs to the specific risk and insurance circumstances of their operations. Traditional captives remain the industry's risk management pick-up trucks, insuring a broad range of its owner's risk retentions or un(der) insured exposures. Stronger captive programs are often employed to underwrite project deductibles for large joint-venture projects where a CCIP is put into place or one GC partner assumes the insurance lead and assumes the risks. For owners and developers, captive access to the federal terrorism program (TRIA, TRIPRA, etc.) via reinsurance remains in high demand for high value, high visibility projects. For developers, there is some use of captive cell segregation techniques to provide Chinese walls between individual projects and facilitate insurance closeouts as finished projects enter permanent financing or investment portfolios.

Small captives: Often referred to as 831(b)s or "micro-captives," these are U.S. *federal tax qualifying* insurance companies that elect, under Internal Revenue Code §831(b), to be taxed solely on investment income; all underwriting activity is exempted from federal tax.

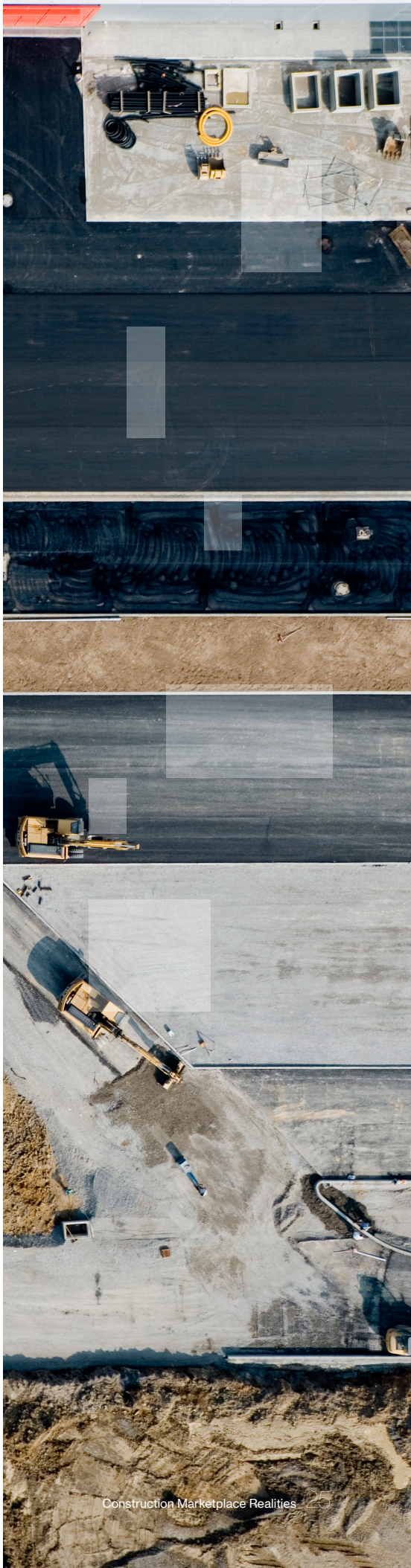
We do see sound, small captive programs being formed and operated as true risk management mechanisms where there exists sound risk underwriting, good tax facts and circumstances, a risk control and facilitation mindset, and high-quality management and governance. Higher severity/lower frequency coverages, such as subcontractor default, high deductible builders risk, professional and pollution, and WC and casualty deductible buy-downs are the most common.

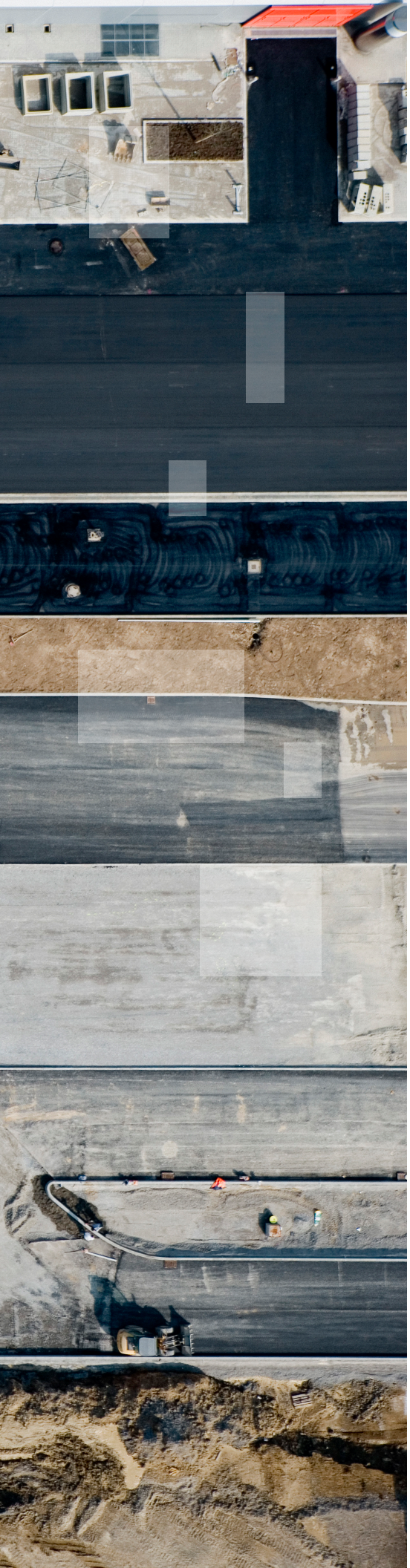
Alternative risk transfer

Alternative risk transfer (ART) shows some signs of industry interest where risk exposures are large, traditional insurance is limited and pricing severe.

We do see the development and placement of non-traditional, insurance-based approaches and products that have applicability to construction and development. Areas generating the most interest include:

- **Weather-related parametric triggers:** Large projects or properties that are geographically climate sensitive areas are good candidates. However, because these products respond to causal events and not direct losses, in the past they may have resulted in a triggered payout where the insured did not actually suffer a loss and, of course, vice versa (basis risk). Modern data capture has addressed a great deal of that basis risk. The contracts can also be "insurance" where indemnity is validated by simple insured certification or as "derivatives" where the prospect of a gain is acceptable.
- **Multi-year, multi-line integrated risk placements:** In the construction industry, pricing and terms are not yet uniform, and clients must become comfortable with aggregated limits across lines of business. Aspects such as clarity on terms, including deductibles, deductible erosion, clash issues, potential specific coverage and sub-limits must also be addressed – the expected ultimate loss value determination, administration fees and collateral to remain consistent with traditional policy constructs, as these programs do not replace primary casualty risks (WC, GL, AL).
- **Structured (re)insurance:** Today, new accounting rules are significant speed bumps, but the strategy is still quite popular albeit in more sophisticated constructs. Industry examples include "buffer" arrangements for New York general liability on large projects (addresses low insurer appetite for Labor Law risk) and, on a much smaller scale, "matching deductible" covers for first and/or second level primary placements, where an insured wants to push up insurer attachment levels, yet needs evidence of lower retentions for contractual purposes.





Alternative collateral arrangements

Insureds seeking alternatives to LOCs can generally find carrier-supported options in the form of reinsurance trusts, escrow accounts and special deposits. We encourage insureds to pay close attention to the policy payment or collateral language and mechanics. Use of loss paying or depleting accounts is usually preferable since the account balance secures unpaid loss obligations and is also used to pay claims. These arrangements work well with single-parent captive insurance programs that fund the same deductible losses that the accounts secure to the carriers, avoiding “doubling-up” where captive loss premiums and carrier collateral exist concurrently to back, essentially, the same losses.

Contact

Kelly Kinzer
Construction Broking Leader, North America
+1 763 302 7250
kelly.kinzer@willistowerswatson.com

Bill Creedon
North America Construction Industry Leader
+1 303 803 9125
bill.creedon@willistowerswatson.com

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