

Firming in the Construction Insurance Marketplace

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To manage risk, a company likely draws on two key risk management areas. The first is the use of risk controls or those solutions that prevent and mitigate risk. The second is the use of risk finance solutions which provide capital in the event certain risks manifest and cause damage (financial loss) to a company. These two risk management areas feed each other. Those solutions that we utilize to prevent and mitigate risk (the risk controls) reduce the likelihood and severity of claims against the risk finance solutions. From a risk finance perspective, the claims made against the risk finance products are a rich source of data which can be utilized to create new and improved risk controls. The interplay between risk controls and risk finance is a virtuous cycle of risk management and all organizations involved in the construction sector should ensure these two risk management areas are closely linked and continuously improve the risk management platform for your organization and for the projects that are part of your organization.

In recent years there have been several trends within the global construction marketplace that have created a deterioration of risk control implementation and we are now seeing signs that the marketplace for risk finance is beginning to firm. Risk finance products like professional liability, property insurance, casualty insurance and subcontractor default insurance are all showing signs of price firming in most global regions (firming represents the beginning of what could be a hard insurance marketplace – a term used by the insurance sector which denotes the capacity for risk finance is shrinking and thus the cost of risk financing is going up or the coverage under the risk finance solutions is being limited). Stakeholders within the construction sector can expect to see some firming in the areas mentioned above, or in the least they can expect to be asked for more information from their brokers (on behalf of their insurers) in order

to better assess the risk and perhaps avoid price increases or coverage limitations. All stakeholders should do their best to understand not only which insurance product lines will be firming (and where), but they should also be asking their broker partners and insurance carriers what is causing this firming of risk finance terms? It is only through understanding the causes of price firming can the industry put in place the appropriate risk controls to bring the market back to a softer position.

It should be noted that there are factors outside of the construction sector also driving market firming – for instance the significant losses suffered from natural catastrophe events like wild fires and flooding (extreme weather is taking a toll on insurers). Outside factors aside, the following are some of the high-level trends from within the construction sector that appear to be driving market firming:

1. **Low Margins** – The global construction marketplace is experiencing margin deterioration on a global scale. Several factors are contributing to lower margins but the key point for the purposes of this article is risk increases in a lower margin environment.
2. **Labour Shortages** – Both the design and construction sector are experiencing a deterioration in the quality of their workforce. Several of the most experienced members of their workforces are retiring and the supply of experienced labour isn't there to replace these workers at the pace they are retiring. Less experience leads to greater risk.
3. **Interaction Between Design & Construction** – The global construction marketplace has been flooded with several new construction delivery models and many are creating communication disruptions between the design community

(the plan) and the construction community (the execution of the plan). More collaboration and improved communication between these two communities would help improve losses being suffered by insurers. NOTE: Some of the delivery models being utilized have the construction stakeholders bidding work where very little design work has been executed (“Fast-Track Design” is a term often utilized). The industry should look very closely at this trend as it seems to be a root cause for many losses suffered by the construction sector insurers.

4. Project Size and Complexity – Projects have become more complex and that complexity brings additional risk. In addition, we see more large projects and larger projects can cause bigger losses which lead to claims against insurance policies that erode the entire policy limits.

5. Lack of Technology Adoption – There are several new technologies coming to the market that can significantly reduce risk, however, construction stakeholders are slow to adopt these solutions. The industry is trying to adopt these technologies, but it appears that there are so many technology choices in the market it could be hampering adoption (too many options leads to paralysis of decisions). In addition, lower margins within the industry do not help with innovation adoption.

6. The “Level Playing Field” Assumption – When bidding against your competition do not assume you are bidding against a competitor that is using the same labour, material, technology, supply chain, etc., that you are. In an age of massive change with so many solutions coming to market that can help increase productivity and reduce risk, never assume you are on a level playing field and always strive to learn about the competitive solutions in the marketplace to drive improved bidding terms.

7. Owner Engagement – Construction experience within the owner community is also contributing to increased frequency and severity of insurance losses. Owners’ should find ways to accelerate their employee’s knowledge around construction risk and construction procurement models. In addition, owners should look at models that improve communication and collaboration amongst all parts of the construction value chain.

In closing, the insurance sector is beginning to firm so be prepared (for more detailed information have a look at the Global Market Review and Market Outlook document linked below. <https://www.aon.com/getmedia/4770f346-3fd8-44cb-8bab-14ed92543a3b/Global-Construction-Market-Update-Report-2019.aspx>

There are several factors driving the insurance sector’s firming so ensure you understand these factors and be prepared to help your insurance carriers understand how your firm, or your project, is addressing these factors through use of strong risk controls that help prevent and mitigate risk.

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