THE CRISIS IN INSURANCE

Insurance premiums for the construction sector have increased by as much as 300% over the last three years. The industry asks why.

BY SHANNON SUTHERLAND

WHEN YOU ASK A CONTRACTOR FOR his thoughts on insurance, you risk the kind of response you might get from Chef Boyardee on the low-carb Atkins diet.

Unless you want to learn some inventive new adjectives that will never make it into the Concise Oxford Dictionary, don't bother inquiring.

Over the last several years, insurance premiums have increased, in some cases exponentially, and deductibles have exploded upwards, even as coverage has dwindled or simply disappeared. Through the 1990s, the cost of insurance was an accepted expense that was, for the most part, fairly predictable and stable. The insurance industry wasn't making a ton of money off of their construction clients, but earnings from investments were providing some padding and there was cash aplenty, so there was little need to upset the applecart.

Unfortunately, that applecart took a very serious hit about the same time as the twin towers came crashing down in 2001. In New York, where the disaster hit closest to home, insurance premiums increased by up to 500% in a single year and some contractors couldn't buy insurance at any price, according to the New York State Construction Industry Council. Commercial property insurance premiums here at home have increased by 42% over the last three years, according to the Insurance Bureau of Canada (IBC), and those in the construction industry have been particularly hard hit with increases of up to 300% or more.

"The insurance industry came off a 12-year period of intense competition that pushed rates down during which the insurers underwriting results were propped and supported by solid investment gains in spite of a deteriorating loss scenario – more claims, larger claims, higher litigation costs," says Garth Lane, construction practice leader for Lloyd Sadd Insurance Ltd. "This was being addressed and changed in the final quarter of 2000 and early 2001 as we began to see rate increases, but this was exacerbated and accelerated by 9/11.

"Not only were insurance companies increasing prices, but they were also deciding what businesses they wanted to write, and when we got into a hard market, many vacated the construction marketplace," he says.

Those in the insurance industry, of course, were quick to provide explanations, which essentially boiled down to, "Hey, it's just business."

"The insurance industry needs the capital to pay claims, and an insurance company has to be in a position to pay any and all outstanding losses on any given day," says Louise Bremness, manager of regional services for the IBC in Edmonton. "Increases weren't created because of personal greed, but because there was a need for capital, so they can pay losses. In the commercial marketplace in particular, there are bigger risks and higher needs."

Insurance companies were doing exactly what they encourage their clients to do – they were managing their risks by proving some padding in their underwriting agreements given the greater potential for payouts to the construction industry.

There's no denying that the insurance industry is hurting. In 2000, 21% of the industry reported over-

PHOTOGRAPHY BY JOHN GAUCHER

"Proven adequate management processes, track records and financial strength are very important factors."

Leo Ducharme
SENIOR ADMINISTRATION MANAGER
PCL CONSTRUCTION MANAGMENT LTD.

all losses, according to IBC statistics, and about 33% reported losses in 2001. Between 1999 and 2003, 32 federally regulated personal and casualty insurance companies ceased activity in Canada.

While there won't be a return to a soft market any time soon, commercial insurance buyers said the cost of property insurance fell almost 9% in the fourth quarter of 2003, marking the first decline in premium prices in any major line of commercial insurance in nearly four years, according to the Risk and Insurance Management Society (RIMS) benchmark survey, an industry survey of market conditions in North America.

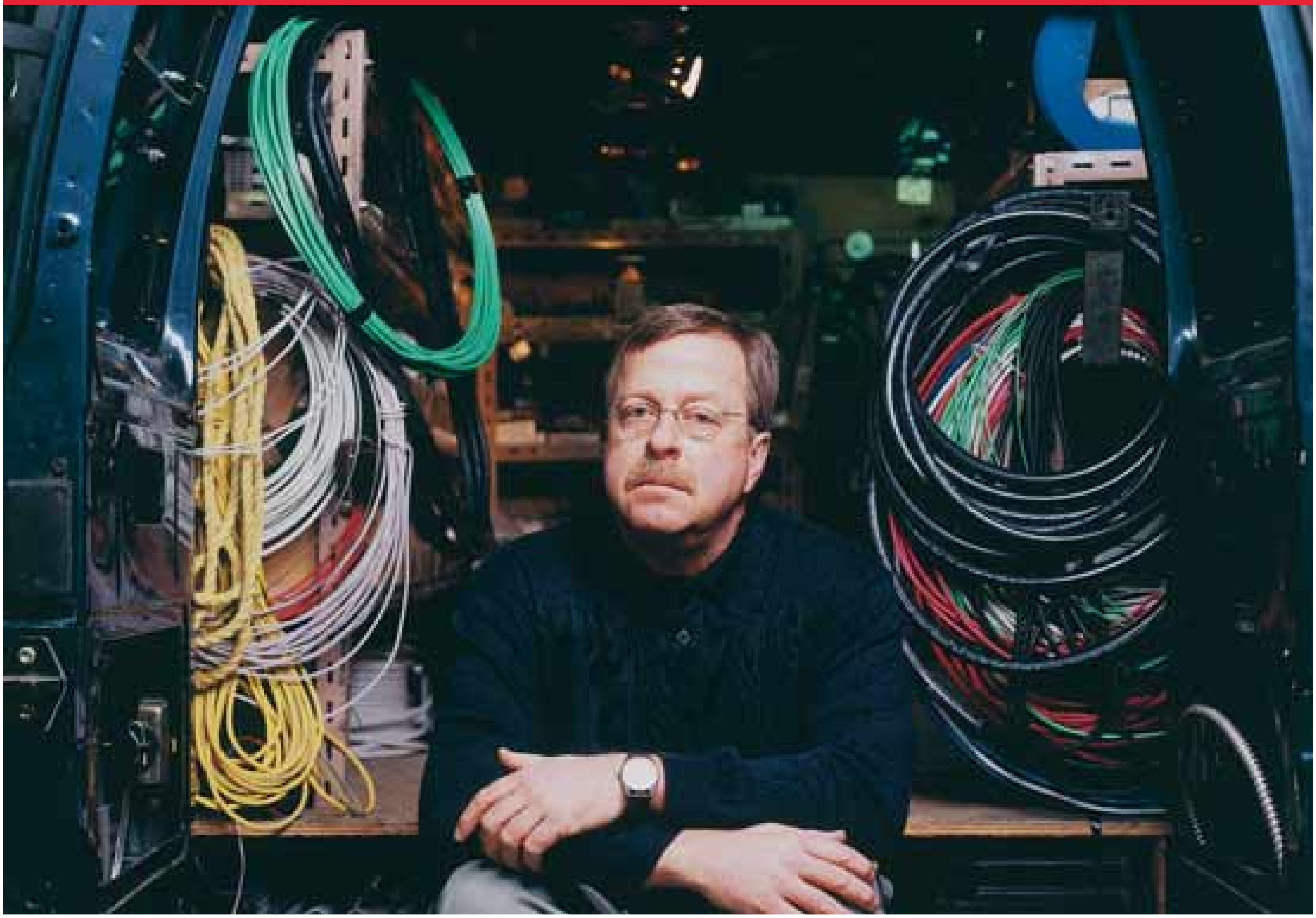
That's little comfort to electrical contractor Don Daly, however.

"People say it's starting to stabilize, but what good is stability when our insurance costs have already increased 300%?" asks Daly, president of Territorial Electric Ltd. in Edmonton. "If we hadn't put our safety program in place 10 years ago and managed it and streamlined it since, doing everything we can to limit our liability, I seriously doubt we'd still be in business."

Creating and effectively administering risk management programs and coming up with a convincing underwriting presentation is instrumental for those in the construction industry trying to manage premiums, deductibles, bonding and coverage.

"Our approach was that you may still get a rough, rude increase, but with a strategic, intelligent and collaborative process, you'd still get coverage," says Lane.

"An underwriting presentation is the most pivotal, important and strategic document in your insurance portfolio," says Lane. "The insurance company needs to understand why they should expose their capital to get your construction account. It will tell them who you are, what you do, what makes you great and why you are a good account. Insurance companies hate the 'general' part of general contractors. It makes them nervous, and most general contractors have specialties so you want to tell them exactly what it is you do. You want to differentiate yourself. If you land



"Between 2002 and 2004, our liability insurance has increased threefold."

Don Daly
PRESIDENT
TERRITORIAL ELECTRIC LTD.

on the underwriter's desk as just another contractor, you won't get any individual attention and if he does underwrite you, it will be on an average basis.

"You want to act as if you're going to someone for financing capital," says Lane. "Insurance is financing and you have to treat it just as seriously. It's just like going to see your banker. Have all your financials ready and be prepared to address concerns. This wasn't required in a soft market, but it certainly is now."

The insurance industry has a terrific memory, and it's not ready to forget about past unpleasantness such as mould litigation, massive losses to theft, roofing-related fires or terrorism threats. Liability insurance, however, isn't the only type of insurance that has been taking a bite out of the bottom line.

"Bonding has become harder to get. Proven adequate management processes, track records and financial strength are very important factors," says Leo Ducharme, senior administration manager for PCL Construction Management Inc. in Calgary.

Some contractors have been hit harder than others. If you want to see a roofer's sunny disposition turn foul faster than a tornado can take out a trailer court, ask him what he's paying for liability insurance.

"It isn't unheard of to learn that a roofer paying $25,000 three years ago (in annual insurance premiums) is paying up to $300,000 now," says Mark Jarosch, owner of Standard Roofing Company Inc. in Edmonton and a member of the Alberta Roofing Contractors Reciprocal Insurance Exchange. "There used to be a handful of insurance companies that covered roofers, but now there's only one or two."

No one is sure how many roofers were actually forced to close their doors, but everyone is aware the situation was – and still is – desperate.

"Some were close to losing coverage, and many accepted very large premium increases," says Lane. "There are groups of roofers that have formed self-insurance mechanisms to meet these issues. Everyone had cost, price and rate issues. Smaller contractors probably felt like they had less ability to deal with the changes."

The Alberta Roofing Contractors Reciprocal Insurance Exchange was formed last July in an effort to provide roofers with another option for coverage. A reciprocal is an alternative to conventional insurance where members share the risks, pool their premiums and pay claims out of their own funds. Establishing a reciprocal means that premiums are paid into the members' own insurance company as opposed to turning to Bay Street in downtown Toronto. It may sound simple, but it's really not. Setting one up takes a great deal of time, patience and cash. Such an agreement is not meant to cover small losses, so deductibles are still high at between $10,000 and $25,000, but at least the roofers now have another means of purchasing adequate insurance coverage.

Although roofers lobbied aggressively to try and address the issue of insurance, the roofers' relationship with the insurance industry has continued to deteriorate, but Bremnes says roofers were not singled out.

"There has been a lot of talk that certain segments of the commercial industry were targeted, but no one was targeted," says Bremness. "Changes were reflective of overall claims and capitalization."

Roofers weren't the only ones that turned to self-insurance, however. For many companies self-insuring simply meant accepting more risk.

"Other contractors are reviewing their coverages, questioning some types of insurance carried, the limits carried and the deductibles on the programs," says Lane.

He says generally the deductibles are very low – $1,000 to $5,000 – but company leaders should do a retention analysis and determine what size of loss is meaningful to the organization since passing small losses off to insurance is not a good long term strategy.

Some contractors, including Brad Wright, president of Total Integration Inc. in Edmonton, say they are considering divesting certain assets to reduce insurance costs.

Wright says not only did his general liability insurance increase by about 14% over last year, but his vehicle insurance also increased 29% thanks to two fender benders, and he's now considering disposing of his fleet to create a situation where the opera-

"An underwriting presentation is the most pivotal, important and strategic document in your insurance portfolio. You want to act as if you're going to someone for financing capital. It's just like going to see your banker," suggests Garth Lane, construction practice leader for Lloyd Sadd Insurance Ltd.

"We are not always able to reduce premiums but we can reduce operating costs."

Doug Harrison
ADMINISTRATION MANAGER
STUART OLSON CONSTRUCTION LTD.

tors become the owners.

"We anticipated increases in our general liability and vehicle insurance, but we certainly didn't foresee double digit increases again," says Wright. "We haven't been able to flow through the costs to our customers, so we've had to do some belt tightening. Insurance has become a major input cost to doing business, and we might have to do a cost benefit analysis to determine what our best options are."

Contractors are just doing what they can to keep managing their insurance as best they can, but to a certain extent Daly says contractors just have to "suck it up."

"How do you keep insurance costs down? I have no idea," says Daly. "Every year we go out to the market, and every year the rates have gone up. It's astronomical, and the level of service certainly hasn't followed the rates. Between 2002 and 2004, our liability insurance has increased threefold, and it's cutting into the bottom line – that's for sure. And I don't see it changing any time soon.

Risky Business

There's no getting rid of risk.

The most one can do is manage it, and that has become an absolute necessity given today's difficult insurance market.

Not only have premiums increased, but deductibles also exploded upwards, says Doug Harrison, administration manager for Stuart Olson Construction Ltd. in Calgary. He says deductibles for theft and vandalism at Stuart Olson, for instance, went from $2,500 to $5,000 to $25,000. Putting risk management procedures and processes in place has helped, because Stuart Olson is now able to present underwriters with a document that outlines exactly how the company operates on site.

"Ensure that you have a full, broad, company-wide safety program," says Garth Lane, construction practice leader for Lloyd Sadd Insurance Ltd. "Show how it has worked and has been successful. Be prepared to show minutes from safety meetings. Can you show how your safety program has impacted your loss profile? Today underwriters want to see how your approach to loss prevention is handled in your organization. Good luck is not going to be enough today."

Stuart Olson saw significant increases in the costs of insuring wood frame projects, for instance, so the company now employs full time watchmen to combat concerns of theft, vandalism and arson. That prompted the company's underwriter to reduce the deductibles. And to reduce some of the costs of employing a watchman, company administrators negotiated with the underwriters to waive the need for a watchman once the doors and windows were installed and they were better able to secure the work site.

"We are not always able to reduce the costs of the premiums and we may not even be able to reduce our deductibles, but we can still reduce our operating costs," says Harrison.

While theft and vandalism are one concern for those in the construction industry, there are dozens of potential risks and addressing these formally may give a contractor some bargaining power with an underwriter. A few potential risks to consider in an underwriting presentation and risk management program include:

- multiple work sites
- mobile equipment which is often very valuable
- outdoor work with susceptibility to weather and theft
- the use of potentially dangerous equipment
- a higher-than-average amount of new and untrained employees
- projects that are often at the mercy of unpredictable conditions including those of the ground, weather and labour supply.
- work that is time-sensitive and vulnerable to strikes, subcontractor failure and other delays
- vulnerability to financial markets.