



**Report to the Construction Sector
Unit (CSU), Department of Trade
and Industry (DTI)**

**A scoping study
looking at the
difficulties
construction
contractors face in
obtaining insurance**

DAVIS LANGDON CONSULTANCY

Acknowledgement

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1 **Executive summary**

This report has been commissioned by DTI following considerable media coverage and representations by trade organisations since summer 2002 of the apparent difficulties contractors face in obtaining insurance. There are currently other studies, including the Department of Work and Pensions (DWP) review of Employers Liability and the Office of Fair Trading (OFT) study into UK liability insurance market.

The aim of this scoping study is to provide DTI with a clear understanding of the nature and extent of the difficulties facing contractors in obtaining and maintaining adequate insurance. Our approach involved liaising with key players within both the construction and the insurance industry to provide a balanced view of the main issues, problems and possible solutions rather than a comprehensive investigation (*see section 2*).

The key difficulties that contractors have been experiencing since summer 2002 are broadly:

- Limited availability of cover (*see section 3.2.1*),
- Increases in the cost of cover (premiums) (*see section 3.2.2*),
- More stringent conditions (*see section 3.2.3*), and
- Shortcomings in underwriting discipline (*see section 3.2.4*).

These difficulties have arisen following broader changes in the global financial and insurance markets as well the construction market itself. These changes have affected many industries, however, given nature of construction-related risks and its track record in health and safety, the impact on contractors has been more significant. The key recent developments in these fields include:

- trends in the general insurance and financial markets, including terrorism losses following the September 11, 2001 World Trade Centre (WTC) (*see section 3.4.1*),
- changes in legislation and costs of insurance (*see section 3.4.2*),
- limited capacity within the construction insurance market (*see section 3.4.3*), and
- the track record (and perception) of construction firms, especially with regard to health and safety and risk management (*see section 3.4.4*).

Construction organisations, in collaboration with the government and insurance organisations, have an opportunity to alleviate the current difficulties as well as enhance the overall performance of the industry by:

- exploring alternative insurance arrangements (*see section 4.2*),
- improving risk management (*see section 4.3*),
- promoting best practice (*see section 4.4*),
- reviewing structural and legislative aspects (*see section 4.5*), and
- engendering longer-term relationships (*see section 4.6*).

Insurance is essentially a form of risk management and accordingly, the study also investigated the nature of risk management within construction as well as its health and safety aspects. Risk management presents a significant tool in enhancing a company's health and safety performance as well as its business performance. It is essential therefore, that rigorous risk management is practiced, not only because of the discipline that insurers or legislation may impose, but also because it makes good business sense.

2 Introduction

2.1 Background to the study

2.1.1 Construction insurance

There has been considerable media coverage since summer 2002 of the apparent difficulties contractors face in obtaining adequate and cost-effective insurance. In addition, contractors and their trade associations have been making representations to government - through formal submissions, correspondence and verbal briefings – about these difficulties and their implications. Their key concern is that the apparent lack of widely available, cost-effective insurance for contractors could result in more firms withdrawing from certain activities, ceasing to trade altogether or trading illegally.

The construction media and the contracting sector are in general agreement that the key difficulties contractors face include:

- Limited availability of cover
- Increases in the cost of cover (premiums)
- More stringent conditions
- Shortcomings in underwriting discipline

The key issues in respect of these difficulties appear to be:

Limited availability of cover

Reported difficulties range from contractors being unable to obtain cover for some or all of their works (and in some cases, unable to get a quote) to obtaining cover with increased restrictions on the types of works that can be undertaken. The situation appeared particularly acute for certain activities/trades classed as high-risk.

Increases in the cost of cover (premiums)

Contractors report that they have faced substantial increases in their insurance premiums over the past 12 months or so. The construction press has quoted figures of up to 1500%¹ for some companies. The rise in costs of insurance premiums appears to have affected both large and small companies, but the impact is reported to be more significant for the smaller businesses.

More stringent conditions

In addition to increased premiums, contractors report that their excess levels have also increased, and that they are obliged to agree to more restrictive conditions in order to obtain cover. They argue further that policies are increasingly written in favour of insurers who reserve the right to cancel or alter them.

A particular concern of contractors is that the pricing of premiums does not always seem to reflect their claims experience or the risk management measures they have taken.

¹ Broughton, T. (2002) cites increases of up to 300% for NSCC members and 500% for NFB members, whilst Cowan, E. (2002) quotes a 1500% increase for some roofers.

Shortcomings in underwriting discipline

Contractors report their concern that not enough notice was given by insurers about proposals to increase premiums or vary conditions. Many report that they receive renewal notices shortly before the expiry date, making it difficult to seek alternative cover or to budget appropriately.

All these issues are dealt with in more detail in Section 3 below.

2.1.2 Broader developments

The situation facing contractors reflects broader changes, both in the construction insurance markets, the wider insurance market and the national and global financial markets.

Significant recent developments in these fields include:

- Losses in the general insurance and financial markets
 - Continuing losses in the public liability classes of insurance
 - Poor stock market performance
 - The attack on World Trade Centre (WTC) on September 11, 2001 and associated terrorism losses
 - Directors and officers (D&O) liability losses following the collapse of Enron
 - Reduction of reinsurance capacity
- Changes in legislation and costs of insurance
 - Retrospective law reforms
 - Increase in occupational and ‘long-tail’ diseases
 - Increase in level of damage awards and costs of compensation
- Limited capacity within the construction insurance market
 - Collapse of Independent Insurance Company Ltd
 - Withdrawal from construction insurance by major providers
- Continuing poor track record of some construction businesses, in particular as to:
 - health and safety
 - risk management.

All these issues are dealt with in more detail in Section 3 below.

2.2 Aims and focus of the study

It is against this background of change in the construction insurance market and developments in the broader insurance sector and financial environment that Davis Langdon Consultancy (DLC) was commissioned by the Construction Sector Unit of the Department of Trade and Industry (DTI) to undertake a short scoping study into the difficulties encountered by construction contractors in obtaining and maintaining insurance.

The aim of the study was to assist DTI by:

- establishing the nature and extent of the difficulties contractors face in obtaining a range of different types of insurance, and of the steep rises in many insurance premiums
- providing a clearer understanding of the reasons for the problems facing construction firms, large and small, in terms of both insurance market aspects, operational practices and developments within construction itself, and

- suggesting how the industry could better represent its approach to risk assessment, management and control to the insurance industry, in ways that would help insurers better assess premiums.

The study commenced in mid November 2002 and was complete by the end of January 2003. During the course of this study, the government has held meetings with insurance and construction industry organisations. There are currently other studies, including the Department of Work and Pensions (DWP) review of Employers Liability and the Office of Fair Trading (OFT) study into UK liability insurance market.

2.3 Study approach and consultation

2.3.1 Overall approach and study design

Our approach to this study was dictated by DTI's need to have an initial review of the issues, problems, market perceptions and possible ways forward, rather than a comprehensive investigation. We designed the study to identify and provide a balanced view of the main issues, problems and possible solutions, via two main lines of enquiry:

- A desk review of available literature and recent media reports on the current situation, and
- Structured consultation with key representatives of the contracting and insurance sectors, including contractors of different sizes, their representative bodies, insurance companies, brokers and agents.

2.3.2 Approach to consultation

Resources for consultation were limited to some 20 organisations. In the event, we consulted a total of 29, using a combination of structured interviews and self-completion questionnaires. Interview outlines and questionnaires were designed to elicit a mixture of quantitative and qualitative data on recent developments in the construction insurances market (including cost and price increases, availability of cover, etc). A sample questionnaire is presented in Appendix D.

A breakdown of the types of organisations consulted is provided in the following table 1, and further details of organisations interviewed are given in Appendix B.

Table 1: Consultation summary

	Interview	Questionnaire	Interview and Questionnaire
Insurers	2		
Brokers	1	2	
Insurance industry representative bodies	4		
Contractors		10	2
Construction industry representative bodies	7		
Health and Safety Executive (HSE)	1		
TOTALS	15	12	2

Seven representative bodies in construction were consulted: The Construction Confederation (CC); National Federation of Builders (NFB); National Federation of Demolition Contractors (NFDC); Federation of Master Builders (FMB); National Specialist Contractors Council (NSCC); National Federation of Roofing Contractors (NFRC); and National Access and Scaffolding Confederation (NASC).

The contractors consulted represented a cross section of small and medium-sized firms, employing between 2 and 900 people (having turnover in the range £160K to £60M).

We further consulted two major insurers, (who target both small contractors i.e. with turnover under £2m, and large contractors), three brokers/agents, and four insurance industry representative bodies: Association of British Insurers (ABI), British Insurance Brokers' Association (BIBA), General Insurance and Standards Council (GISC) and Lloyd's Market Association (LMA).

2.3.3 Basis of findings

The study findings presented in this report are therefore based on a review of current literature and limited consultation with key players in the construction insurance market. The focus of our consultation with construction sector representatives was mainly on the problems experienced, and our consultation with the insurance industry sought some verification of these problems and their underlying causes. We also sought views on possible ways forward, given the current situation.

It should be noted that our findings are not definitive, nor are they intended to be. They provide an indication of the nature and extent of the difficulties contractors face in obtaining insurance in the current market, and help improve understanding of the reasons for such difficulties. They also indicate possible ways forward, though it was not part of our brief to undertake an evaluation of any of the options suggested.

2.4 Scope of the study

The study concentrated on construction contractors based and operating in the UK. It covered general building (including housing), civil engineering projects and specialist trades. It took into account the different sectors, types and sizes of contracting firms.

The study focused on those types of insurance that are relevant to contractors and are necessary for the proper functioning of a contractor's business. The study did not look specifically at professional indemnity except in so far as it relates to contractors' liabilities in contracts where they have design responsibility.

In particular, the study covered:

- **Employers Liability Insurance (EL)** – a compulsory insurance covering liability for injury, disease or death of employees as a result of and in the course of their employment.
- **Public Liability Insurance (PL)** – covers liability to the general public and third parties for legal liabilities and loss arising out of negligence, nuisance etc as a result of business activities.
- **Contractor's All Risk Insurance (CAR)** – usually a first-party 'material damage' insurance covering all works, excluding defective designs, planning, specifications and materials.

- **Professional Indemnity Insurance (PII)** – insurance covering liability for design (relevant to contractors that have design responsibility, e.g. in design and build contracts).
- **Motor Insurance** – a compulsory insurance required when using motor vehicles on the public highway for business activities.
- **Products Liability Insurance** – insurance for materials in transit and for plant, materials etc on site
- **Commercial Property Insurance** – insurance to cover damage to real property

In addition to insurance taken out directly by individual contractors, we explored alternative insurance arrangements that bring all those involved in a construction project under an ‘umbrella’ policy and hence provide a single point of responsibility for risk management. These included: Pooled/mutual insurance; Captive insurance; Single project insurance; and Client/principal effected policies. These are discussed further in Sections 3 and 4 below.

The study also looked at risk management and health and safety issues within the construction industry, and how these could be used to alleviate the difficulties experienced.

3 The current scene: market perceptions

3.1 Introduction

The representative bodies began receiving calls from members complaining about their difficulties in obtaining insurance in Summer 2002. Many of their members complained that despite no significant change in their claims experience or necessarily undertaking work that was more hazardous than they previously had, they were subjected to high levels of premium increases and in some cases, could not obtain renewal on their expiring policies. The initial reason given for the increases was the World Trade Centre (WTC) attack on September 11 2001. However, this was later found to be only the tip of the more fundamental causes of the problems (refer to section 4).

The representative bodies were particularly concerned that their members would not be able to continue working on on-going projects or possibly go out of business if they could not obtain or afford the necessary insurance. Many of the trade bodies contacted government whilst others also conducted quick surveys to confirm the difficulties.

3.2 Varying perceptions of the current difficulties

Contractors have been faced with difficulties in obtaining and maintaining their insurance since summer 2002, as outlined in section 2.1.1. The following section summarise comments from the respondents about each of these difficulties.

3.2.1 Limited availability of cover

Following the September 11 (2002) attacks, the construction trade organisations claim to have observed that insurance companies are reducing the breadth and scope of coverage, available coverage limits and in some cases, refusing to renew or write certain types of risks or lines of business. They feel that this places their members in a particularly difficult position, especially with regard to the compulsory Employers Liability (EL) insurance.

Although many of the trade organisations we spoke to mentioned that there were companies who were refused cover², we were unable to get any hard evidence of companies unable to obtain cover except from NFRC who had suspended a member for lack of cover.

Although EL is compulsory, insurers are not obliged to provide it. Nevertheless, the ABI claimed that all those who required insurance were able to obtain or at least get a quote, albeit a high one.

The construction insurance market is a specialist sector and our estimation is that it is a limited market and that buyers do not have much choice. There has been a reduction in liability insurance, particularly for the high-risk sectors, as outlined in section 3.3.1. For instance, we have been informed that there are only 2 primary underwriters prepared to consider new demolition contractor liability enquiries in the UK, following the withdrawal of about 4 to 8 'traditional' primary liability demolition insurers. A full survey would be required to establish the capacity (i.e. both number of insurers and value of policies) within construction.

3.2.2 Increases on cost of cover (premiums)

With regard to costs, the contractors we consulted have been faced with increases in premiums ranging from 10% to 500%, as well as substantial increases in excess levels (see section 3.3.2 below). However, we have not been able to validate the increases of up to 1500% quoted by trade journals.

It was difficult to obtain data from insurers regarding the premium increases for each class of insurance provided to contractors, as they do not necessarily collect the data in that format and the increases would vary for sector and for each client. Nevertheless, the rates they mentioned (30-53%) were much lower than those cited by the contractors in our study (10-500%). A full survey would need to be done to ascertain the precise level of increases.

Nevertheless, the main classes of insurances affected are the Public Liability (PL) and the compulsory Employers Liability (EL) that a business requires in order to employ staff and operate. Insurers have often used these as loss leaders to attract customers for more lucrative classes of insurance. They normally package PL and EL together with other classes of insurance rather than provide them independently. The insurers then invest the income elsewhere to cover for the liability losses.

Whilst insurers tend to consider the claims function as a means of making an income by setting premiums in excess of claim payments or reserves, a substantial amount of their income is derived from investment in the stock market³.

In the current climate of poor financial markets, insurers argue that they have now sought to make a profit in each class of insurance, and hence the premium increases (see section 3.4.1). Thus, since these classes of insurance were already significantly under priced, the recent adjustments have been more significant.

² The NSCC undertook a survey in which they identified 105 companies who were refused cover.

³ The ABI estimates that insurance industry accounts for over 20% of the investment in the London stock market.

The insurers we spoke to confirmed that they would continue to write both EL and PL insurance, albeit at higher premiums. The number and value underwritten by one insurer for both EL and PL went up by 5-10% between 2000/1 and EL went down by 3% in 2001/2, while PL increased by 6%.

The Contractors All Risk (CAR) insurance was also affected. Other classes of insurance such as property, motor and products liability also faced increases but it was difficult, given the available time, for insurers to split out construction specific cases. Nevertheless, they cited general increases of between 0-10%. These classes of insurance were often provided as a package together with EL and PL or as part of CAR.

PII was also faced with the same pressures especially with regard to shrinking capacity, increasing premiums, increase in collateral warranties and difficulties in getting cover for professional advisers and design and build contractors.

3.2.3 More stringent conditions

Apart from the direct costs of insurance premiums, contractors argue that they were faced with increased indirect costs. To offset the significant increases in premiums, the contractors had to increase their excess levels. Similarly, they were faced with more restrictive conditions in their cover, particularly for those working at heights, such as scaffolders and roofers, and those working at depths and confined spaces, such as tunnelling, mining, railwork.

Insurers argue that they have had to define their liabilities more precisely and have not necessarily restricted the kind of activities that contractors undertake. In order to reduce their exposure to numerous small claims and to lower the overall premium rates, insurers have recommended that contractors increase their excess levels.

3.2.4 Shortcomings in underwriting discipline

Construction companies and their representative trade bodies were particularly concerned with how the issue of increases in insurance premiums was handled. They felt that not enough notice was given to contractors regarding the substantial increases. Most received notices less than a week before they were due for expiry. The construction organisations felt that a 'grace' period should have been offered where an insurer was unable or unwilling to renew cover, especially for the compulsory EL insurance.

Most contractors did not consider that they had received 'reasonable notice' for their renewals, especially given the current difficulties. Clause 32 of the General Insurance Standards Council (GISC)⁴, Commercial Code of Practice states that 'members will notify commercial customers of the renewal or expiry of their policy in time to allow them to consider and arrange any continuing cover they may need'. GISC states that it does not stipulate a specific period for giving notice as this would vary depending on the different classes of insurance.

Construction organisations further felt that there was no differentiation between 'good' and 'bad' contractors, i.e. in terms of their past claims experience, track record in risk management and training. However, the insurers argue that where a good case was

⁴ GISC is a voluntary governing body for insurers.

presented, mainly via a broker, companies with a good track were able to negotiate reasonable increases in their premiums.

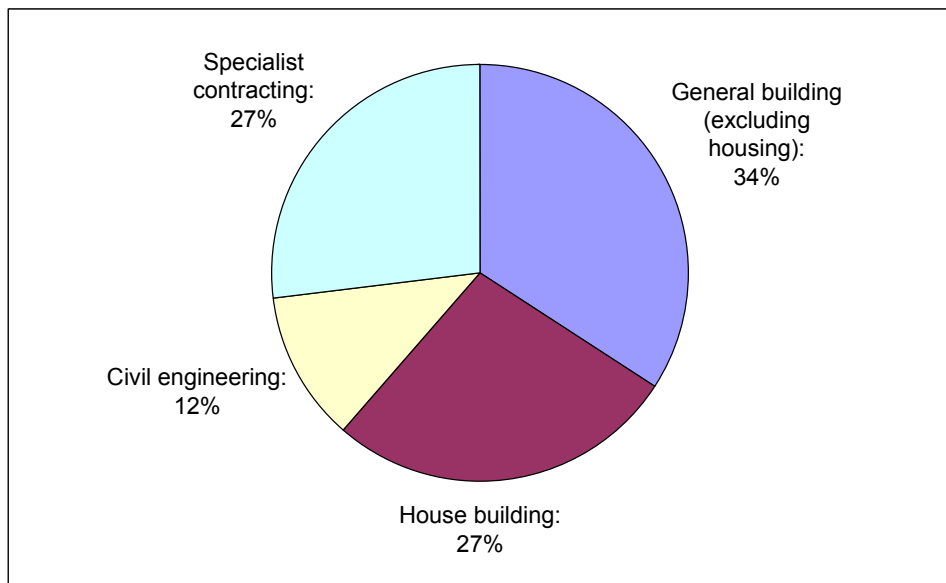
The tendency by insurers to under-price in good market conditions and over-price in hard markets was noted as creating instability and unpredictability in construction companies. The construction organisations felt that this consequently made it difficult for contractors to budget their finances accurately and created an uneven playing field. Contractors believe that the proper pricing of premiums, with actuarial input, would provide more a stable marketplace.

3.3 Implications for contractors

As outlined in section 2.3, we developed a self-completion questionnaire (see Appendix D), which we requested the trade bodies to distribute to a small number of their members. We got twelve completed questionnaires, which although not in any way meant to be representative, did complement the information we received from the interviews we had with the trade bodies and insurance organisations.

All the respondents were in senior management i.e. managers or directors of the companies. Thirty-four percent of the work undertaken by these companies was in general building, 27% in both house-building and specialist contracting and 12% in civil engineering (see Figure 1).

FIGURE 1: Proportion work undertaken by respondents



The companies that responded were mainly small to medium sized, employing 2,062 people in total (68% of whom are site-based) and with an average turnover of £17.7 million. The smallest company employed two people, undertaking projects of up to £30,000, while the largest employed 900 people (600 of whom are site-based) and had an annual turnover of about £60m. All the companies operated regionally, except for a couple that operated nationally.

3.3.1 The main construction sectors affected

Various construction trade bodies, including the NSCC and NFDC, surveyed their members to ascertain the extent of the difficulties. However, unless an industry wide survey is undertaken, it is difficult to get an accurate picture of the extent to which certain sectors have been affected i.e. did not get any cover, capacity available etc.

Nevertheless, the following sectors were generally mentioned as being most affected:

- Workers at height e.g. scaffolding, roofing contractors, metal fabricators, steel erectors, shotblasters and to a lesser extent painters and finishers.
- Workers at depth and confined spaces e.g. tunnelling, quarrying and mining
- Working with ‘dangerous’ plant and equipment and in high risk environments e.g. asphalt roofers

Small and medium-sized enterprises (SMEs) were also affected more significantly because the increases in premiums form a larger proportion of their turnover relative to the larger contractors. However, it would be useful for a more detailed analysis of the correlation between the premium increases and the trades’ claims experience.

A survey by BIBA (2002) among its broker members showed that some of the key business sectors affected by recent significant increases in premiums were mainly construction related and these include scaffolders, consulting engineers and roofing contractors.

This is further consistent with the study by Brabazon et al (2000), which concluded that the three most hazardous trades within construction, based on Health and Safety data collected from 1993 to 1998, were:

- Scaffolding
- Roofing, and
- Steel erectors, barbending and structural trades

3.3.2 Cost and availability of insurance

Table 2 below outlines the types insurances that contractors obtained and the range of premium increases that they experienced. Only one respondent was willing to provide us with data or hard evidence in relation to the increases in costs and conditions of cover. Nevertheless, all the respondents did provide average estimates of the increases.

All the companies obtained Employers Liability (EL) (as is required by law) as well as Public Liability (PL) insurance. The premium increases for EL ranged from 10% to 368%, whilst PL ranged from 10% to 500%.

All the companies obtained annual policies as there were no benefits for taking longer policies. One company that had a tri-annual with Independent prior to its collapse could not get a similar deal, whilst another company that had agreed a three-year premium deal, payable annually, had this deal reneged by the insurers due to ‘unforeseeable premium rises’.

Most contractors obtained insurance in packages, rather than as discrete classes of insurance. Given that EL is compulsory, insurers often use this to get companies to purchase other classes of insurance. Similarly, insurers offer Contractor’s All Risk (CAR) insurance together with other classes of insurances. Seventy-five percent of the contractors consulted obtained CAR insurance and experienced increases ranging from 10% to 80%, and 83% obtained insurance for plant and materials, which increased by 10% to 50%.

Table 2: Types of insurances obtained

Type of insurance	Percentage of respondents obtaining insurance	Range of percentage increases (min to max)
Public Liability Insurance (PL)	100%	10 to 500%
Employers Liability Insurance (EL)	100%	10 to 368%
Contractor's All Risk (CAR)	75%	10 to 80%
Insurance for plant, materials etc on site	83%	10 to 50%
Commercial property insurance	75%	10 to 60%
Insurance for materials in transit	67%	0 to 50%
Professional Indemnity Insurance (PII)	58%	-5 to 300% ⁵
Motor/ Commercial Vehicle insurance	50%	22.5 to 47%

All the consulted companies used the services of an insurance broker and they felt that the brokers were able to present a good case to insurers and thus obtain cover. The companies that had a good claims record and had a good relationship with the insurers were able to obtain cover, albeit at higher rates and with more restrictions on the cover, or they had to increase the excess level to offset the premium increases.

3.3.3 Risk assessment, management and control

Most contractors felt that neither their claims records nor the level of insured construction risks had significantly increased between 2000 and 2002 so as to warrant the substantial premium increases they had witnessed. However, as outlined in section 3.4, the causes were broader than construction-specific issues.

The contractors views of the assessment of insured construction risks ranged from those who felt it was adequately met by the statutory requirements (i.e. Health and safety and other relevant regulations) to those who felt that these requirements were the minimum acceptable standards. It was generally considered that annual assessments of a company's risks may not be adequate, especially where a company's turnover of employees and number of sites worked on was high. However, they considered that the resources required to audit the implementation of risk management measures on all construction site would be prohibitive.

Insurers, on the other hand, claim to not have seen any real evidence of changes in risk management, particularly for the smaller contractors. They felt that contractors were very vocal about the increase in premiums, but the tight margins still meant that many did little more than comply with the statutory minimum health and safety controls. They argued that

⁵ The company whose PII premium went down, claimed to have been overcharged previously

better margins in the industry would allow more serious commitment to health and safety, given that some trades were so competitive that they almost inevitably had to cut corners.

The insurers claim to have increased the number of health and safety surveyors employed to assess risks rather than relying on answers to questions on a proposal form or brokers submissions. However, they do admit that their resources are only able to assess about 10% of the construction projects that they insure, and this would mainly be utilised on the larger projects and/or clients.

3.4 Insurers views of the underlying causes

There are number of factors that have contributed to the current difficulties, many of which have emanated from the broader insurance and financial markets. These have, in combination, impacted many industries but have had a particularly significant effect on the construction contracting sector. Furthermore, the impact of these factors has occurred in chorus, thus making the current phase of rising prices more pronounced than in previous cycles.

We have identified a number of causes for the current insurance crisis, which can be grouped into four broad categories:

- trends in the general insurance and financial markets,
- changes in legislation and costs of insurance,
- limited capacity within the construction insurance market, and
- the track record (and perception) of construction firms, especially with regard to health and safety and risk management.

3.4.1 Trends in the general insurance and financial markets

The general insurance market is highly competitive and experiences cyclical price movements. Rates are currently rising following a long period of low prices and underwriting losses.

Professional Indemnity premiums rose significantly between 1984 and 1985, and then fell in late 1980's. Consequently, professionals turned towards a mutual insurance concept with the formation of the RICS Insurance Services Company, which placed a master policy to provide worldwide cover for its member surveying firms based in UK⁶, and the Wren Insurance Association, a mutual for architectural firms.

In the mid to late 1990's, the competition in the insurance industry was very high and with more insurers in the market, many were cutting costs to attract customers by providing low premiums. The general insurance class made losses every year since 1996 and Key Note (2001 and 2002) estimates that between 1996 and 2000 the revenues fell by 16%. Furthermore, underwriting losses since 1993 on liability insurance have amounted to £3 billion, caused by floods and other natural disasters, amongst other factors.

2001 was a particularly difficult year for insurers, due in part to poor stock market performance and was made worse by the September 11 World Trade Centre attacks. The recent steep reduction in interest rates and falls in equity values have resulted in a reduction in investment income insurers can earn on the reserves they set aside to pay claims. The

⁶ RICS News (1988); Wren Insurance Association (1992)

September 11 (2001) attacks, and associated terrorism losses are estimated at about £40 billion⁷. Although much of this has been borne by the global re-insurance industry, it is inevitably reflected in premiums charged to insurers' customers.

The renewals of reinsurance treaties⁸ at the start of 2002 were therefore conducted against a backdrop of negative news for reinsurers. Consequently, almost all treaties were renewed with substantial rate increases and with more restrictive terms and conditions⁹.

3.4.2 Changes in legislation and costs of insurance

Employers Liability (EL) insurance is the main way of providing compensation for damages for accidents and occupational disease. A number of law reforms and court awards have caused the costs of claims to increase significantly. The average cost of liability claims has increased by over 100% in the last 5 years. It is further estimated that 40% of the total damage awards goes towards legal fees. This has consequently required EL and other liability insurance premiums to rise to fund the extra compensation.

The law reforms that have impacted on costs of compensation include:

- The Consumer Protection Act, which was enacted prospectively but having retrospective impacts
- The extension of those with a right to claim compensation for wrongful death and liability for psychiatric illness, especially following the Hillsborough disaster in April 1989
- The reduction in October 1998 of the discount rate used in the calculation of lump sum damages in personal injury cases. One of the insurers consulted estimates that the ½% reduction in the discount rate, cost them £20 million and it cost the industry £150 million.
- Changes to the law on the availability of damages for non-pecuniary loss, which includes pain and suffering and loss of amenity, following the 1999 Law Commission report (The Woolf Reforms)
- The Access to Justice Bill (April 1998) has added significantly to the burden on contractors.
- The introduction of Conditional Fee Arrangements in early 2000, commonly referred to as 'no-win, no fee', and After-The-Event (ATE) insurance to promote access to justice.
- The insurance premium tax also adds to the costs of insurance since it is a sales tax on purchases of insurance.

The significance of these law reforms is that, first, the timing of the changes has been at a time of falling investment incomes for insurers (see above) and the resulting effects have occurred within a relatively short time period. EL became a legal requirement in 1972 from an Act passed in 1969. Much has changed since then, in particular, society has become more litigious and a rise in new liabilities, particularly with regard to occupational diseases.

Second, they have been applied retrospectively as well as applying to all future claims (regardless of when the injury occurred and the level of premiums at the time). Many diseases were unknown when the liability legislation was first drafted and the level of premiums charged then did not reflect these. This has meant that insurers have had to

⁷ RICS Business (2000) pg 13

⁸ Most reinsurance treaties are renewed on one of the four quarter start days: i.e. 1st January, 1st April, 1st July and 1st October. The busiest start day is 1st January.

⁹ Jardine Lloyd Thompson Group (2002)

increase their claims reserves on old policies. Insurers estimate that the reductions in the discount rate mentioned above (ordered by the Courts or the Lord Chancellor) have alone cost them about £500 million. They fear that the consequences would be alarming if the 100% rise in EL claims in the last five years were to be compounded over the coming years for claims occurring 20 or 30 years in the future.

Insurers thus claim to be facing great difficulties in setting liability premiums accurately, especially for EL. They argue that premiums have to be set to pay claims for occupational diseases and long term diseases which current work practices may be causing, but which may not manifest themselves until 20 or 30 years in the future (toxic mould and asbestos-related diseases exemplify this pattern). EL insurers cannot know which diseases medical science will in future link to present working practices nor do they know at what level the Courts will value such claims thus making it difficult to accurately forecast the number and size of claims.

3.4.3 Limited capacity within the construction insurance market

The UK general insurance industry accounts for 9% of total worldwide premium income, making it the largest in Europe and the third largest in the world. There are over 800 insurance companies authorised, either by the UK or by another European Economic Area member, to carry out insurance business in the UK (ABI, 2002). However, only a small number of these operate within the construction insurance market.

The number of insurers within the construction market has decreased due to insolvencies, mergers and financial rating downgrades. The recent insolvency of Independent, Builders' Accident, Municipal Mutual, Reliance and HIH insurance and the reduction in underwriting capacity in certain construction sectors by the larger insurers, has resulted in a limited capacity¹⁰.

The responses to these changes have varied from insurer to insurer. A few have reduced their involvement in construction insurance following a strategic appraisal of all their lines of business. This is particularly severe for some sectors of construction that are considered as being very risky. For instance, NFRC claim that there were only five underwriters in 2000 specialising in roofing and now there are even less. The larger construction insurers have, instead, mainly chosen to stay in the market and have therefore had to increase premiums.

Some Lloyd's syndicates, which have traditionally written high-risk business, have been forced to reduce the number of risks they insure because of capital constraints. When the premium levels are high, the number of policies that the Lloyd's market can write is reduced, as they are constrained in the level of income they can obtain under each class of business.

3.4.4 The track record of construction businesses

The construction industry covers works as diverse as roads, power stations office construction, tunnels and housing. These works are carried out in circumstances varying from seashore works in the north of Scotland to office construction in the city of London. The works are also carried out in weather conditions that vary through from inclement to perfect over the four seasons.

¹⁰ Independent Insurance Ltd and Builders' Accident Insurance Ltd were major players in the construction insurance market.

The works can also be undertaken by contractors under a number of different types of contractual arrangements, with varying risks in respect to timely completion, quality control and ability to make a profit. In some sectors, specialist subcontractors undertake the majority of the works and such a contractor may not have full control over all the risks associated with their work.

Injury or death to workers and site visitors, vandalism, fires, theft of tools and building materials are just a few of the risks facing contractors. Such physical losses become relatively insignificant when compared with the extra expenses/losses accrued when a project is delayed.

The construction industry suffers more severely in relation to other industries because of the inherent risks in construction works and a poor history of risk management. Despite attempts to improve health and safety matters, deaths per annum on construction sites have not fallen significantly. For instance, 62 people died on building sites between April and September 2000, compared to 39 during the same period in 1999¹¹.

3.5 Impact across the industry

The effects of these increases will take some time to be fully felt. Although the magnitude and outcome of the current difficulties cannot be measured within the scope of this study, in the short-term the effects have had significant impact on all businesses, and particularly the small specialist contractors. This is particularly severe, given the compulsory nature of EL insurance.

There were fears that the insurance difficulties could result in more firms ceasing to trade, reducing staff or trading illegally. The trade organisations claimed that companies had resorted to reclassifying the way they categorise their employees and their businesses in order to obtain cover. Some of the examples cited included, some specialist contractors changing their business classification to general building and still undertaking specialist works, general builders undertaking specialist works for which they have not specifically obtained cover and reclassifying employees as self-employed and companies cancelling direct debits and still showing certificates.

BIBA claims that it has been approached, directly or via its individual broker members by numerous businesses threatened with closure because they have been unable to obtain EL insurance.

In our consultation, we tested this and did not find hard evidence of companies that had ceased to trade or were trading illegally. However, we do acknowledge that the consultation was not comprehensive and it would be unlikely for a firm that was trading illegally to come forward.

3.6 Future trends

The Lloyd's of London Insurance Market (Lloyd's) reported a loss of £2 billion in 1999, which was as a result of weak market conditions as outlined in section 3.4.1. Moody's September 2002 forecast¹² for the Lloyd's indicates that in 2000/01 Lloyd's would lose £5

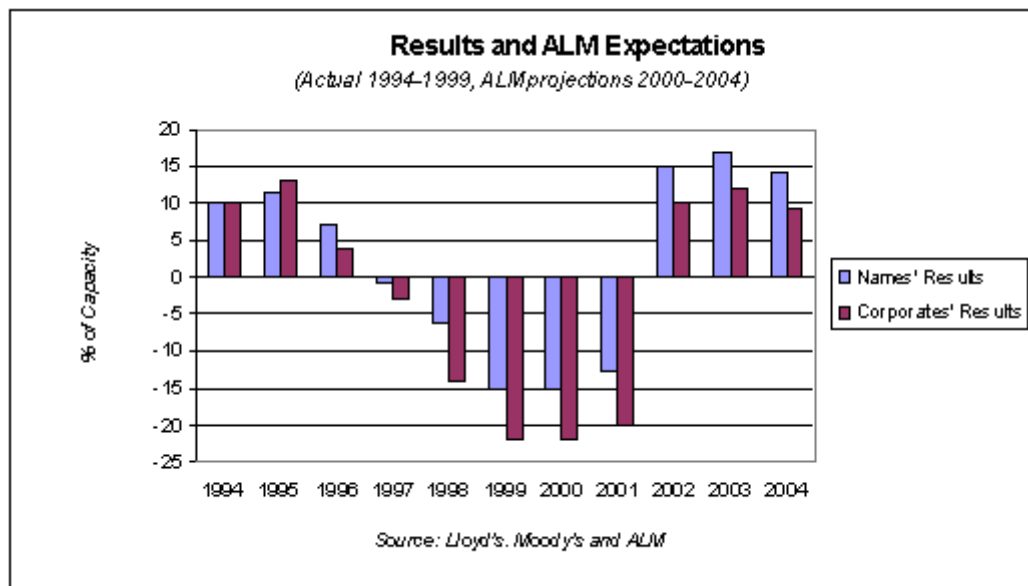
¹¹ Lloyds.com Ltd (2001)

¹² Moody's Investors Service (2002)

billion and have a profit potential of over £1 billion for 2002. The forecasts for 2000 and 2001 were larger because of the WTC disaster in September 2001, and are seen as representing the bottom of the most recent down cycle. Moody's further confirms that premium rates have increased significantly in many lines of business during 2002 and expects further increases in 2003. This will offer Lloyd's a £1 billion-plus profit potential, assuming a "normal" loss experience¹³.

The Association of Lloyd's Members forecasts that the Lloyd's market will be profitable from 2002 as shown in Figure 2 below (ALM, 2002). However, the factors that caused the current hard market i.e. increasing asbestos claims, weak stock markets, low investment returns, WTC and directors and officers (D&O) losses, will continue to exist and thus the current hard market is expected to continue in 2003 and, given the current uncertainties in the international political and economic climate, probably into 2004. Thereafter, trading conditions will depend on loss experience, developments in world stock markets and other factors at the time.

FIGURE 2: Underwriting results ALM's expectations



In general insurance, the motor and property sectors have the best prospects for recovery as they are captive markets, being supported by the legal requirement that all vehicles used on public roads to be insured, and by mortgagers' insistence that mortgaged property be insured. The commercial market will be restricted by the high cost of premiums, especially for all classes of liability insurance.

Insurers, insurance representative bodies and rating agencies expect further premium increases in 2003, although not as high as witnessed in 2002. It is possible that with the insurance market beginning to soften, capacity will increase. In fact, Lloyd's Names have

¹³ Underwriters and rating agencies assume a "normal" pattern of loss, which takes into account the underwriting capacity utilisation, claims, reinsurance costs and recoveries, but excludes syndicate expenses and investment income.

increased their capacity for 2003 from £2.8 to £3.0 billion¹⁴. This may, in the short term, make available more choice for buyers but may not necessarily make it cheaper. The recent experience of Independent Insurance may hinder under-pricing tactics.

The WTC has been used by the insurance industry as a catalyst for significant increases in rates, terms and conditions. Similarly, the current difficulties witnessed by construction companies could be used to further improve construction's risk management and health and safety record. The proportion of insurance costs for an individual company will increase, further squeezing the tight margins that contractors operate within. Contractors will subsequently either operate at low profit margins (if they can survive) or load the costs onto clients. However, where companies are able to demonstrate proper risk management and adoption of high health and safety standards, they should be able to negotiate reasonable premium levels with insurers and consequently offer clients reasonable value for money for their projects.

4 Overcoming the difficulties

4.1 Introduction

Construction organisations, in collaboration with the government and insurance organisations, have an opportunity to alleviate the current difficulties as well as enhance the overall performance of the industry by:

- exploring alternative insurance arrangements,
- improving risk management,
- promoting best practice,
- reviewing structural and legislative aspects, and
- engendering longer-term relationships.

The September 2002 conference organised by BIBA and ABI, which was also attended by construction organisations, is an example of the kind of collaborative effort required. The conference explored possible solutions to the difficulties, some of which are already being taken forward. These include developing a 'template' for assessing the implementation of risk management procedures by contractors, which would subsequently be used in the setting of premiums.

4.2 Exploring alternative insurance arrangements

There is a range of possible alternative insurance arrangements available, though not many have been sufficiently tested within construction and it is not clear, from this study, how acceptable and practical some would be. Some of the alternative insurance arrangements that we considered as front-runners include:

- Single project insurance – provides cover to a whole or part of a single project, and is common on major projects but also increasingly on PFI/PPP projects
- Client effected policies – clients take on the responsibility of insuring their projects and/or some of the liabilities of those executing the work.

¹⁴ ALM, 2002

- Pooled/mutual insurance schemes – a group of companies, such as the members of a trade association, form a non-profit making company, whose sole business is to provide insurance for its members who may have subscribed capital.
- Captive insurance – a type of self-insurance in which a company or an association forms an insurance subsidiary to insure itself or its members

We have not evaluated the merits or practicalities of implementing these options, particularly as to how they could be applied by SMEs and on smaller projects where the bulk of the current difficulties exist. Table 3 presents a summary of some of the merits and weaknesses of each of these alternative arrangements.

Single project and client-effected insurance policies cover the whole construction team on a project and are packaged to include PII, CAR and some liability insurance cover. Egan's (2002) 'Accelerating change' report is supportive of project insurance and has recommended that it be trialled.

The benefits of these types of arrangements are that they overcome the overlapping of insurance cover taken out by the various project teams and facilitate integrated working. However, they are best suited to large-scale projects and/or with major clients who have a steady stream of projects. They also disguise the high risks of specific trades/activities within a project (hence potentially taking responsibility away from individual contracting companies) and could be costly to set-up and administer. Individual companies will also have to take out insurance for other projects that they undertake that are not covered by the project insurance.

Some of the trade bodies are in the process of developing insurance schemes with insurers, whereby the trade bodies can vet members before they are offered insurance. These arrangements seem to have worked well with the RICS, Wren Insurance Association and FMB.

The RICS Insurance Services and the Wren Insurance Association were set up in the mid 1980's, when PII premiums had risen significantly. The FMB's insurances services operates a similar scheme for FMB members, which provides a package policy cover for liabilities but can extend to include tools, plant and the construction works. AON Insurance, who back the FMB scheme, have increased their premium rates at rates that are lower than the average increases we identified in section 3.3.2¹⁵.

The NFB are also considering setting up a similar scheme that would move beyond the Construction Health and Safety Scheme (CHASS) questionnaire-based audit of policy, planning and method statements, to auditing on site the application of these principles and the technical competence of personnel. The audit would be undertaken more than once a year and would provide an accredited status to the successful companies.

¹⁵ There was no increase in 2000; a 10% increase in 2001 and 17.5% increase in 2002 for those with no claims. Where there were claims and for certain trades, e.g. roofers and scaffolders, the insurer generally set the terms and the increases were larger based on either past losses or potential for losses.

Table 3: Advantages and disadvantages of alternative insurance arrangements

Advantages	Disadvantages
<p>Single project insurance</p> <ul style="list-style-type: none"> Overcomes overlapping of cover within projects with subsequent savings in cost of their own insurances for the various participants Facilitates integrated working 	<ul style="list-style-type: none"> Mainly suitable for large and/or projects Difficult to distinguish the high risks of specific trades/activities within a project Can be more costly to administer and because of a lack of repeat information can be difficult to underwrite Companies still have to obtain insurance for other projects not covered
<p>Client effected policies</p> <ul style="list-style-type: none"> Overcomes overlapping of cover within projects Facilitates integrated working 	<ul style="list-style-type: none"> Mainly suitable for clients with many/repeat projects e.g. utility companies Difficult to distinguish the high risks of specific trades/activities within a project Could be more costly to administer Companies still have to obtain insurance for other clients not covered
<p>Pooled/mutual insurance</p> <ul style="list-style-type: none"> Uniform interests and knowledge among those who are participating in the pooling arrangement. Being non-profit making, potential savings could be reflected in lower premiums or having more cash available for claims 	<ul style="list-style-type: none"> Because there is a lack of diversity of risks the spread of risks is not as great as would be the case in a more general market Insurance matters may avert construction organisations from their core business
<p>Captive insurance company</p> <ul style="list-style-type: none"> Since the captive will be part of the same business group as the insured, any savings by improved management of risk are retained within the group. 	<ul style="list-style-type: none"> Not an option for smaller companies High costs of setting up and administration the captive

4.3 Improving risk management

All businesses have to take risks in order to grow, but none can survive without a proper understanding of risk assessment and management. Contractors could do more to reduce the risks inherent in their business activities by reviewing their health and safety plans, hazard and risk management procedures and analysing their claims history to identify any significant patterns.

The majority of causes of the current difficulties have emanated from the wider financial markets and the legislative changes. The government is currently reviewing the UK insurance liability market. However, regardless of the current insurance difficulties, construction's poor health and safety record demands better risk management. The industry now has a significant opportunity to improve its track record, especially with regard to risk management and health and safety.

As outlined in the Appendix A, much has been done at the strategic and industry levels to improve health and safety and enhance risk management practices with construction. Leading companies have applied these principles and have seen benefits. These now need to be adopted more by SMEs and self-employed contractors and tailored to specific construction activities.

It is imperative that construction organisations integrate risk management into management thinking and planning at all levels. This motivation should not be merely to make cost savings on insurance, but also because it is vital to their business survival in the same manner financial, marketing and other operational issues do.

Contractors ought to be developing risk assessment and management strategies that are robust for the kind of activities that they undertake. They should further develop procedures for ensuring that these are implemented appropriately on all activities that they undertake.

Other opportunities for improving health and safety in UK construction via better risk management include:

- Further engendering and sustaining a safety culture. Risk management policies and procedures will not be enough, if there is no change in behaviour on site and throughout the construction process.
- Training organisations, such as the CITB, could review, in conjunction with HSE and insurers, their management and operational training schemes to identify opportunities for improving risk management and instilling higher standards of health and safety awareness and behaviour on site.
- With the assistance of insurance brokers, contractors could determine the adequate levels of insurance coverage, reserves and excess levels required by measuring exposures and re-evaluating their risk transfer options. Similarly, clients could ensure that contractors and sub-contractors have the adequate and appropriate insurance cover.
- Brokers have a significant opportunity for providing advice and creating the link between contractors and insurers. Contractors, and indeed insurers, should nevertheless not rely solely on brokers/agents to determine the appropriate levels of cover (including excess levels and policy conditions) for their business. Similarly, insurers should take steps to validate that the necessary risk management procedures are implemented appropriately.

4.4 Promoting best practice

In addition to improving risk assessment and risk management, there is a need to develop and promote best practice more widely. Larger companies, in particular, have developed good practices that could be promoted to the smaller companies and projects, specialist trades and self-employed contractors.

The development of guidance and best practice in risk management, and a ‘template’ for assessing its implementation, would spell out more clearly what is required from all parties and may alleviate the pressure to treat all contractors similarly, regardless of their capability, track record and risk management culture.

The construction trade bodies together with their member companies and with the support of government could endeavour to develop systems for target setting, management, control and reporting to engender a culture of zero tolerance to dangerous practices and help ensure a ‘level playing field’. Trade bodies should set high standards of practice and take action where they have evidence or reason to believe that these are not being appropriately followed.

There is need for the insurance industry to develop and promote codes of practice that construction can buy into for underwriting practices, premium pricing and renewal notices, etc. Insurers also need to develop robust and transparent mechanisms for distinguishing ‘good’ and ‘bad’ performers by taking into account the specific health and safety records, claims experience and risk management procedures of individual firms and construction sectors.

Other measures that contractors can take in dealing with the difficulties include:

- Better housekeeping – i.e. keeping proper records
- Communicating throughout the organisation the importance of risk management
- Starting negotiating renewals early, at least three months before policy expiry.

4.5 Reviewing structural and legislative aspects

The government has on occasion, exceptionally, taken a role in ensuring availability of the necessary insurance at reasonable and competitive levels, as well as intervening where there is a market failure. For instance, the government successfully intervened in 1992 by establishing Pool Reinsurance Ltd (Pool Re) to reinsure primary property insurers for terrorism-related losses following attacks in London by the Irish Republican Army. However, efforts to lower overall rates through price regulation in competitive markets are often futile.

A similar Assigned Risk Pool (ARP) could be considered to provide temporary cover to companies who have been ‘constructively declined’ the compulsory EL in the open market. Entry to such a pool would, of course, be subject to strict rules of entry, such as a business and risk management review. The cover would only be for a limited time or for specific ongoing projects.

The statutory requirements are the minimum level of risk management that a company should put in place. Each company should endeavour to have higher standards, especially with regard to training, assessing and monitoring the implementation of proper risk management practices. Companies with a proactive culture to renewal i.e. demonstrated a

good case such as training staff, has increased communication and openness between insurer and client, reviewed their claim trends, maintained proper housekeeping and record keeping, and educated their staff, would be in a more favourable position. Companies should consider having a dedicated senior staff (i.e. with authority) to manage these issues.

As noted in the Appendix A, the introduction of Construction Design and Management (CDM) regulations did have a positive effect in reducing fatalities on construction projects. However, this effect seems to have dissipated and there is a need to review these and other related health and safety regulations, especially with regard to how they are implemented by smaller companies.

The Health and Safety at Work Act, CDM regulations and other relevant regulations require risk assessment and management to be done on sites as well as at corporate level. However, the resources required to comprehensively monitor the proper implementation of these practices on all sites is enormous, especially taking into account all the construction sites that may be live at any one time. Nevertheless, effective, efficient and economical ways of monitoring site activity need to be sought. For instance, having cameras on site would not only deter theft, but also would also deter workers from undertaking work in an unsafe manner and provide a record of construction activity.

Increased compensation is not cost-free. This implies that, under the current system, liability premiums will inevitably increase to fund the compensation. These premiums are, of course, paid for by businesses and ultimately consumers. The insurance industry reckons that fundamental reform is needed because the current system is unsustainable.

4.6 Engendering longer-term relationships

A key weak point, in the current climate has been the lack of communication between the construction and insurance industry. Construction organisations feel that the efforts they have put in place to manage and avoid risks, have not been reflected in their insurance costs. Similarly, insurers claim not to have seen any conclusive evidence that the industry as a whole is managing its risks better.

Therefore, the government and industry have a role to play in promoting understanding and stimulating further discussions on how the current situation can be improved. This could be achieved via further more focussed investigations, such as evaluating various alternative insurance arrangements; comparing how other developed countries are dealing with the situation and supporting the development and dissemination of practical solutions and best practice.

Premium stability is desirable, especially for budgeting purposes. Contractors should consider negotiating two or three year policies, especially for those companies that are likely to maintain their existing size and can foresee a predictable pattern in their business activities over this period. Such a policy could be paid for either by a single discounted premium for the extended period or a fixed premium payable annually but does not change over the extended period.

It is important for contractors to seek quality insurers and develop an open and strong relationship with them as part of the risk management process i.e. a relationship that involves much more than the policy.

Competent insurance brokers, who understand the specialist construction markets, are the best people to guide the client through the maze of insurance alternatives and present a case to the insurer on behalf of a contractor. Brokers/agents are in a position to negotiate terms as well as educate both insurers and contractors about the construction insurance market.

The insurance industry should assist the construction industry in exploring alternative modes of insurance, including ways of risk management. This would include developing and codifying best practice.

4.7 Further work

It would be useful to investigate the premium increases for each class of insurance and correlate these increases with the various construction activities as well as their respective claims records and Health and Safety statistics. This would pinpoint the specific activities that are affected and would enable specific remedies to be taken, rather than providing generalised remedies that may not adequately address a specific activity.

An analysis of the health and safety statistics and claims records to identify and make publicly available the specific construction sectors, activities and, if possible, companies that contribute to the high accident rates. This would enable insurers and construction industry to better understand and address specific risks.

5 APPENDICES

A. Background to the construction insurance market

Insurance, in the construction context, is generally a contract to indemnify i.e. the insured will recover compensation for losses that are actually incurred and can be proven (Levine and Wood, 1991). Construction projects, given their size, complexity and number of participants working in close proximity, present a vast range of risks during their lifetime. This, therefore, necessitates various types of insurance to be effected (see figure 3). Broadly, these can be categorised as either liability insurance – e.g. Public Liability (PL), Employers Liability (EL), Professional Indemnity (PII) and motor insurance; or property insurance – e.g. Contractors All Risks (CAR), products and plant and equipment insurance.

Motor, Property and Employers Liability insurance have traditionally been considered as captive markets due to the legal requirement that all vehicles used, mortgaged property and employees be insured. The means by which an organisation insures itself will vary according to its needs but essentially a business decision will be made in which the cost of insuring will be weighed against the risk of a loss. The exception to this relates to compulsory insurances such as employers liability and motor when the decision to insure is required by law. In the event that an insured cannot afford or procure those insurances then the business can be fatally affected.

The construction insurance market is a specialist sector within the overall insurance market. There are over 800 companies authorised by the UK or Europe to transact insurance business in the UK. However, only a very small number of these operate within the construction insurance market.

Companies seeking to transact insurance business in the UK market must be authorised to do so. Their operation and the methods by which they make provision for claims through their reserves is regulated by HM Treasury and this, relative to their capital, limits the cover that they can provide (i.e. their capacity). The reserving capacity sets limits on the amount of business that an insurer can take on.

Like any other market, the insurance market comprises of sellers – the insurance companies and the Lloyd's of London; buyers – the general public, industry and commerce; and intermediaries – the insurance brokers and agents. Although a buyer of insurance (the insured - or assured at Lloyd's) may approach an insurer directly, the majority of business is placed through intermediaries. Indeed a buyer can only place business at Lloyd's through an approved intermediary (i.e. a Lloyd's broker). (see Figure 4)

Figure 3: Construction projects participants and their insurance cover

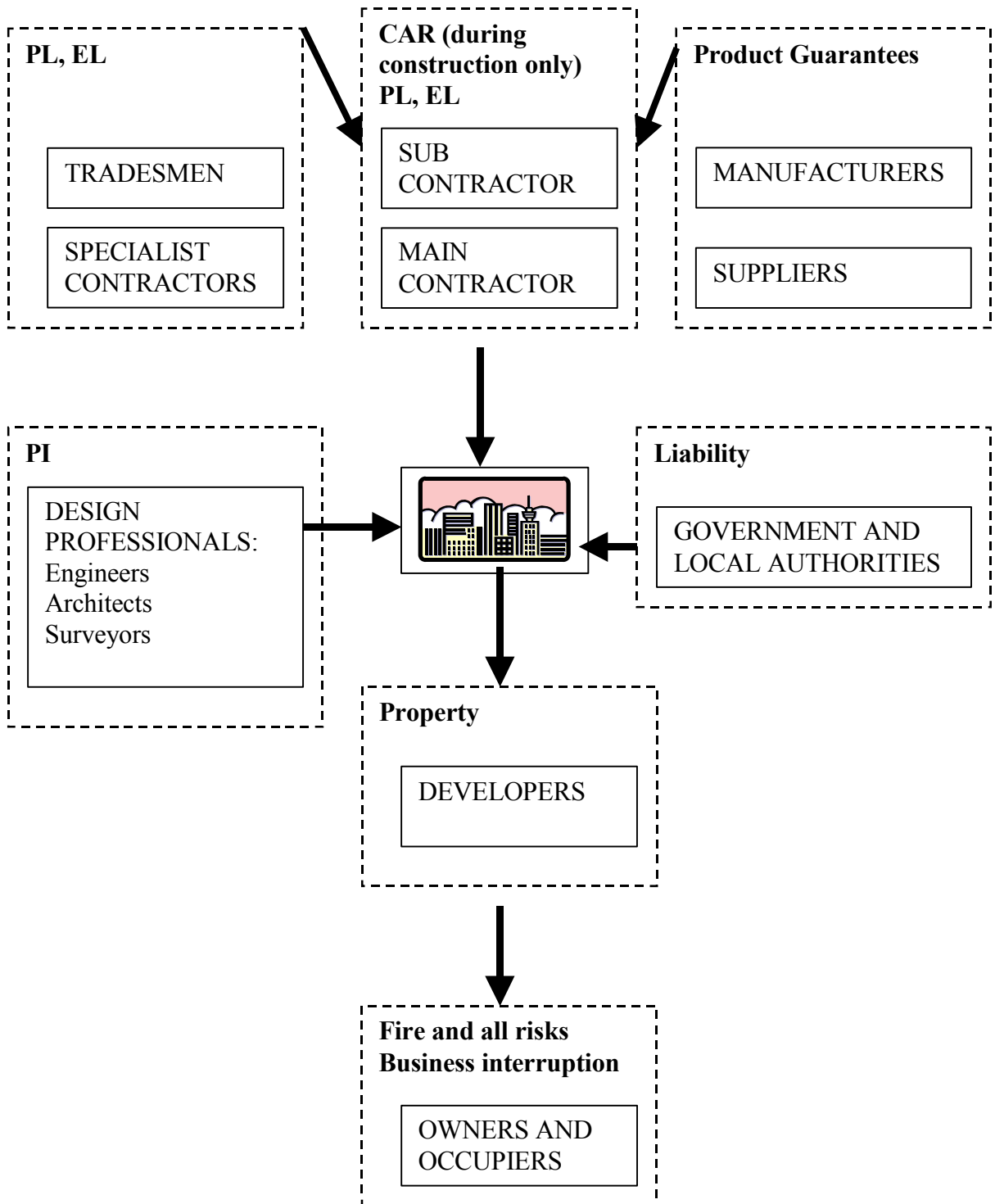
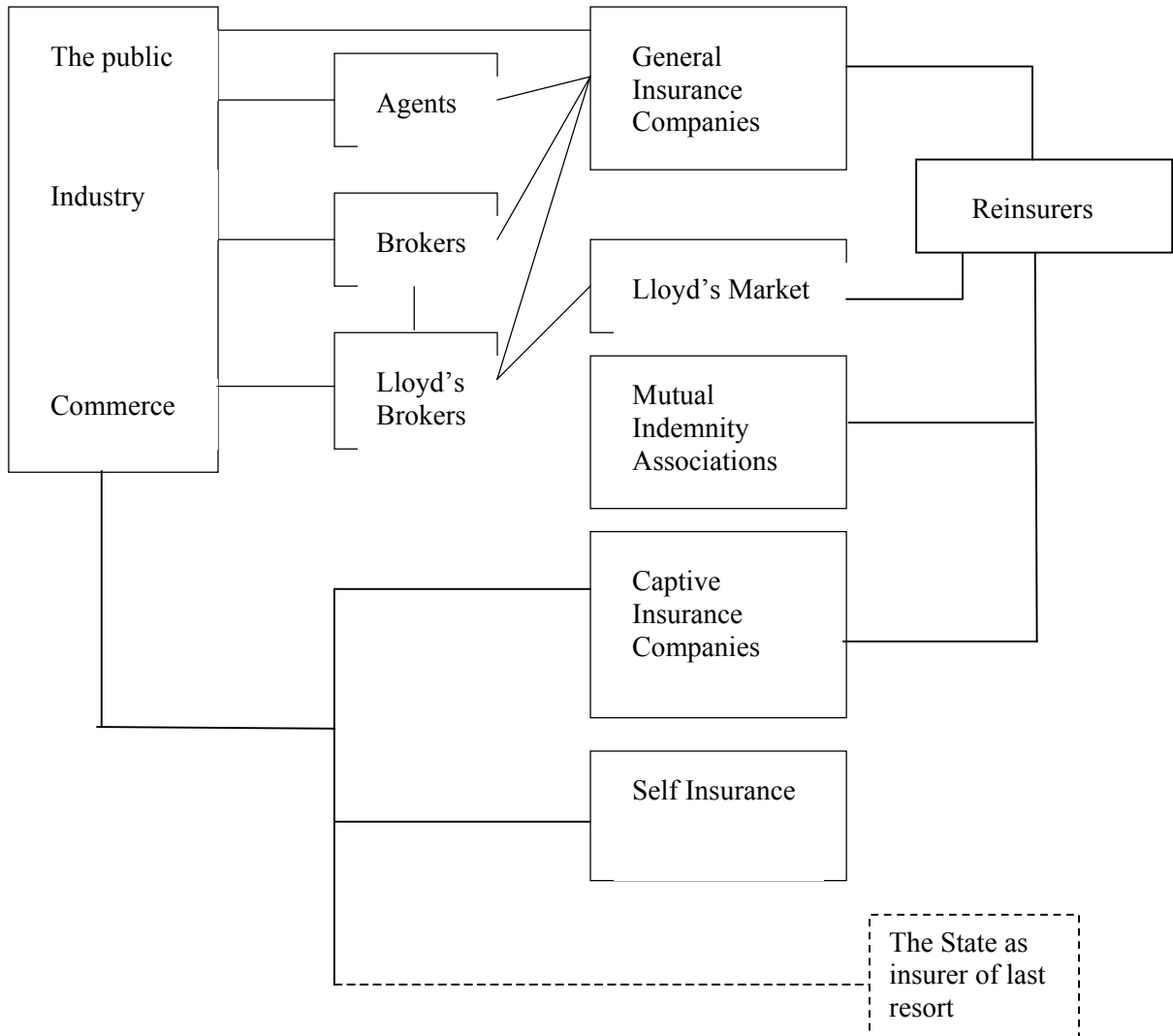


Figure 4: Overview of the insurance market



Intermediaries can be classified as:

- Broker - An individual or firm whose sole occupation is the placing of business with insurance companies on behalf of clients.
- Lloyd's broker - Similar to a broker, but in addition, the firm has been approved by the committee of Lloyd's to place business at Lloyd's.
- Agent - Someone who places insurance with companies but whose main occupation is in another field that brings him into contact with individuals or businesses that require insurance. These include solicitors, accountants, garage proprietors, etc.

There are generally two broad classes of insurers:

- General insurance companies
- Lloyd's of London (commonly referred to as Lloyd's)

Insurance companies can be categorised as either proprietary companies or mutual companies. The former have been historically created by Royal Charter, Act of Parliament or Deed of Settlement but generally are now reformed under the Companies Acts. They have an authorised and issued share capital with any profits going to the shareholders.

Mutual Companies are non-profit making organisations formed by deed of settlement or by registration under the Companies Acts and are owned by the policyholders. They are limited by guarantee and have no share capital. Mutual Indemnity associations differ from Mutual Companies in that the former may accept business from the market at large whereas Mutual indemnities originally accepted business only from a specific trade. Most associations have been taken over by ordinary insurers.

The Lloyd's market is an association of individual underwriting members (and more recently companies) who form themselves into groups or syndicates. The Names had unlimited liability which due to significant losses in the past led to the bankrupting of many individuals. Changes in the regulation of Lloyd's now means that companies can write business through Lloyd's on a limited liability basis.

The insurance market is also populated with reinsurers who provide insurance for the primary insurers. By allowing primary insurers to lay off some of the risk that they undertake to finance, the risks are spread more widely through the market thus increasing capacity. Whilst there are some insurers who specialise in reinsurance only, most primary insurers will share their risks with other insurance companies with each taking a pro-rata share (i.e. co-insurance).

Whilst there are numerous interrelated factors that influence the market for insurance as faced by those seeking cover, the availability and terms of reinsurance is one of the more important ones. The use of reinsurance increases the capacity of the insurance market to accept risks by allowing direct insurers to underwrite risks by using a separate reinsurance company to provide capacity beyond their own risk retention limits. The apparent capacity of the direct insurer is thus increased by the reinsurer taking on some of the risk and increases the market capacity. However, charges in the terms imposed by the reinsurers will impact upon the direct insurers and in this regard, the effect of incidents on world markets will find its way into specialised local markets such as construction.

In recent times, many large businesses or associations have set up captive insurance companies as a means of obtaining the full benefit of their risk control. The captive insurance company is formed as a subsidiary of a main company or association to insure the parent company/association. These captive companies enjoy tax benefits and whilst they are dealt with by the parent company at arms length, the benefits of better risk control are kept within the group. These captives retain the risk for an element of the losses arising but reinsure in the reinsurance market thereafter.

The state also acts as an insurer, in some instances and where there is a need to do so, may step into a void in the market to make good deficiencies therein, as in the provision of terrorism cover.

As an alternative to purchasing insurance in the market, or as an adjunct to it where the first layer or proportion of a claim is not insured in the commercial market, some public bodies and large industrial concerns set aside funds to meet insurable losses. As the risk is retained within the organisation, there is no “market” transaction of buying and selling, but such arrangements have an overall effect on the funds of the market in general and on premium levels where the organisation is carrying the first layer (excess or deductible).

Risk management

Wright (1997) describes Risk Management as “the identification, analysis and economic control of those risks which can threaten the asset or earning capacity of an enterprise”. There are numerous methods for identifying risks, including check lists, flow charts, fault trees and physical inspections. For a small to medium sized contractor, a checklist is often the starting point, whilst larger multinational contractors may have a full time risk manager working in conjunction with an insurance specialist.

In the analysis of risks, the key factors are frequency and severity¹⁶. It is common for larger and financially capable firms to self-insure themselves against the small but often high frequency losses/risks.

Risks can be controlled by avoidance, retention, reduction or transfer. This can be achieved financially (e.g. by insurance or retention), physically (e.g. improving security and safety measures) or contractually (e.g. via contract conditions and warranties). Insurance, the means by which an organisation finances the losses associated with risk events, is thus just one aspect of risk management.

The challenge with construction is that each project is unique and involves a complex set of relationships, which creates a large number of risks from when the project is initiated and increase in intensity and likelihood as work starts on site. In addition, there are indirect risks such as insolvency of contractors, non-negligence issues and more increasingly liabilities for occupational diseases.

All annually renewable insurance may be subject to changes in premium and/or policy conditions at renewal. However, virtually all insurance in the UK, other than Professional Indemnity, is underwritten on an ‘occurrence’ rather than a ‘claims made’ basis. An ‘occurrence’ policy is one where the claim on an incidence is paid for by the insurer providing cover at the time of the incident, while a ‘claims made’ policy is one that is paid for by whoever is providing cover when the claim is made and notified, irrespective of when the claim occurred.

This further places professionals and insurers engaged in construction in a difficult position. They have to enter into contracts and design buildings without the certainty of adequate insurance cover being available to meet claims that may be brought against them several years after completion of the project. By then they may be unable to obtain sufficient levels of insurance at a reasonable price or, just as serious, the scope of cover available may have been restricted at subsequent renewals.

The Turnbull Report and other publications as well as support from industry bodies, such as the Institute of Risk Management (IRM) and Association of Insurance and Risk Managers

¹⁶ Risk = severity of hazard X probability of occurrence

(AIRMIC) has led to increased awareness of the benefits of risk management in industry generally.

Whilst there has been a take up in the use of the Risk Management one of the questions that arises in relation to the investment in implementation of risk management techniques or procedures is what the motivation is. If the risk is financed by the operating company themselves then results which give rise to benefits will become known through the changes in the accounts as a result of the diminution of losses. Where, however, the risk is transferred to a separate company, such as an insurer, there will be no obvious benefit unless it is reflected in the cost of the insurance cover.

Although, for simplicity, insurers may apply a single rate to the total value of an insurance policy, underwriters will initially look at the different categories of a contractors work, taking into account local factors and the experience and ability of the contractor. Insurers, generally, obtain their information on contractors by means of a proposal form/slip. They may also undertake a site survey, especially for larger projects/contractors or following a loss. Surveys are beneficial to both the insurer and contractor, as they are carried out by experienced people who not only assess the physical risks, but also the character of the business and its attitude to risk management by meeting the people involved. In addition, the surveyor is able to identify areas of weakness and propose improvements.

Health and safety in construction

The Health and Safety Executive (HSE) has put in a great deal of effort into reducing the number of people killed, injured or suffering ill health from construction work. Although the many initiatives over the years have increased awareness and produced a long-term reduction in the number of injuries and fatalities, the construction industry still lags behind other industries on health and safety matters.

The facts are:

- Roughly a third of all work fatalities happen in construction and fatal injury rate of 6.0 per 100,000 workers (2000/01) is 6 times the all industry average
- In the last 10 years nearly 900 construction workers and over 50 members of the public were killed as a result of construction work
- A much larger number died prematurely or were disabled due to health problems arising from their work

Most people agree that the health and safety record of construction is poor, and has been made worse by a legacy of asbestos and the problems of noise, vibrations, solvents, dust, allergic reactions to cement, epoxy resins, isocyanates etc and musculoskeletal disorders (e.g. strains, sprains and back injuries).

The Health and Safety at work etc Act (1974) provides the basic framework/foundation for the regulation that HSE operates within. The 1974 Act confers a wide range of functions on the HSE including proposing new law and standards, enforcing health and safety legislation, investigating accidents and complaints, conducting research and providing information and advice.

By the introduction of the Construction (Design and Management) Regulations 1994, which came into force in March 1995, a new awareness of the part to be played by the various participants in the construction process in relation to health and safety took place. The

influence of designers and clients as well as those actually undertaking the work came to the fore and improvements made in the way that health and safety was dealt with in the construction process. Following the introduction of the CDM Regulations there was a slight decrease in the number of fatalities in the construction industry.

In 1999, the HSE launched the 'Revitalising Health and Safety Initiative', which resulted in a 10-point strategy statement that sets the framework for further action for the next 10 years. Some of the key themes that emerged from the initiative include:

- Raising awareness of health and safety among employers, workers and the general public
- Greater enforcement of existing legislation
- Ensuring that health and safety was considered at Board level
- A more proactive role for the insurance industry in promoting health and safety awareness
- Enhancing the role of safety representatives in managing health and safety at work
- Better access to occupational health services and a focus on rehabilitation
- Financial incentives to motivate employers

In February 2001, the government, key industry organisations and HSE held a Construction Health and Safety conference amidst growing concern about the industry's health and safety performance.

The Health and Safety Commission Strategic Plan for 1999/2002

- To raise the profile of occupational health
 - To develop a long-term occupational health strategy
 - Good Health is Good Business campaign
 - Preventing and managing musculoskeletal disorders
- To improve health and safety performance in key risk areas
 - Development of legislative and enforcement programme on asbestos
 - Work to improve health and safety standards in construction - Working Well Together campaign
- To develop health and safety aspects of the competitiveness and social equality agendas
 - Improving the management of health and safety in small firms –
 - Provision of adequate welfare facilities
 - Access to occupational health services
- To increase the engagement of others and promote full participation in improving health and safety
- To improve our openness and accountability

Other industry bodies have also been actively engaged in promoting better health and safety performance. The Strategic Forum for Construction, in its Accelerating Change Report, stressed the importance of health and safety. The report recommends, *inter alia*, that:

- clients should, for both business and ethical reasons, promote the delivery of excellence in health and safety in the construction process as well as in the final product
- HSE should consider publishing details of all companies, including clients, associated with fatal accidents
- project teams should be trained and educated to ensure that they are all aware of the demonstrable business, efficiency and safety benefits of integrated teams and processes
- designers should 'design in' health and safety and design out risks (e.g. falls from height)

Rethinking Construction's working group on Respect for People has developed toolkits and performance indicators for health and safety¹⁷.

Other relevant schemes and regulations include:

- Considerate contractors scheme
- Investor in People
- The Joint Fire Code - Fire Prevention on Construction Sites: the Joint Code of Practice on the Protection from Fire of Construction Sites and Buildings Undergoing Renovation
- National Plant and Equipment Register (TER) that deals with theft and vandalism

In a study by Brabazon et al (2000), which analysed injury data from 1993/94 to 1997/98, it was concluded that the average rate of fatalities for the primary building trades was 1 in 11,000 per year, which is below the HSE Intolerable Risk Criterion (of 1 in 1,000) and also below the 1 in 10,000 general guideline. The study identified the following three¹⁸ trades within construction as the most hazardous:

- Scaffolding trade (1 in 5,400)
- Roofing trade (1 in 3,800), and
- Steel erectors, barbending and structural trade (1 in 3,000)

The average fatality rate in these trades (see table below) was 1 in 4,000 per worker per annum, which is equivalent to a 1 in 100 probability of having a fatal injury in a 40-year working life. The average rate of major injuries in these three trades is on average 1 in 258 per worker per annum, which is equivalent to a 1 in 6 probability of suffering a major injury in a 40-year working life.

¹⁷ "A framework for Action" October 2002

¹⁸ Glaziers had the fourth highest fatality.

Table 3: Annual risk of death from industrial accidents to employees for various industry sectors (Health and Safety Commission, 2001).

Industry sector	Annual risk	Annual risk per million	Basis of risk and source
Fatalities to employees	1 in 125 000	8	GB 1996/97 to 2000/01*
Fatalities to the self-employed	1 in 50 000	20	GB 1996/97 to 2000/01*
Mining and quarrying of energy producing materials	1 in 9 200	109	GB 1996/97 to 2000/01*
Construction	1 in 17 000	59	GB 1996/97 to 2000/01*
Extractive and utility supply industries	1 in 20 000	50	GB 1996/97 to 2000/01*
Agriculture, hunting, forestry and fishing (not sea fishing)	1 in 17 200	58	GB 1996/97 to 2000/01*
Manufacture of basic metals and fabricated metal products	1 in 34 000	29	GB 1996/97 to 2000/01*
Manufacturing industry	1 in 77 000	13	GB 1996/97 to 2000/01*
Manufacture of electrical and optical equipment	1 in 500 000	2	GB 1996/97 to 2000/01*
Service industry	1 in 333 000	3	GB 1996/97 to 2000/01*

*Health and Safety Commission, *Health & Safety Statistics (1996/97, 1997/98, 1998/99 & 1999/2000)* published by HSE Books. Figures used for 2000/2001 are provisional.

With regard to ill health, the study concluded that the greatest number of reported cases of musculoskeletal disease was for builders. There was a tendency for the occupation ‘Builder’ to be used, nevertheless, of the other trade categories used, the following had a high incidence of respiratory and skin disease:

- floorers,
- roofers, and
- carpenters/joiners, bricklayers/masons, painters and plumbers.

The Brabazon et al (2000) study was not able to analyse trends by size of company due to lack of data.

B. List of trade organisation consulted

Organisation	Interviewees
Association of British Insurers (ABI)	Tim Humphreys – Liability Manager David Powell – Assistant Manager, Liability
British Insurance Brokers' Association (BIBA)	Mike Williams – Chief Executive Peter Staddon – Technical Services Manager
Construction Confederation	Stephen Ratcliffe – Chief Executive Andy Sneddon – Director, Health and Safety
Federation of Master Builders (FMB)	Robin Hood-Leader – Director, Membership Services
General Insurance Standards Council (GISC)	Angela Darling – Head of Policy
Health and Safety Executive (HSE)	Phil Kemball – Head of Construction Policy Martin Thurgood – Inspector (Construction Sector) Stephen Wright – Head of Construction Policy (Legislation)
Lloyd's Market Association	Tim Wilcock – Technical Executive
National Association of Scaffolding Confederation (NASC)	Robin James - Director
National Federation of Builders (NFB)	Barry Stephens – Chief Executive Simone Powell – Policy Planning Manager
National Federation of Demolition Contractors (NFDC)	Christine Macfarlane – Chief Executive
National Federation of Roofing Contractors (NFRC)	Edward Cowan – Chief Executive Gary Simcock – Company Secretary
National Specialist Contractors Council (NSCC)	Suzannah Nichol – Chief Executive

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D. Proforma for consultation with construction contractors

CONSTRUCTION COMPANIES QUESTIONNAIRE

Introduction

Davis Langdon Consultancy (DLC) has been commissioned by the Construction Sector Unit of the Department of Trade and Industry (DTI), to undertake a scoping study into the insurance-related difficulties encountered by contractors in the construction industry. The study aims to assist DTI by:

1. Establishing the extent and nature of the difficulties contractors face in obtaining a range of different types of insurance, and of the steep rises in many insurance premiums.
2. Obtaining a clearer understanding of the reasons for the problems facing construction firms, large and small, in terms of insurance market aspects, operational practices and developments within construction itself.
3. Understanding how the industry could better represent its approach to risk assessment, management and control to the insurance industry, in ways that would help them better assess premiums.

You are considered as someone with knowledge and views that will be valuable in this context and your assistance is particularly useful in providing information, and where possible data, with regard to the above-mentioned objectives and particularly as they are applicable to the construction insurance market. As a contractor, we anticipate that you will provide us with insight into how the difficulties, if any, you face in obtaining insurance and how the construction industry can better represent itself given the current difficulties.

In general, all questions relate to annual policies of insurance for contractors although we do pose questions on one off or project policies later. The study is concerned with UK based and operating contractors. The term 'insurer' refers to both lead and other insurers and the term 'construction' covers general building (including housing); civil engineering projects and specialist trades such as scaffolding, demolition and roofing.

Please complete the questionnaire as comprehensive as possible and return it to DLC. DLC will then contact you to discuss your responses in more detail. This interview will take around 30 to 45 minutes. The findings of this study will be shared with others in DTI and across government, who are keeping a close eye on developments in this area.

Thank you for your assistance.

Yours sincerely,

Dr. Lawrence Mbugua

Consultant

Davis Langdon Consultancy

Company details

Name of Interviewee:	
Position:	
Organisation Name:	

1. In which construction sectors do you operate? Please specify the proportion of work you undertook in your last financial year in each of the following headings:

	Proportion of work done
General building (excluding housing): <i>(Please specify sectors you specialise in)</i>	%
House building: <i>(Please specify sectors you specialise in)</i>	%
Civil engineering: <i>(Please specify sectors you specialise in)</i>	%
Specialist contracting: <i>(Please specify sectors you specialise in)</i>	%
Other: <i>(Please specify sectors you specialise in)</i>	%
TOTAL	100 %

2. Approximately, how many people do you currently employ directly?

3. How many of these are normally site-based operatives?

4. Do you seek to undertake projects of a particular value?

- *(If yes, please specify approximate range)*

5. What, approximately, was your turnover during your last financial year?

6. In which geographical regions do you operate mainly?

- In a specific region *(please specify the region)*:

On a national basis:

On an international basis *(please specify proportion of turnover earned overseas)*:

Cost and availability of insurance

7. Which of the following types of insurances do you normally obtain? For each type, please state when you last renewed and for how long.

Types of insurance	Year and month last renewed /procured	Year and month of next renewal	Other comments on availability
Employers Liability Insurance (EL)			
Public Liability Insurance (PL)			
Contractor's All Risk (CAR)			
Professional Indemnity Insurance (PII)			
Commercial property insurance			
Insurance for materials in transit			
Insurance for plant, materials etc on site			
Non-negligent indemnity			
Other relevant insurances (<i>please specify</i>)			

8. The majority of contractors purchase annual policies. Are you aware of any benefits of purchasing shorter or longer (e.g. bi-annual or tri-annual) policies? Please explain.

9. By what percentage has your costs for obtaining the various types of insurances you use increased/decreased since January 2000.

Types of insurance	Percentage change since January 2000	Why?
Employers Liability Insurance (EL)		
Public Liability Insurance (PL)		
Contractor's All Risk (CAR)		
Professional Indemnity Insurance (PII)		
Commercial property insurance		
Insurance for materials in transit		
Insurance for plant, materials etc on site		
Non-negligent indemnity		
Other relevant insurances (<i>please specify</i>)		

10. What have been the most significant changes in obtaining and/or maintaining insurance since January 2000, in terms of:

- Cost of premiums? Please explain.

- Do you utilise the services of a specialist insurance broker? Who are they?

Availability of insurance:

- Have you experienced any difficulties in obtaining and/or maintaining insurance? Please explain?

- Have you increased (either by choice or by a need to reduce premium costs) the amount of any self-insurance under any or all of your policies? Please explain.

How have the conditions (including excess levels) imposed on your policies changed? Please explain.

Number and value of insurance claims made?

- Have you made more or less claims this year than you did in 2000?
Please explain.

Any other comments?

11. Are you able to provide us with any evidence and/or data relating to the changes in the costs and conditions of your insurances since January 2000? If yes, please provide us with the details.

12. Given the current situation, what alternative insurance arrangements could be utilised in construction? Why do you think they could be useful? What has been your experience in using them?

- for example:

Single-project insurance

Pooled/mutual insurance schemes

Client- effected policies

Risk assessment, management and control

13. What have been the most significant changes since January 2000, in terms of:

- The level of in your insured construction risks? Please explain.

The way you assess your insured construction risks? Please explain.

The way you control and/or manage your insured construction risks? Please explain.

Other comments.

14. Have you, since January 2000, implemented any risk management measures that you consider should have reduced the risk that you present to insurers upon renewal? If yes, what form did these measures take?

15. Have your insurers given any discount or other ascertainable measure of acknowledgment of improved risk management in your organisation? Please explain.

16. What factors do you consider as critical in minimising your insurable construction risks?

○ For example:

Training in health and safety

Membership of professional and/or trade bodies

Adoption of schemes /initiatives such as considerate contractors etc

Form of procurement route chosen

Allocation of risk to subcontractors or specialists

17. Have you considered other forms of risk financing as options in dealing with insurable risks? Please explain?

18. How can contractors, in general, improve their construction risk management?

Other more general comments

19. Will the current situation facing contractors in obtaining insurance change (i.e. improve or get worse) in the short-term (less than 1 year) to medium term (1 to 2 years)? Please explain

20. What do you consider to be the likely future trends/drivers in the construction insurance market? Please explain.

21. Do you have any other comments and/or suggestions you would like to make?

Thank you for your time. Please send back the completed questionnaire to:

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71 High Holborn
London WC1V 6QS**

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**Scoping Study Report Prepared for the Department of Trade and Industry
by Davis Langdon Consultancy**

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