



ARCHITECTS & ENGINEERS PROJECT-SPECIFIC PROFESSIONAL LIABILITY INSURANCE

# Understanding your insurance deductible

Know how your project-specific professional liability policy deductible works, prevent surprise costs—and be prepared.

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**Transferring risk from an architectural, engineering or design firm to a professional liability insurance policy is a common risk management practice. It can also protect your firm's financial bottom line.**

Purchasing insurance can be a contractual requirement imposed by your clients or even a condition determined by your regulator. When you are placing insurance coverage for your firm—on either a *practice* basis or *project* basis—the three most common terms encountered are:

1. **Premium** – The cost to purchase an insurance policy;
2. **Limit of Liability** – The maximum amount payable under an insurance policy (subject to its terms and conditions); and
3. **Deductible** – The amount of a loss retained by the policyholder (insured).



# Deductibles defined

Insurance contracts do not transfer *all* the risk to an insurer; insureds retain some of the risk, in part, by way of a deductible or similar obligation.

A **deductible** is defined as the **amount of money an insured is responsible to pay directly towards an insured loss**. Simply put, it is a risk financing strategy that can be used as a cost savings tool. There can be a direct correlation between a premium and a deductible—broadly speaking, higher deductibles result in greater premium savings. This notion, however, can be a double-edged sword. It can save your firm money at the outset, but it can also cost your firm considerably more down the road than the initial premium savings realized if your firm finds itself the subject of multiple claims that trigger your policy and deductible obligation. Claims in the construction industry can take years to resolve. As a result, you may not know your firm's actual professional liability insurance costs in any given year until years after you have purchased your policy and paid your premium. It is not until all claims covered under your policy have been settled and your deductible obligations paid that these costs can be finalized.



# How deductibles work

A *project-specific* professional liability policy transfers the risk that would otherwise fall to a firm's own *practice* professional liability policy. Unlike with a firm's *practice* policy however, they may have no input or control into the negotiation of terms of the *project-specific* policy. This includes any deductible that may be applicable to a claim.

Architectural, engineering and design firms embarking on new projects typically follow a systematic approach when evaluating a project. This approach helps a firm determine if the project fits within the firm's corporate goals and if it is worth pursuing. Internally, some firms refer to this evaluation as a "Go/No-Go" checklist. This process typically starts with an evaluation of the project proposal, technical requirements and stakeholders—then ends with a review of the contract.

Conducting a due diligence assessment when undertaking any project ensures firms are considering the risks associated with client selection, type of industry sector and contractual obligations. The assessment ensures that the

project is within the parameters of the firm's risk tolerance and strategic plan. However, does your firm's "Go/No-Go" checklist include thorough review of the insurance requirements outlined in the contract? Specifically, are you considering the impact an insurance deductible or retention amount can have on the profitability of a project to your firm? (See [Victor's loss control bulletin: "The 10 principles of good practice"](#) for information on how you can manage liability exposures.)

Firms who have *not* performed appropriate due diligence in the careful scrutiny of client-proposed insurance requirements may find that they are faced with paying significant amounts of dollars when a claim is presented against the firm or as part of a settlement on behalf of the firm.

Different insurers incorporate different risk-sharing methods. Some use a traditional deductible while others apply a Self-insured Retention (SIR) or an Uninsured Excess. A SIR and Uninsured Excess are essentially 'one and the same' and refers to the amount you pay

*before* the insurance policy responds to a covered loss—meaning the policy is not triggered until the SIR or Uninsured Excess has been exhausted.

A policy with a deductible, on the other hand, will respond to a covered loss *before* the deductible is payable. Even in instances where the deductible is applicable to claims expenses, the policy will respond to a covered loss, and, if required, the insurer will retain investigators and counsel on behalf of the insured. The insured, however, is responsible to pay for all or part of these incurred expenses up to their deductible amount.

It is important to read your insurance policy carefully so that you understand the amount and what type of deductible or risk-sharing retention methods your firm is obligated to pay in the event of a claim. Your insurance broker can help you navigate this and answer any questions that you may have. (See also [Not all deductibles are created equal resource page](#) for more information about [Victor's deductible features](#).)



# The financial impacts of deductibles



Some insurance providers of *project-specific* professional liability coverage have a tendency to apply high deductible amounts as a means of risk sharing with the insured(s) and reducing the policy premium.

Deductibles and retentions can be as high as 1 million dollars, an amount well above most consulting firms' *practice* professional liability policy deductible. The obligation to pay such a high deductible or retention amount can become a burden to your firm. Such an obligation can have a significant adverse impact on your firm's financial health and would be particularly devastating if you did not adequately plan for the financial risk or did not have the opportunity to plan for it.

In addition to being aware of potential high deductibles applied to *project-specific* professional liability policies, firms should also be aware that often, the stakeholder purchasing the policy may also be the claimant in a claims scenario. It is becoming more prevalent for owners or design-builders to purchase this coverage on behalf of the consulting team. Moreover, while these project stakeholders are not generally covered under the *project-specific* policy, they are potential claimants who can claim against the design consultants in order to seek the proceeds of such insurance in the event of a covered loss.

Owners and design-build contractors have an interest in a *project-specific* professional liability policy. They want to

ensure there is adequate coverage in the event of a loss. However, because they are not insureds of that policy—or in instances where the design-builder is insured under the policy but claiming against a design consultant(s)—they are not obliged to pay a deductible under the policy even if they are responsible to pay the premium. The deductible is payable by those insured firms on behalf of whom a settlement is negotiated or against whom a judgment is rendered. As a result, this can create conflicts between the insurance purchaser and the insured (i.e., those paying the premium versus those paying the deductible).

To compound matters, *project-specific* professional liability coverage is typically placed at the start of construction, well after your firm has begun to render design services on the project. At the time you are negotiating your service agreement with your client, you may not be aware if the owner, prime consultant or design-build contractor intends to purchase a *project-specific* professional liability policy. Contractually, you may be required to be insured under this policy. Quite possibly, your firm will not be the entity purchasing the *project-specific* professional liability policy. Thus, you may have little control with respect to the placement of such coverage. You may also not have a seat at the table during the negotiation of the terms and conditions of the policy, including the negotiation of the deductible amount.



# Tips and best practices

## How to identify and manage your firm's deductible exposures

So, how can your firm manage the financial risks associated with potential high deductibles under *project-specific* professional liability policies? First, let's go back to your firm's "Go/No-Go" checklist and ensure your due diligence processes include a thorough review of the insurance requirements, including the *type* of professional liability coverage mandated (i.e., *project-specific* professional liability coverage and/or *practice* professional liability coverage). It is essential that your firm understands your contractual requirements and risks before undertaking any project.

If *project-specific* professional liability insurance is *not* referenced in your client's contract, ask your client if they are aware of any future intentions on behalf of the owner, design-builder or prime consultant in regards to the placement of such coverage when construction begins. This is particularly relevant if your firm is participating in a large project or a public infrastructure project as these project types are more commonly insured under a *project-specific* professional liability policy.

If your client's contract or proposal includes reference to the placement of a *project-specific* professional liability policy, initiate a frank discussion regarding your deductible concerns and inquire if a maximum or minimum deductible amount will be sought by the insurer or purchaser. If a large deductible is on the table, clarify who will be responsible for the payment of the deductible discussed, and how and when the deductible becomes payable. For instance, is the deductible payable for each claim? Is the deductible payable when claims costs are incurred or only when damages are paid on behalf of the insured? In addition,

which consultant insured under the policy is responsible for the deductible obligation? Is it the consultant(s) being claimed against, the consultant for whom the insurer is negotiating a settlement on behalf of or the prime consultant/first named insured under the policy?

Consult your corporate counsel to assist in the negotiations of your contract specifically with respect to the inclusion of language that stipulates the parties responsible for payment of any insurance deductible under a *project-specific* policy.

Consider including a limitation of liability clause that limits your liability for the payment of a *project-specific* policy deductible to your *practice* professional liability deductible amount. While your obligation to the *project-specific* policy insurer regarding the deductible payment will remain unchanged, you may be able to seek reimbursement or compensation for part of your deductible obligation from your client if there is a contractual agreement to do so.

In the event you are insured under a *project-specific* policy, ensure you obtain a copy of the policy or at the very least a certificate of insurance. If you cannot negotiate an affordable deductible amount or transfer some or all of that risk to your client, contact your insurance broker. They may be able to secure some coverage for your deductible obligation under your firm's *practice* policy by way of a buy-down deductible endorsement. This endorsement, if available, will likely be subject to an additional premium. It may only be offered if the request is received at the time the *project-specific* policy is purchased and no claims have been reported. As such, it is essential you prioritize communication between your firm and your client regarding the placement of insurance policies at the start of construction.

There are several steps your firm can take to mitigate the financial risks associated with large deductibles applied to *project-specific* professional liability policies. But, you may be asking yourself, "What is the insurance industry doing to protect the design consulting industry from these pitfalls?".

Some insurers recognize the financial burden high deductibles can have on the consulting industry, particularly for small to mid-sized firms. They can refuse to offer deductibles in excess of \$250,000 or limit this offering to firms who can demonstrate the ability to afford such a high deductible. Some providers of professional liability insurance—on both a *project* and *practice* basis—are taking steps to educate insurance brokers and policyholders on this issue. Steps have been taken to ensure that a consulting firm is:

- aware they are covered under a *project-specific* professional liability policy *before* a claim is made against them; and
- attuned to the deductible obligations under this *project-specific* policy

However, the reality is, the onus rests with you.

Architectural, engineering and design firms must prioritize the inclusion of proper due diligence assessments throughout the duration of a project. Through the various phases of a project, it is essential that you evaluate the financial risks associated with the insurance program procured by the various project stakeholders. This can help you better understand—and properly assess—the financial risks associated with potential deductibles that your firm may be responsible to pay in the event of a loss.



Contact your broker to learn more about the [deductibles available to your firm](#) as part of [Victor's Architects & Engineers Professional Liability program](#).

Visit us at [victorinsurance.ca/ae](https://victorinsurance.ca/ae) to learn more.

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