

The Scene is set for a perfect storm:

- a) The frequency and severity of Professional Indemnity (PI) claims against Surveyors has been exacerbated by UK and overseas buyers regarding every property as an investment.
- b) Surveyors' fees have not kept pace with the increase in property prices, which in turn are causing larger claims. In many cases Surveyors charge less than a Conveyancer; considerably less than a Solicitor; and a fraction of the fees charged by Agents.
- c) UK Insurers have lost money on Surveyors PI every year for the last 7 years and have started withdrawing from the Market. Those that are left must either increase premiums (to afford the increasing cost of claims) or withdraw. Unregulated, overseas Insurers are entering non-PI markets, such as property.

The purpose of the PI session at the 2014 ISVA Conference was to answer all the questions that Surveyors at the "sharp end" of your Profession had about Professional Indemnity Insurance (PII). For the purpose of this summary, we have condensed all of the questions into 3 main areas: **PII and Insurers ; Claims ; Run-Off.**

The Conference this year was a sell out, so for those of you who could not get a ticket, I hope this Summary will answer some of your questions, whilst helping you and your business avoid the common pitfalls and saving you a lot of time, money and stress.

It was a lively meeting and it was great for me to see that ISVA members are as passionate about Surveyors' PII as I am – although perhaps for slightly different reasons! Fraser Miller arranges the Legal Expenses Insurance that you receive as part of your membership of the ISVA and for more than 20 years has arranged PI insurance every year for nearly 12% of the UK's Chartered Surveyors: including many ISVA members. Through unique facilities we provide cover for all disciplines: including Sole Practitioners undertaking Lending Valuations.

Please call me on 01483 722211 if you would like to discuss any of the issues raised or your own PII arrangements.

**Simon Marsh** - Associate Director, Fraser Miller Limited

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## **Professional Indemnity Insurance and PI Insurers**

**Q1:** Can you use a crystal ball to tell us where PI premiums are likely to go in the foreseeable future?

**A1:** *They have to increase.*

*2012 is the latest year for which we have confirmed premium / claims statistics:*

***Surveyors total Annual Premiums: £42m***

***Surveyors Open Claims: £500m***

*Now, not all open claims will be paid but Insurers still have to find the money to Reserve for £500m worth of Claims (the FCA has ensured the days of The Independent Insurance Co. reserving every claim at £1, regardless of size, are fortunately long gone). However, you don't have to be a rocket scientist to realise that £1 income for every £12 in potential claims, makes for an unsustainable business.*

Other sobering facts:

*Aviva withdrew last year from writing any PII for firms <£10m income*

*RSA is not renewing cover for S&V, Architectural work or Design & Construct*

*QBE bought Brit Insurance's PII book and is not renewing Surveyors*

*Torus are not offering renewal to the majority of their PII Clients*

*Other Insurers are likely to withdraw if the volume of claims emanating from Surveyors continues at the current rate*

*In January 2014 the RICS issued a report entitled: **Balancing Risk and Reward: Recommendations for a Sustainable Valuation Profession in the UK**. This report contained many useful insights into the problems but it singularly failed to suggest a resolution to the crux of the problem, which is that **Surveyors' fees are too low**.*

*If you look at property values over the past ten years and then compare this to the fees you charge, the disparity is glaringly obvious. Claims inflation mirrors this, as claims settlements are correspondingly higher. Add to this the substantially increased cost of legal and other professional services and you can see that Surveyors cannot currently afford to pay for a stable and secure PII market.*

*No other profession has this problem, as no other profession cuts its own throat, or undervalues itself the way Surveyors do. It is vital that your fee reflects not only the work involved but also the liability you are forced to accept and this increases every year, in line with property inflation.*

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**Q2:** I am insured with RSA and have heard they are pulling out of PII for Surveyors. Is this true and what will this mean for the future?

**A2:** *RSA has confirmed that it will no longer provide PII for any firm undertaking Design & Construct, Architectural or Survey and Valuation work. It is therefore vital that all RSA clients speak to their broker NOW, regardless of renewal date, to find out what arrangements are being made with alternative Insurers.*

*RSA also provided "capacity" to Towergate. If you have a PII policy with Towergate you may find that you are also affected.*

*RSA's withdrawal from the Survey & Valuation market underlines the acute lack of capacity for Chartered Surveyors' PII and it is worse now than it has been at any time in the 24 years that we have arranged PII for Chartered Surveyors.*

*To our knowledge:*

- There are now only 5 insurers (including Lloyd's Syndicates) writing S&V.*
- If you are a Sole Practitioner the number reduces to 3.*
- Only 1 of those Insurers has a proven track record of insuring your profession.*

**Comment:** RSA has walked away from S&V for a good reason and no new entrants are likely to risk re-entering the S&V PII market for at least 12-18 months. A senior Lloyd's Underwriter said to me only last week that he would be sacked if he took on any additional S&V risks.

*The threat of increased interest rates and resultant increase in repossessions, allied to the number of interest-only mortgages coming to maturity, has made Insurers more cautious than ever before.*

*The reason Insurers will not provide cover is that the majority think it is impossible to even cover their costs from the premiums Surveyors can afford to pay, so they are putting their capacity into areas where they can make a profit.*

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**Q3:** I don't know if this is a question but it is something which most people at that Conference will be very acutely aware of: the perceived impact on their PI premium of large claims made by the big corporate companies and their (from our point of view) apparently cavalier attitude that if the fee is big enough and there's enough work, they can afford to take the odd 'hit'. They are therefore not being as careful as, perhaps, a sole principal whose livelihood relies upon a clean claims history! Does this actually affect our premiums, or not?

**A3:** *Smaller firms understandably have a jaundiced view of the Corporates. However, claims from Corporates do not have the impact you might expect. The reason is that many self-insure for a large proportion of their risk (by having a very large Excess) and only seek cover for events that would materially damage their business. The majority of paid claims are actually from the SME sector and this has increased substantially since 2007.*

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**Q4:** Can you give information on the type of activity giving rise to the most number of claims and the type of claimants.

**A4:** *Almost all activities undertaken by Surveyors are experiencing claims, the most common being:*

- *Pre-sale Surveys*
- *Valuations*
- *Property Management*
- *Project Management/Co-ordination*
- *Bank Monitoring*

**Comment:** New property owners continue to be the most likely to claim. In general claims arising from private individuals are containable. Lenders are still creating massive problems. The only reason a lender employs a Surveyor or Valuer is to have someone to claim against.

**Q5:** How does the Statute of Limitations vary between the different EU member states? I have asked the RICS this question, but never received a constructive reply.

**A5:** *In Germany, France and other EU countries this varies and can be greater than our own Limitation Act. However, currently these differences do not affect business in the UK. What is important is to correct some common misconceptions regarding Limitation Periods:*

- *Limitation Act: 6 years, but recent Case Law, (see Nykredit v Edward Erdman Group) has meant for valuers the limitation could be 9-10 years and the same for Surveys as date of discovery is key.*
- *Contract Under Deed: 12 years.*
- *Latent Damage Act: Longstop 15 years – this is the cut-off date for all actions against a professional.*

**Comment:** Where possible, do not sign any contract that extends the Limitation Period of the work you undertake, especially if you are close to retirement.

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**Q6:** It has come to my attention that the Citrus Group may have been using part exchange valuations on behalf of McCarthy and Stone and perhaps others to secure finance. The reason I say this is that it has recently changed its valuation forms to include “Valencia Finance”.

Whether Citrus had been using the previous part exchange valuations, without disclosure, to support lending no one seems to know. I suppose that there are two issues here:

Valuers need to be sure that the purpose(s) of the valuation is clearly stated in the instructions, and on the report form itself. This does not necessarily need to be couched in a negative way, as a clear statement of the intended purpose of the valuation would reflect good practice (RICS Red Book) in any event.

This should be straight forward if the valuer is negotiating and accepting instructions directly from the client, but less so when receiving instructions through an intermediary. Should valuers simply use a recommended text to exclude use for lending for the latter scenario perhaps and if so, what?

**A6:** *Any report you issue should state who the recipient is, the purpose of the report and the limitations. Therefore a part exchange valuation should state that it is not to be used for lending purposes and the report is for the sole use of the instructing Client.*

*The use of caveats and written parameters can be vital when defending losses. On many occasions the end user of the report will not fully understand the limitations of the work being undertaken. Make it clear what your duties are and you will be able to avoid many common complaints.*

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**Q7:** I am aware of local Surveyors capping their liability by contract with their clients as a multiplier of the fees they receive. One has limited liability to a maximum of 10 x their survey fee to house purchasers on the advice of the RICS. Is this allowable?

**A7:** *In January 2013 the RICS issued a discussion paper called "Risk, Liability and Insurance in Valuation work". Within this document it was suggested that Surveyors should seek to limit their liability under contract to either a multiple of the fees they charge or a fixed maximum amount. This mirrors many other professions such as Accountants and the IT Industry.*

*In practice this is rather more difficult. The Courts will not look favourably at Surveyors limiting their liability when working for members of the Public and Valuers would get short shrift from Lenders if they tried to do this.*

*In the commercial arena limiting liability is becoming more common. We have seen contracts where a maximum liability is set but please ensure that it is no greater than your PII Limit.*

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**Q8:** Why isn't it possible for smaller surveying practices to have one off increased limits of Indemnity for higher valued projects or valuations?"

**A8:** *There are a number of reasons for this but principally :*

- *Most Insurers buy re-insurance to offset the cost of claims above a certain Limit of Indemnity. This is a fixed cost to them based on the Limit of Indemnity and is not project specific.*
- *The work itself is outside the normal range of work the Surveyor undertakes and is therefore deemed to be a higher risk, so insurers are less willing to provide one off cover.*
- *The Surveyor could not afford to pay the premium that is actually commensurate with the significantly increased risk, which is why Insurers aggregate the cost into the premiums charged over the following years.*

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## **Claims**

**Q9:** When does a complaint become notifiable to the Insurer?

**A9:** *All PI insurers require "any circumstance which may give rise to a claim" to be reported as soon as you become aware of a problem. If your delay causes the claim to escalate, then the Insurer can claim that you have prejudiced their position and ability to defend you or make a settlement at a lower level. In the worst case, a delay in notification could invalidate your PI insurance .*

**Example 1.** A Purchaser says you did not report a structural crack in their garage on a home survey. You know from your notes that the crack was not structural but thermal in nature. At worst, the cost to rebuild one wall of the poor quality garage would be £5000 which is below your Insurance excess.

*The level of your Excess is irrelevant. You must report any circumstance where there could be a claim. It is not unusual for problems to escalate and we have seen "simple" losses become large claims as more problems are uncovered. You are paying for your Insurer's advice as well as their ability to settle claims – get them involved to deal with this matter as soon as possible.*

**Example 2.** A Purchaser has moved into their new home in January to find water ingress around the chimney stack. Their builder (who needs the work) says that the whole chimney stack needs to be rebuilt at a cost of £15,000. Your survey in November showed no evidence of any damp to the chimney (and you have the site notes to prove it). There have, however, been the worst storms in living memory in the intervening period, with record rainfall and high winds. You know that the cause of the water ingress is wind driven rain entering under the flashings and the solution is little more than routine maintenance and minor re-decoration.

*This is a typical scenario, where the Purchaser has been panicked by the Builder and is another situation where a good Insurer can help you and the Purchaser. By providing practical advice to defend the allegation and bring common sense to bear. The insurers we work with make use of specialist Loss Adjusters and Solicitors who work at no cost to you and may even prevent a problem from developing into a claim.*

**Comment: Please take photographs to back up your site notes, even for a Valuation. These really do help build a defence and also can convince the Purchaser that you know what you are talking about. A dated photograph is worth a thousand words!**

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**Q10: (we were told this was a hypothetical question)**

I advised a farmer selling 10 acres of agricultural land, subject to the purchaser obtaining planning permission to develop it. Planning permission is obtained, the sale completes and the farmer receives £10m. Shortly after, the farmer discovers the purchaser has sold the site for £20m to a third party. The farmer is unhappy and comes after me for advising and representing him negligently. Where would I stand?"

**A10:** *Any problem of this magnitude will lead quickly to litigation. Whilst such a problem is rare, I was interested in this question as it raises the question of Indemnity Limits and how much is enough?*

*The RICS sets minimum Indemnity Limits based upon income and not risk, which is perverse as there is no correlation between your earnings and the risks your business faces. You might earn, say £90,000 per year and the RICS requires only a £250,000 aoc Indemnity Limit, but you could be providing project management services or undertaking surveys on high value properties etc.*

*Property, land values and Solicitors fees are increasing every year but most Surveyors still have the same limit of indemnity they started with. Discuss your work with your broker, review your current limit and analyse your work: estimate what the maximum claim against you could possibly be and fix your limit of indemnity accordingly.*

**Comment: In this example, everything will come down to the Surveyor's Terms and Conditions and what form of Contract they entered into when taking the instruction. We would always recommend taking legal advice where such large sums are involved.**

*The activities which are commonly under-insured are:*

- *Surveys & Valuation - due to increasing property values, the Indemnity Limit we recommend is 33% of the highest value property on which you report. In some geographic areas we may recommend a Limit of 50% because the legal costs of the Complainant are often greater than the actual claim!*

**We recommend £2m any one claim as the minimum limit for all of the following, regardless of the fees earned from them:**

- Commercial Property Management – injury claims are increasing
- Construction related work such as Project Management, Co-ordination etc.
- CDM

**Comment:** If your Indemnity Limit is less than the amount claimed and your insurer believes that there is no realistic defence or way to mitigate the loss they are within their rights to pay you the Indemnity Limit and leave you to resolve the claim. This could result in your losing your business and all your personal assets if the Claimant pursues the loss beyond your Indemnity Limit.

**Q11:** Insurers complain that the costs of handling valuation claims in particular are making the PII business for surveyors/valuers risks unprofitable and unsustainable. Chartered Surveyors have responded through the Valuer Registration Scheme but what has the commercially powerful Insurance Industry done to challenge the Lenders and their corporate associates' often irresponsible contribution to this problem?

**A11:** *The Valuers Registration Scheme has had no immediate impact upon claims but The RICS needed to be seen to do something to address the problem of negligent Valuers.*

*I wish I could say that Insurers are using their muscle to fight off spurious claims more aggressively. Unfortunately the time for doing that was when the first of the "confetti" letters was issued. A successful landmark action against a Lender for spurious notification of loss would have saved us all a lot of time and money.*

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**Q12:** In light of a recent occurrence where I acted as CDM Co-ordinator, there was an accident on site and the contractor's insurers have sent everyone involved in the project a claim for contributing to the injured party's loss. If I am found in some way partly guilty (which I hope won't be the case) will my premium increase? Should I choose not to undertake this role going forward?

**A12:** *Large claims do impact premiums but an Insurer will look at the particular circumstances and how culpable the insured is before increasing a premium.*

*For those undertaking CDM, as this is a Health & Safety function, we advise that your Indemnity Limit is a minimum of £2m, as losses of this nature can be very large.*

*Our advice is never to "dabble" in high risk work. We would rather see a firm specialise as even though their exposure to claims is higher, the likelihood of problems is more remote due to their expertise. If CDM forms only a small proportion of your work, it may be wise to avoid it all together.*

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**Q13:** What “circumstances” should be notified when no allegations have been made by a client, as dealing with the insurers requirements for detailed project information is very time consuming?

**A13:** *If you have an inkling that a project is going wrong, then you should speak with your broker/insurer. The established insurers have dealt with every conceivable problem and they should be able to help you resolve or mitigate any loss. Their early intervention can often help avoid litigation, which will benefit you.*

**Q14:** Do notifications that do not lead to claims effect premiums?

**A14:** *With Survey & Valuation work the premiums charged by insurers take into account the attritional nature of pre-sale surveys. By that I mean that insurers expect there to be a certain amount of complaints as long as the complaints are the usual misunderstanding over the extent of a survey, then premiums should not be affected.*

*However, with the “Lender Confetti letters”, this has had an impact on premiums, as the sheer volume require Insurers to spend considerable time, money and effort on them.*

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**Q15:** What would be the increase in premium if there was a valid insurance claim against the company for £50,000? Would the premium increase dramatically if the claim was higher?

**A15:** *Claims payments do have an impact on premiums. However, if you have been with the same Insurer for a long period of time, one would expect that any increase to be much less than if you had just insured with that Insurer. The nature of the loss also dictates premiums. If the error was understandable and not grossly negligent, then the Insurer is likely to be more sympathetic.*

*Insurers are concerned by the number of claims caused by a lack of knowledge. This is due to the recession where reducing income has forced some surveyors to take on unfamiliar work. Some of the resulting claims have been very large indeed!*

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**Q16:** How many claims do you have to have against you before you come uninsurable?

**A16:** *If a loss is due to fraud then no Insurer will provide cover. If there is a run of unconnected losses, Insurers may well commission a risk management inspection and if there is a common theme this can be problematic as your business could be viewed as having a “systemic” problem. This could make you uninsurable.*

*In the vast majority of cases a good broker and insurer can help you with risk management and in our experience it is very rare for an insurer to deem a surveyor uninsurable.*

## **Run-Off Insurance**

**Q17:** Over how many years should Run-Off cover be expected to continue?

**A17:** *The RICS used to stipulate a “minimum” Run-Off period of 6 years. For many Surveyors longer periods would be prudent, depending upon the nature of your work.*

*Limitation Act: 6 years, but recent Case Law, (see Nykredit v Edward Erdman Group) has meant for valuers the limitation could be 9-10 years and the same for Surveys, as date of discovery is key.*

*Contract Under Deed: 12 years.*

*Latent Damage Act: Longstop 15 years – cut-off date for all actions against a professional.*

*When you no longer have the ability to work is perhaps when you most need the protection of insurance.*

**Q18:** Prior to retirement, payment of the annual premium can be off-set against tax. However, after retirement payment is made from post-tax, pension income. Would it not be possible for the insurance industry to create a product whereby a single payment can be made immediately prior to retirement (out of pre-tax income) to provide cover for the next six or more years?

**A18:** *For those undertaking Survey and Valuation work, no Insurer could run the risk of providing extended cover due to the frequency and severity of losses that occur. We recommend that our Clients set aside 4 times their last premium to pay for their Run-Off.*

*Fraser Miller is currently discussing with Insurers, better ways to arrange Run-Off for lower risk Practices. We have also asked Accountants to advise on whether there is a tax-efficient way to pay for Run Off. Ideally the RICS should seek a ruling from HMRC but in the meantime, Fraser Miller will share any information with the ISVA as it becomes available.*

**Comment:** We would also suggest that for those considering Run Off in the near future that they speak with their own Accountants.

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**Q19:** Could you say something about the importance of Run-Off insurance? How it works and how surveyors should consider winding down high risk work before closing their business? Also what files should be kept and for how long? Retirement often means a wholesale clear out either by the Retiree or whoever is taking over.

**A19:** *This contributor makes a very good point about winding down a practice before retirement. It makes no financial sense to enter into Run Off in the same year your fee income is at record levels. We advise people to taper their activities and income so they “glide” into retirement. Our advice is that 3 years before your planned retirement you cease or substantially reduce your high risk work and reduce your income, otherwise, like a Fixed Interest Rate Mortgage, you run the risk of setting the premium at a much higher rate than needs be. The question of retaining files is also raised and our advice is to retain files for a minimum of 12 years and preferably 15 but they can be thinned out and it is sensible to start categorising your files NOW into “high”, “medium” and “low” risk work.*

**Comment:** Retaining files is vital and if you had a claim and were unable to locate your file your Insurer would be unable to mount a defence and might be unwilling to continue providing Run-Off cover.

**Run-Off is a complex subject. Seek professional guidance and plan how to reduce your liabilities and PI insurance cost well before you retire.**