ISSUE NO.1

BuildingBlocks

RISK INSIGHTS FOR THE CONSTRUCTION INDUSTRY

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Gallagher

Insurance | Risk Management | Consulting

ABOUT GALLAGHER

Founded by Arthur Gallagher in Chicago in 1927, Gallagher (NYSE: AJG) has grown to become one of the largest insurance brokerage, risk management, and human capital consultant companies in the world. With significant reach internationally, the group employs over 26,000 people and its global network provides services in more than 150 countries.

Gallagher's London divisions offer specialist insurance and risk management services. We provide bespoke policy wordings, programme design and risk placement solutions, and consulting support across a range of specialisms. We manage complex, large, global risks on a direct and wholesale basis and serve as primary access point to Lloyd's of London, London company markets, and international insurance markets.

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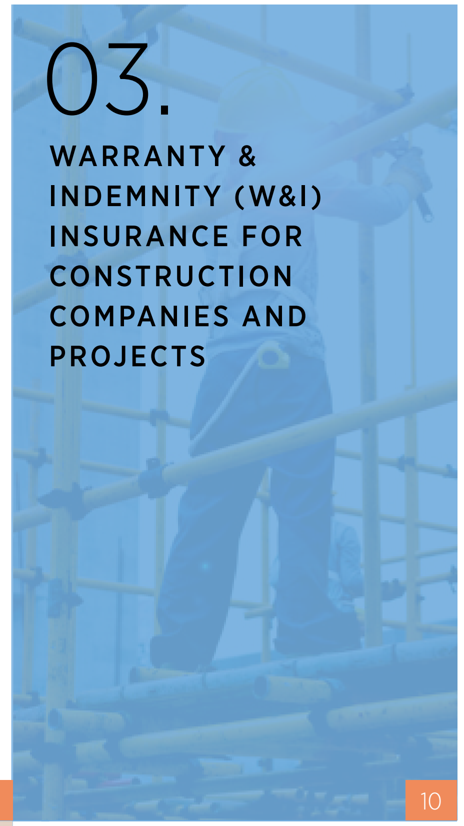

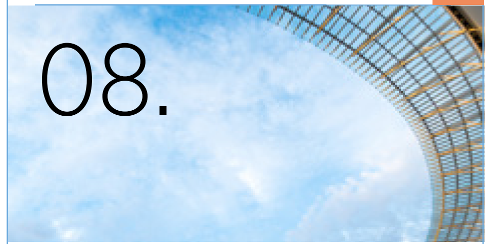

EXECUTIVE SUMMARY

In this edition of Building Blocks, our focus is turned on developments in the insurance market and how these changes, both in respect of new products, and changing underwriter appetite, present the construction sector with better ways to manage risk.

We've collaborated with specialists across Gallagher to showcase a range of products and services that are becoming increasingly relevant for stakeholders across the construction sector, from contractors and developers to financiers. The message from all of our teams is consistent – the London insurance market is rapidly changing as insurers seek to diversify and differentiate their offerings during a stubbornly soft market cycle.

Gallagher has teams both in London and across the UK, as well as a growing international capability. This means that you'll have access to specialists locally, to help you identify, understand and manage risk. Our advice is 'test the market.' Talk to our teams if you have difficult or complex risks that might have been problematic previously – it's likely that we will be able to develop a solution for you.

We hope that you enjoy this edition, and don't hesitate to get in touch.

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ABOUT GALLAGHER CONSTRUCTION

Our Construction division arranges insurance for UK and international contractors and designs bespoke owner-controlled programmes across a wide spectrum of projects. Our clients range from contractors and engineers, to sponsors, financiers and local authorities. With our help, project stakeholders can identify, mitigate and transfer risk more strategically.

We offer products and services to enable our clients to manage complex risks of all sizes, including:

- Construction / Erection All-Risks
- Delay in Start-Up
- Pre-handover & Operational Risks
- Business Interruption
- General & Third-party Liability
- Marine Cargo
- Latent Defects
- Environmental / Pollution Liability
- Terrorism & Political risk
- Mergers & Acquisitions
- Legal Indemnity.

01. CONSTRUCTION INSURANCE MARKET UPDATE

General market conditions

In 2017, several major natural catastrophe events, Hurricanes Harvey, Irma and Maria, led to losses of around USD140bn. There were concerns that these, and localised losses such as the severe wildfires seen in California, might lead to rate increases in the international insurance markets.

However, despite the prevalence of recent major natural disasters, the good news for buyers is that the knock-on effect to the construction insurance market has been quite limited. In fact it is water damage claims arising from burst pipes and the like, which appear to be becoming an increasing focus for underwriters in 2018. This trend was first noted in the US, where shrinking premium pools led to more thorough investigations of attritional losses, revealing the large share of total claims that these losses comprise. This is now starting to become an issue for underwriters in the UK. Increased underwriting scrutiny has also become apparent in the timber framed building sector.

Yet despite all this varied loss activity, Gallagher has seen little or no upwards pressure on premium rates or changes to general policy terms and conditions in the construction insurance market.

Substantial surplus capacity

The main reason for this is the continued availability of large amounts of surplus capacity in the market as a result of continued profitability of this class of business.

Between 3-5 years ago Lloyd's syndicates hugely increased their capacity for construction business; they have been joined in the last couple of years by other new entrants. For example, Aviva has now entered into international construction insurance and Mapfre have established a London office to handle London market construction risks, amongst others. Further, there have been no significant insurer withdrawals from the market in the last few years and no treaty issues, despite some uncertainty in the market in November 2017 triggered by increasing market acquisition costs.

Having said this, one area where we have experienced some difficulty in securing capacity is in the timber framed sector, where losses and the increasing of height limits in the US have seen underwriters become very wary before committing capacity to this type of construction risk.

In other developments

Annual Contractor PI Market and the impact of Grenfell

One area where we have seen extensive pressure on the market is during renewals for Annual Contractor Professional Indemnity (PI). This has been driven by the ongoing investigations into the causes and effects of the Grenfell fire together with a number of other Annual PI claims. In the immediate aftermath of Grenfell, underwriters did not fully understand what the wider impact of Grenfell would be, particularly around likely changes to building regulations and building design standards following the investigation. This environment of uncertainty has led to them turning down contractors erecting large amounts of cladding, while others have drastically reduced capacity. Deductibles are also increasing for some façade coverages.

In this marketplace, contractors need to be mindful that PI renewals are likely to be more complex than previously and, therefore, clients will need to begin their renewal preparation earlier to allow time to understand and collate any additional information required by underwriters.

Effect of Ogden Tables changes

The significant reduction in the Ogden Tables discount rate, which assists in the compensation calculation of personal injury and fatal accident court cases in the UK, has had a marked impact on the Employers' Liability (EL), Public Liability (PL) and Motor markets, which will have a knock-on effect on UK contractors. The motor market has been particularly hard hit with all insurers having to review claims reserves for more serious cases. Lloyd's syndicates as a result of their underwriting of more hazardous trades have in some cases had to increase rates due to their greater reliance on reinsurance. There is due to be a further government review of discount rates.

Inherent Defects Insurance (IDI) market

IDI is an area of the market where we have seen some notable developments, with several new entrants establishing themselves in a sector previously dominated by Allianz. These include Castel, an MGA with £70m of capacity, Helvetia in Switzerland, and Munich Re. Munich Re in particular has developed a real appetite for this business in order to offset dips in market share caused by current soft market conditions in the mainstream construction market.

The impact of the collapse of Carillion

The compulsory liquidation of Carillion in January 2018 made newspaper headlines and will have come as a shock to many. However, the seeds of the company's downfall were sown some time ago and those in the market with stringent due diligence procedures will not have been involved in Carillion contracts in any case. Indeed, despite the surety market in the US having been substantially affected by the collapse, we do not envisage at this time that this event will have a major impact on the wider construction insurance market. Having said this, the case does highlight the benefits to owners of procuring an Owner Coordinated Insurance Programme (OCIP) which covers all stakeholders and contractors working on a major project, thus making it easier to bring new contractors into the programme should the need arise.

Outlook

Generally speaking, we are very much still at the bottom of a soft cycle in the construction insurance market with no sign of significant rate increases on the horizon.

In terms of losses which might see a change in this outlook, another severe hurricane season in 2018 could hit market profitability, despite the current high levels of surplus capacity. We have also seen a renewed focus by underwriters to tighten operational costs, particularly given a recent spate of acquisitions (such as Axis acquiring Novae Syndicate, and AIG purchasing Validus (Talbot) Syndicate), and these in turn could see an increase in rates in due course.

The message for buyers, particularly in the Annual PI market or those with more complex risks, such as timber frame, need to ensure they allow plenty of time ahead of renewal so that their broker has sufficient time to suitably differentiate their risks to insurers, thereby minimising the chances of rate increases or changes to policy terms and conditions.

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02. TIMBER-FRAME CONSTRUCTION: CHANGING PERCEPTIONS IN THE INSURANCE MARKET

The UK Construction industry is continually seeking to develop more efficient and cost effective methods of construction. The government expects developers to turn to new technologies and offsite solutions to ensure buildings are constructed faster, to a higher standard and in greater numbers.

Not only is the construction industry striving to respond to the need to reduce costs and increase the speed of construction, but the industry must also address serious environmental concerns – particularly around carbon footprints – by seeking to utilise traditional materials, such as timber. This so-called 'eco construction' presents contractors with a range of different risks to consider.

Under the catch-all heading of Modern Methods of Construction (MMC), one such example is a growing trend for new, timber-framed structures.

Modern timber frame is already a proven offsite solution, used in the market for 40 years, and readily accepted by warranty, insurers, mortgage providers, with an established heritage and track record - with one out of four homes and soon to be one out of three homes - built using its many advantages.

To underline the significance of building in timber we can see tangible examples of the progress being made with Local Authorities, social housing providers and housebuilders embracing these 'new' build methods. Some are taking this a step further, with the London Borough of Hackney implementing 'a timber first' policy for new housing developments. There is also the case that the top three leading housebuilders have reported that they are using structural timber frame for up to 30% of their projects.

Whilst much has been written about the impact construction has on the environment, what has not been highlighted is the positive impact that a building can have on occupants. However, the health and wellbeing of occupants is becoming an increasingly important factor when it comes to building design and specification - with the World Green Building Council's global campaign, 'Better Places for People' further heightening awareness.

The usage of timber has been rising in the construction market as the renewable and sustainable qualities are becoming valued alongside the practical benefits delivered. As such, this brings interesting opportunities for the construction industry and insurance providers will now need to adapt to meet the growing requirement. From an insurer's perspective, often there is concern that these new construction methods can pose an increased risk, both in the construction process and for the completed structure.

An Overview

Using large quantities of combustible materials increases the risk of a fire occurring, and the severity of a fire, should one take hold. In addition, dependent on the type of timber employed, the resilience of a timber framed building to withstand the effects of a major flood (or indeed a deluge of water used to extinguish a fire) may be less than for comparable steel or concrete framed buildings.

As such from an insurance perspective timber framed buildings are regarded as 'non-standard construction' and can attract increased premium rates. One could argue this is not without reason; timber-framed construction has had a chequered past, including a selection of high-profile fires during construction in the early 2000s that have made their way into the news headlines. In reality, however, from April 2009 to March 2012, there were 134,000 fires across all forms of construction*. 2,485 of these were timber related, however the method of reporting these as 'timber' does not differentiate between a genuine timber-framed construction project and other 'timber' structures for example, a garden shed. In reality, then, it is believed that only 198 of these were actually 'timber frame' as we know it, and there were no fatalities. As a result, in the past, the insurance market has understandably been more conservative when considering timber frame risks as opposed to standard methods of construction. However, perceptions amongst insurers are slowly changing.

The Construction Industry's Response

The construction industry has learnt from its mistakes, following costly insurance claims that have demonstrated a need for change. The industry is moving forward with fire safety strategy and Site Safe Documents aimed at reducing fires in the construction process.

Leading the way in this regard, The Structural Timber Association (STA) has introduced a number of safety initiatives to help the industry address the risk of fire and to improve awareness on how to minimise the risks. This includes the 16 Steps to Fire Safety, which is now being seen as the benchmark for fire safety on a construction site, and is being employed across a growing number of non-timber sites alongside being a mandated requirement for all STA members' sites.

Meanwhile, the UK Timber Frame Association (UKTFA) continues to demonstrate that timber frame remains the most sustainable form of construction in the UK, and also works alongside HSE, BRE (Building Research Establishment) and Zero Carbon Hub to promote and reinforce the reputation of structural timber construction methods and to promote safe practice in all aspects of the construction process.

Changing design methods and the development of 'safer' materials will continue as the construction industry seeks to balance the need for sustainable construction, with a requirement for materials to be sufficiently robust to withstand fire and flood risks. It is certainly not an easy tightrope to tread, particularly when the industry is also required to keep a weathered eye on construction costs and project timelines.

Changing Insurer Perspective

Historically insurers were indeed cautious about writing timber frame construction risks and completed structures on account of losses, or on account of a lack of suitable reinsurance coverage backing their position. Some were unwilling to provide any cover, whilst those that did insure a risk demanded high deductibles and onerous terms and conditions added to the policy wording.

This had resulted in an over-reliance on costly difference in conditions/limits to manage claims during construction and a risk of reduced latent defects cover once the project was completed. Often then once a project becomes 'operational' post completion, the loaded premium for timber frames is also seen in the property insurance cover and wording conditions.

The good news is that the perception of insurers is beginning to change for timber frame projects as the work of the STA and UKTFA filters down through the industry and leads to real, tangible change. This was exemplified at an Insurer Awareness Morning hosted by Gallagher, in conjunction with the STA, in June 2017. 36 insurers and risk engineers representing almost every single major construction insurer in the UK attended, and listened to some of the market leaders in timber frame discuss the latest developments in the industry. The subsequent feedback from insurers was overwhelmingly positive. Almost 60% of insurer respondents to our follow up survey confirmed that the session had positively changed their perception of the timber frame industry, with not a single one responding negatively.

The insurance markets recognise that offsite methods of construction are part of the future for the construction industry in the UK. Crucially, it is the role of the insurance broker, to differentiate our clients' risks and to secure the most appropriate cover and terms. For more complex risks, such as timber frame, there is real advantage to be gained by those brokers that spend the time with both the industry and insurers, helping them understand their clients' risk profile and the reality of timber frame risks. It is our role to help insurers understand what our client is doing differently to help mitigate the risks in order to secure terms, and actively preventing the market from simply discounting timber frame risks immediately because they are categorised as 'non-standard.'

For construction projects this is achieved by gathering detailed and quality information for any given construction project, including material types and construction methods, to negotiate the best possible terms with insurers. An Owner Controlled Insurance Project (OCIP) is one way to ensure that our Construction specialists drill down to the detail, encouraging differentiation in an insurer's response between a 'cautious' one and a well-informed, appropriately underwritten one. This can be a better option than a Contractor Controlled Insurance Programme (CCIP) where costs may be passed on - without the same level of control as an OCIP. The value of the project, materials used, construction methods, number of storeys, evidence of sufficient cavity barriers and separations from other structures as well as site security details to minimise opportunities for arson attacks are just a selection of the additional factors involved in an insurer's decision-making process.

Our Construction team can also achieve better terms by 'spreading' the risk using a panel of insurers, securing broad form policy coverage and pre-agreed risk management requirements such as compliance with UKTFA guidelines, the Joint Code of Practice (JCOP) Fire Code and the 16 Steps to Fire Safety. By involving insurers at the planning stage using a risk managed approach, better results may be achieved. Finally, Gallagher's UK Construction team continue to be an actively engaged member of the Structural Timber Association, sitting on the Commercial Committee of the STA, and constantly working with members to improve perceptions and dialogue between the two industries.

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*www.gov.uk/government/collections/fire-statistics

03. WARRANTY & INDEMNITY (W&I) INSURANCE FOR CONSTRUCTION COMPANIES AND PROJECTS

The Mergers and Acquisitions (M&A) activity around development projects and construction companies has increased dramatically over the last few months. In addition, in the pursuit of yield, buyers are entering new, untapped jurisdictions and sectors that may previously have been dismissed as being too risky. At the same time, sellers are becoming less patient when it comes to offering high liability caps as they are unwilling to accept residual liability, and buyers are concerned that certain risks will not be addressed if the seller makes that 'cleaner exit'. Even commissioning external advisors to undertake diligence does not always mean that sufficient comfort can be obtained on areas such as title, tax, and construction, especially in newer jurisdictions.

Warranty and Indemnity (W&I) insurance is ever evolving. It has traditionally been very popular within the real estate sector as it effectively allows the seller to limit their liability to £1 and make a completely clean exit from a transaction. The buyer policy allows the purchaser to claim directly from the insurer in the event of a breach of warranty by the seller, regardless of any rights they have in the Sales & Purchase Agreement (SPA) to pursue the seller.

In recent months, the insurance market for W&I and tax risks has soared. Market capacity has tripled in two years with 23 insurers offering W&I cover in almost all jurisdictions and sectors globally. Insurers can no longer 'pick and choose' the deals that they want to underwrite and have had to become more commercial when it comes to price, coverage and process. As such, development acquisitions (such as green field and brown field sites) are viewed by most insurers as easily insurable and so are subject to substantial competition.

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Insurers will still pay particular attention to external diligence done on areas such as planning and financial accounting (due to the planning and construction aspects), but they are becoming more accepting of internal financial and tax due diligence, provided these are in a report form and carried out by individuals with the necessary qualifications to do so.

When it comes to construction companies being acquired, underwriters will expect to see robust due diligence around financial, accounting, contracts and employment. It is therefore essential that a broker is involved at an early stage of the deal to assess the feasibility of W&I insurance and to quickly find the right market for the deal. Rates are slightly higher on these deals due to the operational aspects, but we would always aim for circa 1% of the amount of insurance needed.

Due to the influx of new insurers into the W&I insurance, covering the M&A surrounding construction developments and companies is becoming easier and cheaper to insure; on timing, insurers are usually able to get fully tailored, fully negotiated policies in place within 5-7 working days of the first contact.

Furthermore, the premium rates and excess levels for these policies have dropped to almost match those attributable to clean real estate acquisitions. Premium rates have dropped to below 1% (of limit) and average excess levels have dropped from 1% to nil on most deals.

Our advice would be for buyers and sellers to test the market, and to talk to us, so we can advise on the most strategic deployment of this specialist product.

04. CARILLION: SHOULD THE CONTRACTS HAVE BEEN AWARDED?

The collapse of Carillion has brought the Public Services Act back into the spotlight, raising risks to developers and contractors working with local authorities of time-consuming and costly litigation proceedings.

Much more than a construction company, Carillion badged itself as an 'integrated support services business.' In 2016, Carillion had sales of £5.2bn, with an impressive market capitalisation of almost £1bn. The following year, the company collapsed under the weight of £1.5bn of debt, despite attempts between Carillion, its lenders, and the government to reach a suitable restructuring deal. Its demise immediately led to questions as to how the company had continued to secure new contracts from local authorities, and has led to a review of the awarding of large contracts.

The power of the Public Services Act

The Public Services (Social Value) Act forces the government to consider the social consequences of giving contracts to big companies like Carillion. At least 25 local councils had contracts with Carillion, including catering, cleaning, major engineering, library management and road gritting. The issue was that Carillion could not provide so many specialist services, which over time became a systemic risk.

The Act requires local authorities and government bodies to consider the social value of the contracts they award. The Act gives smaller, local businesses a natural advantage. Bidders must prove that how they do business positively impacts the local social and economic value of their area, incentivising good practice and rewarding companies that support communities.

Since the collapse of Carillion hit the headlines, the bidding process and the awarding of public contracts has been scrutinised heavily. Using the Public Services Act, a company which was unsuccessful in the awarding of a bid can challenge the decision of the local authority. This can cause many problems for the winner of the bid, such as project delay and costly litigation.

For example, Developer A wins a bid for the construction of a hospital. Developer B who did not win the contract, feels that the contract was awarded unfairly and a number of factors were not considered. Under the Act, Developer B has 6 weeks to challenge the decision. During this process an investigation can be instigated, causing the project to stall. Meanwhile, the successful bidder, Developer A, may have already incurred project costs such as building materials and the hiring of extra staff.

Due to the challenge, there is a court case and legal fees need to be paid. The court finds the process was unfair and orders another tender to take place. Developer B subsequently wins this contract, leaving Developer A with financial losses.

The solution

Many of the frustrations that emanate within a property transaction, refinancing or development can be insured.

The function of Legal Indemnity insurance is to protect against the risk of third party claims arising from a legal defect or challenge to the ownership or development of assets. These risks are usually discovered during the due diligence process and need comprehensive personalised policies that provide solutions in short timeframes.

Had Developer A taken out a Legal Indemnity insurance policy at the time of being awarded the contract, the following losses would have been covered:

- Legal fees
- Court costs
- Expenses (that the Developer was contracted to spend) that have already been incurred
- The profit that they were likely to make had they been awarded the contract
- Bid costs for the second tender.

Legal Indemnity insurance can assist with ensuring that a transaction, development or refinancing proceeds by providing comfort that there is recourse against a financially stable insurance company in the event that a claimant comes forward. This enables lenders, purchasers and tenants to mitigate the risks associated with the ownership and use of an asset with a timely and cost effective solution.

Applying to the relevant authorities to eradicate these risks can take a long time and halt a transaction, particularly in a bidding situation. Legal Indemnity insurance can be implemented very quickly, allowing the acquisition/disposal to proceed.

Gallagher's Legal Indemnity team is experienced with working to tight timescales, delivering complex transactions and developments. Our clients include law firms, property owners and developers. Our experience enables us to provide advice and comment on the availability of products, coverage and premium rates to assist you quickly and thoroughly without any unnecessary delay.

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With ransomware attacks such as WannaCry and NotPetya and data theft from major companies such as Equifax repeatedly hitting the headlines last year, it is unsurprising that an increasing number of companies are questioning their resilience to cyber risks. While historically the construction industry has been less of a target due to the fact that the majority of construction firms' revenue generating activities are conducted offline, changes within the industry and the increasing importance of technology means that the industry is not entirely free from cyber risk.

Construction contributes 7% of the UK's GDP, which makes it a more valuable target than you might initially expect. With an increased reliance on remote systems such as Building Information Modelling (BIM) and also project management systems, the construction industry's exposure to cyber risks is changing.

05. CYBER RISKS IN THE CONSTRUCTION INDUSTRY

What types of threats exist?

There are a variety of different threats that the construction industry could be impacted by, but the most common include:

- **Phishing** – malicious emails designed to look like genuine emails which encourage employees to click – infecting their computers in the process.
- **Viruses** – code which infects computer system, corrupting or deleting data.
- **Hacking** – an individual or group attempting to gain access to company systems with the intent to steal or destroy data.
- **Ransomware** – a malicious programme which locks access to company files and data until a ransom payment is made, after which time access may be restored.

The business implications

It is a misnomer that only the largest, household name corporates are at risk; these days cyber criminals tend to target ordinary companies banking on the fact that their security is likely to be less extensive and that the company's resilience to attack will be lower as the requisite training, equipment and cyber security policies may not be in place.

All data, whether that is customer databases, employee files, financial information, or even project specific contracts, plans, or correspondence, holds value for cyber criminals so businesses need to take steps to protect their data. Every company holds customer data to a greater or lesser extent, and every company has to issue invoices and use payment systems for both payroll and processing, so theoretically, any company can be made a target for cyber criminals. Data can be stolen (potentially causing financial loss through fraudulent transactions) or sold online, impacting the company that has suffered the breach, and potentially, depending on the nature of the data stolen, also impacting a third party, such as a client. There have also been an increasing number of ransomware cases; not only is there a cost associated with paying a ransom to re-access your systems and files, there is no guarantee that access will be granted even after a ransom has been paid, leaving companies to the whim of cyber criminals that demand additional sums.

Construction industry risks also include the stealing of designs and blueprints, which could lead to an extensive project delay. A serious attack could see a company lose access to their systems, causing a significant impact on day to day operations, project progress and relationships with clients. Indeed, the reputational risks could outweigh the financial; customers are unlikely to work with a company that cannot demonstrate resilience to cyber risks.

The legal implications

A recent Gov.uk survey discovered that senior managers in construction do not prioritise cyber-security, with 41% admitting that senior managers were not focused on cyber security and only 35% agreeing that cyber security was a key part of their daily work. Yet with the EU's new data protection standard, General Data Protection Regulation (GDPR), due to be introduced on 25 May 2018, failing to adequately secure client data specifically, could see the company facing a hefty fine. Companies may also find themselves on the receiving end of litigation by third parties that have been impacted by a cyber event if they believe that their data had not been suitably safeguarded.

How can you protect your business?

With any good risk management policy the key is training and awareness. Educate your staff on how to identify phishing emails and encourage them to report anything suspicious to senior staff. Reinforce the importance of setting good passwords and back up data regularly so that if systems are compromised, operations need not grind to a halt. Treat cyber risks like any other risk to the balance sheet or reputation, rather than leaving the management of cyber risks exclusively in the hands of the IT department.

Cyber insurance

While prevention is better than cure, a robust cyber insurance policy can help to mitigate some of the financial and reputational damage of an attack and will help companies get back up and running with minimal interruption.

All of Gallagher's cyber protection programmes are carefully designed to provide comprehensive cover for a range of risks including:

- Cyber extortion and cyber terrorism
- Data asset loss
- Business interruption and loss of income
- Breach response costs
- Regulatory investigations and defence costs
- Civil fines and penalties (a major concern with GDPR)
- Litigation damages and costs from individuals/class actions
- Multimedia liability.

Extensions are also available for reputational damage and cybercrime.

SOURCES
1. rg-group.co.uk/whitepaper-cyber-crime-and-the-construction-industry/
2. www.gov.uk/government/statistics/cyber-security-breaches-survey-2017
3. www.gov.uk/government/statistics/cyber-security-breaches-survey-2017

Case study

Type
Data breach and ID theft using a fake email

Scenario
An employee in a large construction firm responded to an apparently genuine email request from a trusted source for confidential employee tax records and other information.

Sting
'Spear phishing' involves sending a fraudulent email that looks genuine. Hackers spoof the 'From:' line of the email so the sender feels real – say from the CEO or a trusted third party. The victim recipient then responds, clicking a malicious link in apparent good faith but that response - including any attachments – is re-routed to the hacker's email account.

Investigation
That single email reply harvested the full names, addresses, employment status and tax records for every employee working for the company during that year.

Conclusion
Never put blind faith in what arrives in the inbox. The sender may be fake and click-through links may be malicious. Human processes are key: always double-check all sensitive requests for information directly with the requester to establish bona fides.

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06. PRODUCT FOCUS: PENSION DEFICIT BONDS

What is a Pension Deficit Bond?

When UK construction firm Carillion collapsed in January 2018, one of the primary concerns was what would happen to the company pension scheme.

Companies that have a defined pension deficit are required, by law, to put in place a deficit recovery plan. The deficit is the gap between the expected liabilities of pension commitments and the funds that companies hold to pay for pensions.

The UK's leading plcs have a combined deficit of £62bn, accounting for 70% of their profits - higher than in 2009 after the financial crisis.* As companies experience periods of growth or stagnation on account of broader economic conditions or industry trends, sometimes it can be difficult to ensure that sufficient funds are set aside for pension contributions. Furthermore, the use of a Letter of Credit (LC) arrangement to meet the legal obligation to have some kind of deficit recovery plan in place puts a strain on the balance sheet and ties up working capital.

This is where surety bonds can help. A surety bond is the responsibility taken on by a surety company to pay an amount to the pension fund if a specific trigger occurs; the insolvency of the fund sponsor or refusal to pay an arranged deficit recovery plan. Surety bonds are issued in favour of the schemes trustees, on behalf of the sponsor (Gallagher client). They allow trustees to be less rigid regarding the cash they require from the sponsor, as additional security is provided by the surety bond, if the sponsor becomes insolvent. The critical discussion usually takes place between the sponsor and the trustees to determine whether a surety bond will be the chosen funding strategy. The trustees must approve any recommendation.

When Are Pension Bonds Suitable?

- Predominantly FTSE 250 companies with a strong balance sheet.
- Where there is a scheme merger.
- Where there is a corporate restructuring.
- Risk management and mitigation plans are being written.
- There is a valuation negotiation.
- There is a letter of credit renewal date.

The Advantages of Using Surety Bonds for Pension Schemes

There are a range of benefits:

- Provide alternative security for scheme funding, potentially reducing the immediate need for deficit reduction contributions.
- Frees up existing capital to invest in the business, to enable the company to remain strong and solvent and therefore ease pressure on the cash position/balance sheet.
- The cost of a pension deficit bond may be less than the cost of borrowing cash to put into the scheme.
- The Pension Protection Fund recognises pension bonds as an acceptable asset used in support of a planned schedule of deficit recovery contribution.
- Help to manage the risk of trapped surplus in the fund.

A bond solution might not be the most appropriate solution in every circumstance, so it is best to speak to a qualified insurance broker about the advantages and the potential limitations of bonding solutions, and whether a bond is the best choice for your business.

TO FIND OUT MORE ›
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* Topham, G., Guardian (2017), 'Pension deficit of UK's leading companies equivalent to 70% of their profits'

07. VIEW FROM A LAWYER

Duties of a designer: Where fitness for purpose trumps duty to exercise reasonable skill and care.

Design and build contracts are often very lengthy and complex documents where the obligations of the contractor are set out in several documents and specifications, often produced by different parties. This can give rise to conflicting standards being incorporated into contracts. In two decisions last year, the court held that design and build (D&B) contractors had assumed responsibility for defects in buildings notwithstanding the absence of any negligence or failure to exercise proper or reasonable care on their part.

These decisions highlight the need for D&B contractors (and indeed any designer or contractor) to ensure that great care is taken to verify that the contractual documents are entirely consistent with each other and clearly and accurately set out the standard to which the work must be carried out.

Weightmans LLP is a leading UK law firm with a nationally recognised construction practice providing a comprehensive service for both projects and dispute management across a broad range of sectors. Clients include developers, main contractors, utilities, transport authorities, education institutions, consultants and sub-contractors. The team advises on all aspects of construction risk management from procurement to completion.

Case 1: MT Højgaard v E.ON [2017] UKSC 59

MT Højgaard ("MTH") was appointed by E.ON to design and install 60 wind turbines. MTH's contract required them to design, manufacture, test, deliver and install and complete the works:

- In a professional manner in accordance with modern commercial engineering and design principles and in accordance with internationally recognised standards and Good Industry practice (clause 8.1(iv))
- So that the works complied with the requirements of the contract (clause 8.1(viii)).
- In accordance with Good Industry Practice (clause 8.1(ix)).
- Free "from defective workmanship and materials and fit for its purpose…" (clause 8.1(x)).

The Employer's Requirements contained the detailed Technical Requirements ("TR") for the design. They required MTH to:

- Prepare the detailed foundation design in accordance with an international standard ("J101") (paragraph 3.2.2.2(i)). J101 required the wind turbines to have a service life of 20 years. To achieve this, it set out a technical equation for use by designers in calculating the load capacity of the piles.
- "[E]nsure a lifetime of 20 years in every aspect, without planned replacement" (paragraph 3.2.2.2(ii)). A similar requirement was contained in paragraph 3.2.6.

Clause 3.1(i) stressed that the requirements of paragraph 3 were minimum requirements.

MTH produced its design in accordance with international standard J101. Following practical completion, the authors of J101 became aware of errors in the technical equation set out in J101. That error had the result of overstating the load capacity of piles.

Remedial works were carried out by MTH. The question was whether MTH was liable for the costs involved, notwithstanding the fact that they (1) had used proper skill and care in producing their design, and (2) had complied strictly with the requirements of J101?

E.ON contended that MTH had warranted that (i) the works would be fit for their intended purpose, and (ii) the foundations would have a lifespan of 20 years without planned maintenance.

MTH argued that it was not liable in the absence of any failure on their part to exercise reasonable skill and care and in the absence of any failure on their part to comply with the requirements of J101.

The decision

Reversing the decision of the Court of Appeal, the Supreme Court noted the apparent inconsistencies between the requirements of J101 and Clause 8.1(iv) and (ix) on the one hand and the provisions of Clause 8.1 (x) and Clause 3.2.2.2 on the other and held that, on a proper construction of the contract, MTH had agreed to ensure that the 'design of the foundations was such, that they would have a lifetime of 20 years'. As that term had not been complied with, MTH was in breach of contract. There was no inconsistency between that requirement and the other less onerous obligations such as the requirement to exercise reasonable skill and care and to comply with J101. MTH had to ensure that the 20 year design lifespan was achieved. If necessary, they had to identify improvements to the technical specifications, including the need to identify errors in J101. MTH were liable to E.ON, notwithstanding the fact that they had complied fully with J101 and had acted in accordance with clause 8.1 (x). Strict performance of the obligation to provide a design with a 20 year lifespan was required.

Case 2: 125 OBS (Nominees1) v Lend Lease Construction (Europe) Limited [2017] EWHC 25 (TCC)

In this case, Lend Lease ("LL") was engaged under a D&B contract to design and build a 26 storey tower and install glass cladding. To reduce the risk of the glass from breaking, LL was obliged to 'heat soak' the glass panels in accordance with a European Standard. Even after being exposed to this process, however, the EU Standard acknowledged that there would be breakages at the rate of 1 panel per 400 tonnes.

There was also an express term of the contract that the glass cladding would have a service life of 30 years.

Following practical completion, 17 of the glass panels broke. The employer required remedial works to be carried out (after which 4 further failures occurred), and sought damages for compensation paid to the tenants of the building. The employer alleged that LL had failed to:

1. Expose the glass panels to heat soaking in according with a European Standard;
2. Supply materials of good quality and a curtain walling system that was fit for its purpose (Clause 8.1.1 and section 9G);
3. Supply glass panels with a service life of 30 years (section 33G); and
4. Ensure that all materials supplied complied with the specified standards set out in the contract (section 34G) (A).

LL denied liability. They argued that they had complied with their contractual obligations. Further, in specifying the requirement that the panels be subject to heat soaking in the knowledge that there would still be a risk of residual breakages, the employer had assumed the risk of breakages.

The decision

The court held that the contract contained several discrete obligations, in addition to the obligation to expose the glass panels to heat soaking. LL was obliged both to heat soak the glass and ensure that it had a service life of 30 years. LL was in breach of contract for failing to heat soak between 35-40% of the glass panels. If the glass had been heat soaked, the failure rate would have been less than that experienced on site (between 0 and 1). LL was also in breach of its obligations to supply glass of a satisfactory quality and fit for its intended purposes by reason of their failure to heat soak the glass in accordance with the contractual specification.

Finally, as the glass was neither of a satisfactory quality nor fit for its purpose, LL had also failed to comply with the obligation to supply glass with a service life of 30 years. The court went on to state, however, that even had the glass been heat soaked, but had failed as it did, LL would have been in breach of contract for not providing glass panels with a service life of 30 years.

Lessons

In each of these cases, the fact that the contactor may have carried out its contractual obligation using reasonable skill and care, was held not to be sufficient in order to absolve them from liability defects in the works designed and installed on site. In MT Højgaard, MTH was liable despite the fact that they had complied with the specification J101, and had exercised all reasonable skill and care. Similarly, in 125 OBS , compliance with the obligation to heat soak all of the glass panels (and the acknowledgment in the contractor's specification that this still would still have resulted in some glass breakages), would not have absolved the contactor from liability in the light of their agreeing to supply materials that were fit for their intendeds intended purpose.

In interpreting contracts, courts will consider the natural and ordinary meanings of the words used, consider the meaning of those words against the backdrop of the contract as a whole, consider the overall commercial purpose of the contract, the facts and matters known or assumed by the parties at the time the contact was concluded, as well as a commercial common sense as a means of interpreting contacts and in determining the obligations owed. However, courts will not be slow in interpreting contracts in a manner which impose higher standards of compliance where there appear to be competing standards.

These cases may have a significant impact upon design and build contractors. Contractual obligations to carry out work that are fit for their intended purpose may remove them from any insurance cover that they may otherwise have in connection with the project. Accordingly, these decisions serve to highlight the importance of ensuring that the terms of the contract and the various specifications are both properly understood and consistent with each other. The parties should clearly state whether the overriding duty (in relation to both design and construction) is one that requires reasonable skill and care or a guarantee of fitness for purpose. Care needs to be taken by contractors to ensure that the duties that they are signing up for will be adequately covered by the insurance that they carry on a project by project basis. As construction contracts are "complex, diffuse and multi-authored", the parties should consider incorporating contractual provisions which provide for the order of precedence between the various contractual provisions in the event of inconsistencies. In addition, design and build contractors should consider incorporating an express term excluding liability for fitness for purpose and for the consequences of relying upon errors contained in industry standards.

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08. CHELSEA FOOTBALL CLUB AND THE RISKS OF RIGHTS TO LIGHT

In January 2018, the courts ruled that a project backed by Chelsea Football Club for a new stadium could continue, following a four year delay caused by one local family's opposition to the project on account of a rights to light claim. In this article, we explain how Legal Indemnity insurance could have been used to mitigate risks of project delay and court costs.

Plans for a new world-class stadium – and local opposition

In 2014, the club had developed plans to create the world's most expensive stadium. The plans were granted planning consent by the local council, and had received the backing of the London Mayor, as the project was anticipated to bring an economic boost to the local area. However, on account of the size of the proposed stadium, the project would have infringed the right to light for many neighbouring properties.

However, on account of the size of the proposed stadium, the project would have infringed the right to light for many neighbouring properties. A right to light is a legally protected right to enjoy natural light within your property and can be expressly granted, implied or prescribed over time. If a development infringes a property's right to light, a court can order the works not to go ahead, demand that any works that have taken place are demolished, cut back the scheme in order for there not to be an infringement, or order the developer to compensate the claimant.

Although the club agreed to compensate 50 of the neighbouring homes that would suffer as a result of the redesign, they reached an impasse when a local family, the Crosthwaites, opposed the project. The family secured a High Court injunction to stop the 60,000 capacity stadium going ahead because they thought the completed stadium would cast a shadow over their home. Despite two years of negotiation, with reports of a six-figure sum being offered to the Crosthwaites, the club's lawyers wrote to the council saying the family's opposition 'posed a clear risk' to the new stadium, and funding had been on hold until the issue was resolved.

Using Section 203 of the Housing and Planning Act 2016, which states that the local authority has the ability to override easements and rights in land which have been appropriated for planning purposes, local councillors blocked the family's injunction by overriding their right to light to allow building work to begin because the project was deemed to be in the wider 'public interest.' Councillors voted to buy the disputed land, and then lease it back to the club in order to override the family's rights.

Despite Section 203 providing for compensation to claimants, the family did not back down. In a letter to the council the family's lawyers said, the 'sunlight and daylight will be seriously affected' to five of the Crosthwaites' windows by a proposed walkway, adding that the stadium would have an 'unacceptable and harmful' effect on the area. The lawyers added that not only did the stadium need redesigning, but that the club's insistence that the council override the rights of the Crosthwaites was not in the public interest and was quite possibly illegal.

Mitigating the risks of project delay or cancellation

Section 203 states that compensation must be paid to the person whose rights have been overridden, although the claims are restricted to one of 'injurious affection' only ie; compensation is assessed on the basis of the loss in value of the land as a consequence of this interference or breach of rights.

Yet in the case of the Crosthwaites, compensation was deemed insufficient. As a result, the legal battle started in 2014 and was only ruled final in early January 2018. London Borough of Hammersmith and Fulham Council said the issue over the rights of light may now be held with the council rather than the football club, and as such, development can continue barring any further legal action. The injunction taken out by the Crosthwaites from the High Court is no longer valid.

In circumstances like these a Legal Indemnity insurance policy could have been deployed. There are a number of ways that a policy can be structured. An agreed conduct policy allows for the developer to negotiate with named neighbouring properties and either an excess against the policy or an excess against each property in place. Any expenditure over and above the excess will be borne by the insurer. Alternatively, the policy can be designed with a 'wait and see' structure, whereby the developer is not to speak to any neighbouring properties about rights of light and the policy will respond in the event that a claimant comes forward. Generally, there is no excess on these policies.

In this case of Chelsea Football Club, the Crosthwaite family would still be receiving compensation; the policy would cover this (over and above any agreed excess) and the associated legal fees of the case. We cannot confirm whether a policy was in force in this case, but had it been in place, the insurance would have covered the delay to the scheme, and any future loss of profit to the club as a result of this delay, including increased interest payments, increased plant costs, any contractual penalties, increased security costs and wages and salaries of staff.

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09.CHANGING CAPABILITIES OF THE INHERENT DEFECTS MARKET

Traditionally, the insurance market for inherent defects was dominated by a single mutual insurance company, National House-Building Council (NHBC), with around 80% of premium being placed through this mutual, who distributed this product to new homeowners via the building contractor, their member.

NHBC's dominance is now being challenged in respect of both price and cover by newer, insurer-backed players, who have woken up to the potential of the inherent defects market. This new entrant appetite has been particularly whetted by meagre returns from the mainstream construction market due to the current soft cycle.

Changing appetites

Insurer-backed entrants to this class of insurance are increasingly willing to consider more complex risks, for example, cover for existing structures. Traditionally these types of complex risks may have had cover in place, but with significant exclusions, or in some cases, cover may not have been granted, leaving companies without suitable protection in place.

It is now possible to create a blended solution whereby the needs of all project stakeholders are addressed in cases where there are particularly complex inherent defect issues in place and where gaps in traditional coverage may have seen brownfield projects stall as the various stakeholders are unable to agree who ought to be the responsible party for inherent defects of an existing structure for which they have no prior responsibility.

Contractors and developers alike can use the market to develop a solution to ring-fence their liability, and that of the respective project stakeholders, in order for a project to progress forward. The building contract itself can also mirror the insurance policy by providing a waiver of subrogation for the contractor or developer, effectively providing them with a safety net that any defects over a certain size (the excess) would be picked up by insurers rather than falling at their door. This hybrid solution then ultimately provides future homeowners, developers and the main contractor, with peace of mind.

Gallagher provided a number of unique solutions to a challenging problem brought about by a complex, sizeable and un-warrantied existing basement, coupled with a superstructure design which involving a complex cladding solution. They presented a number of options for tackling the problem, which in turn allowed us to make an well informed decision when selecting the most effective solution for ourselves the lenders, and the principal contractor.

ADAM BROOKS-SENIOR PROJECT MANAGER
URBAN & CIVIC PLC, 2018

Case Study

Gallagher developed this solution for a developer, Urban & Civic plc, who had secured planning permission to build three multi-storey (up to 15) towers on a site with an existing 4 storey basement structure (the largest in Manchester) which had lain empty since completion in 2009. The inherent defects market were cautious of providing cover on account of the basement, so Gallagher approached one of the now leading players in the market Building Life Plans (BLP)/Allianz Global Corporate & Specialty SE (AGCS) to develop a solution to respond to the unique challenges of this site; fine-tuning the wording and ensuring the buy-in of all stakeholders, including lenders and the main contractor.

The contractor was keen to ensure that a workable solution could be purchased by the developer, in the knowledge that any inherent defects in the structure would be covered under, what is, a first-party policy. Our solution therefore provided a waiver of subrogation for the main contractor, and the wording was also written into the building contract itself. Essentially the solution transferred a significant portion of the liability around the existing structure to insurers, thereby ring-fencing the contractor, developer and future homeowners' liability, whilst also ensuring a Council of Mortgage Lenders' (CML) Approved cover was in place that meant future homeowners will be able to obtain mortgages. BLP/AGCS wrote 50% of the risk with the follow 50% underwritten by Castel, a new entrant Managing General Agent (MGA).

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10. MANAGING LAND DEVELOPMENT RISKS WITH ENVIRONMENTAL IMPAIRMENT LIABILITY INSURANCE

Landowners and developers are facing increasing pressure to deliver and develop surplus land to meet the UK's growing housing demand and to create space for employment. Potential risks associated with contaminated land have been highlighted in a number of significant recent cases, such as the Redland-Crest case in 2010. Furthermore, the recent collapse of large UK construction firm Carillion will inevitably lead to questions about how future liabilities, particularly around contamination should be apportioned if a project stakeholder is no longer trading.

Landowners and developers can conduct substantial due diligence on greenfield and brownfield sites, but it can be difficult to ensure that long-tail risks can be identified and managed. There are however, project-specific insurances to mitigate contamination and broader environmental liability risks associated with land development, and contractor default.

Case Study

Crest Nicholson Residential Limited, R (on application of) v Secretary of State for Environment, Food and Rural Affairs and Others [2010] EWCH 561 (Admin).

The Crest case involved St Leonard's Court, an estate comprising 66 residential units near St Albans. From the 1950s to the 1980s the land housed a chemical works, which from 1980 was operated by Redland Minerals Ltd. When Crest Nicholson Residential Limited purchased the site from Redland, due diligence revealed that some contamination had occurred, although the full extent was not disclosed. Crest demolished the chemical works in 1983 in order to build St Leonard's Court, which was finalised in 1987. In late 2000, the St Albans District Council identified a source of water contamination; bromate and bromide had leached into the soil and contaminated the water source. The Council referred the case to the Environment Agency.

The test used for establishing liability in contaminated land cases is based on whether the parties "caused or knowingly permitted" the presence of a pollutant in, on or under the land. The Environment Agency served a remediation notice against both Redlands and Crest, claiming they were liable. Despite both companies appealing, the High Court refused their appeal and apportioned liability.

Redland argued that they had sold the site to Crest "with information." However, while Redland had provided information showing contamination had occurred, the court deemed Crest could not reasonably have been aware of the extent of the contamination, nor had Redland provided information on the specific bromate contamination. Accordingly the "sold with information" test only limited their liability to some extent.

Crest was found responsible for a proportion of the liability. Despite arguing they did not "cause" the contamination, the Court ruled that a party does not have to introduce a contaminant to a site to have caused it to be in, on or under the land. A party can be found liable for contamination to land through both action and inaction. The Court held that Crest's was liable on account of how it dealt with the redevelopment works. Crest had demolished the former factory but had knowingly left the contaminated soil exposed to further rainfall, which would have led to leaching and later, contamination.

Lessons

This case serves as a warning to land owners and developers. Whilst, usually the law works on the basis of the 'polluter pays' model, it could be seen in practice to apply instead on the basis of strict liability, as the responsibility to remediate contaminated land can arise without any active fault, breach of law or intention. Although not dealt with explicitly, the Court's opinion underlined that if it is not possible to find who caused or permitted the contamination, liability will pass to the current owner and occupier. Developers are not immune from liability for historical events, and selling/disposing of contaminated land is not necessarily a bar to future liability, even where disclosures are made.

Professional Indemnity (PI) insurance - perception or reality?

The traditional route of using contracts to transfer liability is understood but there is a limitation in this approach: insolvency. If a company no longer exists, any financial settlement is unlikely and importantly, a PI policy will no longer be in place.

For contaminated land and other developments, clients often seek consultant and contractor PI insurance as a safeguard against potential long-term residual pollution problems, often under the misapprehension that their PI insurance offers a direct benefit.

However, it is important to remember that PI insurance is negligence-based; incepted primarily for the protection of the consultant or contractor against claims of negligence during the course of their work or professional duties. The burden of proof for negligence is extremely onerous.

If a contract is in breach of the terms of the PI policy, the cover can be invalidated and the contractor or consultant will have to defend and settle a claim. Most consultants or contractors will have a very low credit rating when compared to insurers.

Warranty agreements usually require PI insurance for 12 years, provided it remains: 'available at economic cost'. PI insurance is annual cover rather than one-off for the period of the contract the policy is 'claims-made'. This means that any claims have to be made during the policy period. If the insurance is lapsed, cancelled or non-renewed at any time, there is no cover.

Further complicating matters, the majority of environmental PI policies are placed on an 'aggregate limits' basis and are not ring-fenced to a particular project. If a consultant or contractor has entered into a number of agreements and suffers one or more claims during a policy period, the aggregate limit of indemnity could easily be exhausted. The question is, how can you secure a project and ring-fence liability?

Selecting technically capable and experienced advisors and contractors is one key element of risk management. This should include using a qualified insurance professional to undertake due diligence of the insurance offered before being appointed. PI insurance and other insurances will provide some protection but PI insurance and warranties are primarily based on fault and negligence, which can be difficult and costly to prove. Often consultants have to rely on incomplete regulatory guidelines. What is 'definite' may yet be resolved to any degree of confidence in both scientific and legal fields. The shifting sands of liability through scientific discovery and case law add to uncertainty.

Trying to protect your organisation against the wide range of risks merely through reliance on someone else's insurance and contractual provisions is not the only option.

Project-specific Environmental Impairment Liability (EIL) insurance

Increasingly landowners and developers, rather than putting the risk onto other parties or retaining the risk, are acquiring contaminated land insurance through an Environmental Impairment Liability policy.

Polices can cover third-party and regulatory claims and include consequential loss, property damage, bodily injury and on and off site remediation costs.

Benefits can include:

- A site specific 'ring-fenced' policy with long term duration of cover.
- Project specific cover (contractors pollution liability cover) for the development phase based on a long-term occurrence based policy wording.
- Cover for change in law and applicable regulations.
- Cover for legal and technical defence costs.
- Cover to include landowners or tenants business interruption costs.
- Flexibility to add additional insureds to include other stakeholders, funders, tenants and others.
- The policy assigned with the ability to stay protected as an additional insured.
- Secure credit rating with a regulated insurance company.
- Accountability in the risk transfer.

The insurance industry is the most regulated industry for the transfer of liability. For provision of suitable long-term financial protection against the risks associated with land development, project specific insurance should be the preferred method. This could be argued as the only real way of providing long-term accountable protection on a sustainable basis.

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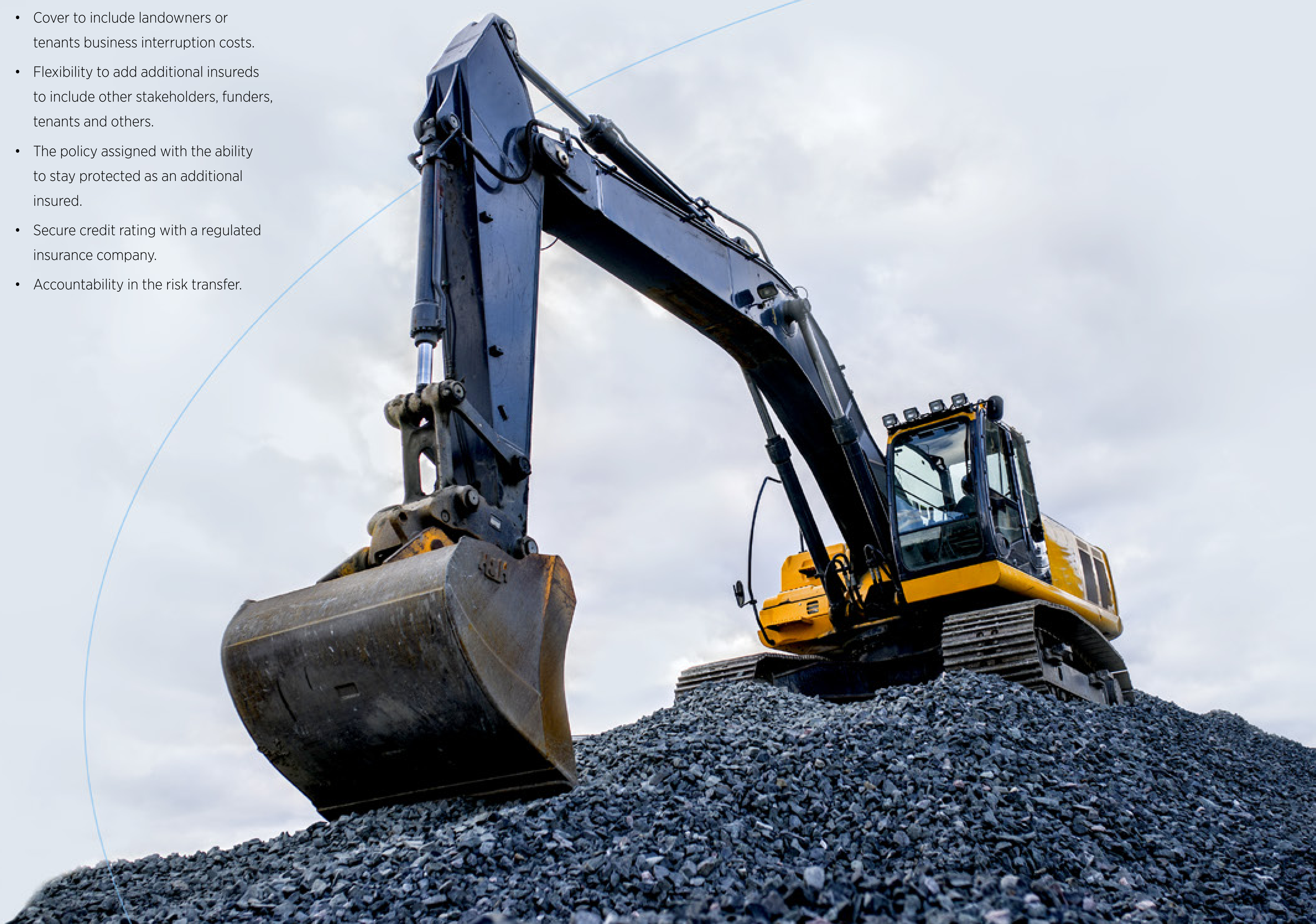

11. BROKER Q&A: LENDERS' DUE DILIGENCE

Building Blocks asks Omar Gonzalez, Construction Due Diligence team, about how his services support the banks and financiers that are lending to the sector, and why due diligence in the sector is becoming more important as the pursuit of yield intensifies.

Q. Which types of financier does the Due Diligence team predominately work for?

A. We normally work for banks, investment funds and fund managers who invest in infrastructure assets (including schools, universities, office blocks, retail park buildings, renewable energy, hospitals, roads etc). We help them ensure their interests and investments are protected by adequate insurance, so we review limits, the scope of cover, wording language and ensure that essential lender clauses and extensions have been included in the insurances procured by the borrowers ('operating partners').

We also ensure that the operating partners are complying with the insurance terms of any loans or facilities and point out any areas of non-compliance, then negotiate with the operating partners' brokers to reach a suitable solution. We also evaluate the insurance markets selected by the brokers and comment on suitability for the project in question. Finally, for refinancing deals we help draft the insurance policy clauses and negotiate with counterparties to ensure our clients get the best protection. No two days are ever the same!

Q. Why is this important for them?

A. Institutional investors are very aware of the need to have high quality advisors - in fact having a Lenders Insurance Advisor is one of the requirements seen on all loan facilities and/or project agreements. Banks and funds see the importance of this advice to ensure their investment is protected.

They are aware that if they choose not to engage a Lenders Advisor that they are taking the risk that the operating partner might not purchase the right type of insurance, that the selected insurers might not have the right expertise, that the scope of cover is limited or that the key clauses and extensions are not included. In the worst cases, I've seen policies where the lender has not even been included as a co-insured on the policy! Often these can just be a result of an oversight from a placing broker - but from a financier perspective, this leaves them exposed if not addressed. As investors remain focused on yield, this does mean that some are looking for larger projects or considering projects with more complex risks, so it is essential that financiers have confidence that the right insurance cover is in place.

Q. Can you provide an example of when something went wrong?

A. A big European institutional investor asked us to review the insurances for one of their projects, which is located in Africa. The loan agreement made it a requirement that the insurances contained certain Lenders Clauses, which all insurers and reinsurers had to agree on. The placement included more than 30 insurers and reinsurers per class of business. The operating partner's broker had finalised the placement yet several of the chosen markets had not agreed the lenders clauses. This was one of the many issues which were uncovered during the due diligence process. This rendered the operating partner's insurance non-compliant and also put our client at risk. Had a claim occurred, our client would have had little recourse. This is why it is important to carry out due diligence on both existing and new projects.

Q. Are you seeing any particular trends at the moment?

A. Many lenders when refinancing are deciding to have us sense check the facility insurance requirements and improve its requirements if needed. Increasingly they are moving away from copying and pasting the existing requirements and are instead going for a more tailored approach, with the insurance clauses pretty much being drafted from scratch.

Q. What might change for due diligence in the next few years i.e what external factors are shaping how lenders/project stakeholders are behaving or the projects they are investing in?

A. The economy will always dictate the strategies that lenders will use to select their investments and insurance market cycles will also play a part in that. However, I'm seeing a lot of activity in the refinancing of existing projects as well as an uptick in construction activity for Grade A office blocks, refurbishments of older stock in city centres, and also developments in industrial estates. It seems like re-generation of existing sites is gaining more interest. I'm also seeing a lot of new investment in the renewable energy sector.

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Q. If you had a top tip for companies that should be using Due Diligence services but currently don't, what would it be?

A. Due diligence gives you peace of mind; it ensures an expert helps with the drafting of insurance requirements (refinancing/new deals only), reviews the insurances (either proposed or existing at the different stages) and ensures your interests are protected.

If due diligence is not used you're relying solely on the word of your operating partner that they are complying with the Project Agreement Insurance requirements, that the covers are suitable and that appropriate insurers have been selected. Most lenders I work with simply aren't happy passing this responsibility to the operating partner when they have so much to lose.

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