Index

- Insurance Market
- Review of Scheme Performance
- Premium Collection Chart
- 2012 Schemes Structure
- Legal Risk Management Services
- Claims: Claims in excess of R500 000
  Claims Triangle
  Claims Graphs
- Conclusion

Insurance Market

For most insurers 2010 provided much needed relief from the financial crisis turmoil of the previous two years. The overall industry results were positively influenced by the return of a more normal claims profile and fewer market losses. However, the industry is by no means in the clear and will have to address some pertinent challenges in the years ahead. The gross written premiums of nine out of the top ten largest insurance companies reported R56.4 billion in 2010, up 3,7% over the R54.4 billion reported in 2009.

The muted growth is indicative of decreased market penetration as the consumer battles with affordability of insurance following sustained period of poor economic conditions. There has been an increase in the number of people out of work in South Africa. Job losses and increasing household debt have led to a reduction in disposable incomes – reducing the affordability of insurance and other long-term savings products.

In the face of increased competition in the market, the lack of premium growth and the management of the expense ratio will force insurers to expand market penetration to remain sustainable in the long term by finding innovative ways to increase market penetration within in South Africa and outside the Republic. Failure to grow the market will put increased pressure on the containment of costs and may result in large scale re-sizing in the industry against the backdrop of the ever changing regulatory environment. Irrespective of premium growth, operational efficiency will also play an important role to ensure long-term sustainability in the industry.

Rates have bottomed out throughout the first half of 2011 to all- time lows in the professional indemnity insurance market. The soft market conditions have now endured for the past six years. This cycle remains the longest soft cycle period experienced in the industry to date.

Santam Limited the only local Insurer that has consistently maintained a presence in the PI Insurance market over the past 25 years experienced a good overall underwriting and investment performance in 2010 against the backdrop of the difficult economic climate and underwriting conditions coupled with the continued pressure of the softening market. The overall net underwriting result ended 153% higher than the comparative period in 2009. Underwriting performance of the crop business came under pressure due to weather-related claims however there was a turnaround in the motor and property sectors of the business. The turnaround in the property portfolio was mainly due to the lower level of large industrial accident and fire related claims. In the speciality classes, liability (which include professional indemnity), engineering and transportation businesses performed well. Results from these areas showed significant turnaround from the loss-making position in 2009 to an acceptable profit margin. Santam's interim results as at June 2011 were pleasing with gross written premium of 7% improved from 6% recorded in 2010. The net insurance margin for the period June 2011 ended 11.2% compared to 11.1% for the comparable period in 2010. This was partly due to the specialist business classes not performing at exceptional levels experienced for the comparative June 2010 period. Domestic insurance industry premium growth for the balance of the year is expected to remain below the nominal growth of the economy due to the slower than expected rate of recovery of the domestic economy affecting underwriting margins in the second half of the year.

Santam's international solvency ratio remains at 45% which is well above the minimum regulatory requirement of 25%. Global Credit Rating Company ("GCR") has accorded Santam a domestic ZAR currency claims paying ability rating of AAA (triple A), which is the highest rating that can be attained by an insurance company.

Lloyd's, the world's leading specialist insurance market, reported a stable performance for the year ending 2010 which was down 43% from 2009. The result for the year was significantly affected by the earthquakes in Chile and New Zealand as well as the loss of the Deepwater Horizon oil rig in the Gulf of Mexico. Lloyd's interim results for the first half year to 30 June 2011showed a loss of £697m driven by the unprecedented level of catastrophe claims experienced in the first six months. The combined loss ratio of 113.3% was due to most notably, the flooding in Australia, the earthquake in New Zealand and the earthquake and Tsunami in Japan. The balance of the year will see added pressure to underwriting earnings post the impact of Hurricane Irene in the USA.

Standard & Poor's as well as Fitch Ratings rates Lloyd's insurer financial strength at A+ which places Lloyd's in the strong category for claims paying ability.

Santam & Lloyd's still remain the dominant providers of PI insurance for the Built Environment Professionals in the South African market.

Review of the Schemes Performance

Hosting the 2010 soccer world cup acted as a catalyst for expanding the country's infrastructure base, skills development, employment creation and economic growth. The tournament boosted the country's standing internationally, showcasing its capabilities in delivering world-class infrastructure on time. We now however are still feeling the effects of the world cup "hangover" where the conditions in the South African construction industry remain difficult and less prosperous compared to a few years ago. The private sector is forecast to remain depressed for the next few years as the market is not conducive to private sector investment due to high debt levels and reduce household disposable income. In the public sector the South African Government's 2011 budget reprioritised expenditure on social infrastructure as opposed to economic infrastructure. It is therefore predicted that the outlook for the next 3 years, is not one of a thriving construction industry, but rather one that will be characterised by internal restructuring to increase operational efficiency, subdued margins, increased levels of competition, higher levels of volatility, uncertainty and weak growth.

This state of the industry has directly translated into a reduction in some Member firms net fee turnover in 2011 with significant reduction in forecasts for the 2012 financial year as well. This in turn directly translates into lower premium contributions into the anticipated claims pool coupled with the soft market cycle currently experienced.

The soft market conditions worked favourably for member firms with reduced rateable fee turnover. Firms that have had reduced fee turnovers saw reductions in premium spend as premiums are largely directly rated in relation to fee turnover. Rates remained flat in most instances for the 2011 year of insurance, we have however seen acceptable rate decreases in the region of between 5% to 10%, from a magnitude growth discount point of view, depending on the individual firm's profile thus resulting in lower premiums being payable for firms that have had a significant increase in rateable fees. Firms that have had adverse loss ratios saw their rate increase nominally in 2011 dependent on the extent of the adverse loss ratio on their individual portfolio.

Insurers have in 2011 continued to incentivised member firms by affording them a 25% discount on the deductible payable in the event of a claim provided they prove that they had adhered to a Quality Management System (QMS) accepted by CESA. A few firms that have had claims in the past couple of years have seen the benefit in QMS by capitalising on the deductible discount. In addition Insurers have incentivised member firms by offering a 50% discount on the deductible payable in the event of a claim if the firm had limited their liability contractually with their client to a fixed amount or multiple of the fee earned on a particular project which was lower than the PI limit of their policy. If a situation arises where both discounts are applicable then the higher of the two applies.

PI claims are long tailed in nature and any particular year of insurance generally matures after a period of 60 months has elapsed. The claims experiences for the 2002 to 2005 years have matured and remain profitable for Insurers with loss ratios on average of 75%. Underwriters adjusted the rates over these years in an attempt to recover the huge losses sustained in the preceding years which had an average loss ratio in excess of 150%. Post the construction boom, an influx of notifications of potential claims and/or circumstances that may lead to a claim is clearly noticeable with the number of notifications increasing significantly since 2007. The 2007 and 2008 year of account has had 90 and 124 notifications reported respectively. Claim trends that are filtering through emanate from inexperienced Consulting Engineers, inadequate or lack of supervision, the fast tracking nature of projects, failure to clearly define scope of services at contract stage and cost overrun claims. Clients have become more litigious of late and the number of litigation matters has increased as well.

There are a few large claims against Single Project PI Policies, relating to the soccer stadia, Gautrain and the related infrastructure surrounding the 2010 Soccer World Cup which is currently going through the claims process. This combined with the claims on the scheme, may influence the local PI market adversely. We have maintained previously that past experience suggests we should expect an increase in the loss ratios going forward as claim frequency and magnitude of claims increases after a period of increased construction activity and it seems that the above is testimony to this. The 2006 year of insurance has matured and is estimated to conclude around a 73% loss ratio. The 2007 year of insurance is due to mature at the end of 2011 and is estimated to conclude at around 40% loss ratio. The 2008 to 2011 years have not matured as yet and it is thus too early to draw any conclusion from them at this juncture except for the 2009 year of insurance which currently sits at an incurred loss ratio of 118%. This adverse loss ratio is mainly due to large claims on projects associated with the soccer world cup.

The Scheme was insured by a basket of Insurers made up of Santam Ltd underwritten by Stalker Hutchison & Admiral Underwriting Agency, Lloyd's & Lombard Insurance underwritten by Leppard & Associates and Marketform (Lloyd's Syndicate) underwritten by General Professional Liability Acceptances in 2011. Stalker Hutchison & Admiral representing Santam Ltd has historically held the market share and currently holds 66% of the CESA Scheme. Leppard & Associates hold 23% and GPLA underwrite 8% of the Scheme.

Premium Collection Chart

Year of Account	No. of Policies	Nett Premium	Gross Fees	Premium as % of Gross Fees
2001	370	R 17,704,508	R 1,709,900,000	1.04%
2002	379	R 23,170,024	R 2,245,700,000	1.03%
2003	364	R 26,543,317	R 2,308,000,000	1.15%
2004	360	R 32,816,966	R 2,864,300,000	1.15%
2005	355	R 32,825,543	R3,100,000,000	1.06%
2006	381	R41,694,858	R3,929,000,000	1.06%
2007	380	R48,182,273	R4,846,000,000	0.99%
2008	387	R56,133,029	R6,347,000,000	0.88%
2009	369	R49,707,512	R9,456,000,000	0.53%
2010	356	R44,743,076	R9,714,000,000	0.46%
2011	359	R39,347,599	R8,460,000,000	0.46% *

* Estimated To 31 December 2011

2012 Scheme Structure

The Scheme is currently stable with loss ratios running at sustainable levels with the exception of the 2009 year of account; however increased cost of claims as clients become more risk averse and litigious coupled with the economic volatility may influence and affect the scheme going forward. The exponential increase in claims notifications and settlements of a few large claims under the scheme has seen rates bottoming out over the latter part of 2010 and throughout 2011. Looking forward into 2012 with the increased levels of competition in the market, we can expect insurers to indulge the soft market conditions in the short term. Rates will remain flat in 2012 with a nominal decrease in rates on profitable individual portfolios with significant increase in rateable fee turnover. Firms with adverse loss ratios will experience nominal rate increases.

The concerning factor, as stated earlier, is the current claim trends that are starting to filter through as well as the magnitude of claims being reported. We have always maintained that the point of departure going forward must be sustainability ie. the premium pool must be able to support the anticipated claims. The rationale is to avoid significant peaks and troughs in the cycle and to attempt to ensure some predictability as to the cost of PI insurance. The reserves held by Insurers must therefore be able to sustain the anticipated claims. The bottoming out of rates into 2012 will seek to ensure some sustainability in the scheme going forward and stabilise the premium pool.

In 2012 we have negotiated with Underwriters as follows:

1. No rate increases with nominal rate reductions for all member firms based on their individual risk profile and who are claims free.

2. Include a section in the PI policy covering Director and Officers liability as protection against the onerous provisions in the new Companies Act. This will be on an optional basis and priced separately should a member firm require said cover.

3. An extension to the PI policy to include Products Liability cover subject to a sub-limit of R1 000 000 in the aggregate at no additional charge to protect against the onerous provisions of the Consumer Protection Act.

4. The PI policy will continue to provide cover for liability attaching to a member firm or its employees arising out of any appointment as Health and Safety Agent as contemplated by the Occupational Health & Safety Act and the construction regulations as promulgated there under.

5. A defect in contracts works extension will be included in the PI policy on a case by case basis where Member firms are engaged in EPC, EPCM and turnkey type appointments to protect Member firms from a contractual liability point of view.

6. Firms that have a Quality Management System (QMS) in place, which have been accepted by CESA, will be looked upon more favourably from an underwriting perspective. Currently only around 61% (up from 50% last year) of member firms have confirmed that they have an established QMS.

7. Firms that adhere to the CESA accepted QMS will continue to be entitled to a 25% discount on the deductible payable in the event of a claim.

8. A 50% discount on the deductible will be claimable in the event of a claim being settled where the member firm was successful in limiting their liability in contract to a fixed amount or a multiple of the fee earned on the project as provided for in standard professional services agreements or any other form of agreement.

9. Firms that have an adverse loss ratio on their portfolio will either have a nominal rate increase applied and/or a higher minimum deductible level may be imposed depending on the extent of the adverse loss ratio.

10. Insurers will continue to provide greater discounts to those firms opting to take higher levels of self insurance.

11. Underwriters will continue to provide the Public Liability extension at a maximum of R5m per claim at no cost, with an additional premium being levied should member firms wish to increase their limits above R5m.

12. Deductibles being the insured's first amount payable in the event of a claim will only be payable towards the damages of the claim and not towards the costs.

13. The criminal and statutory defence costs extension will enjoy the same level of cover as the PI limit of Indemnity on the policy in question.

SHA and Leppard & Associates have been the premier underwriters in the PI market and have been underwriting this class of insurance for the past 20 odd years. In the current soft market conditions, with increased competition and excess capacity available in the market, GPLA has also proven to be a viable alternate Underwriter with sound claims paying ability. Thus we can accordingly vouch for all three of these underwriters, who form the basket of Insurers, for both their underwriting capabilities and claims handling authority.

We believe that in 2012 member firms should have the choice of the above three premier Insurers who have established pedigree in the market. To the extent, as required by member firms, we shall approach the alternate markets available in the engineering PI insurance sector. The current arrangements with the basket of Insurers competing against each other for a share of the book of business works favourably for member firms from a pricing perspective with all Insurers providing the same product and coverage.

On the basis set out above we believe the Scheme will continue to represent the vehicle of choice for members having regard to product, price, coverage and sustainability.

Our arrangement with semi-retired Consulting Engineer Mr Ivor Evans to assist us with professional liability case studies will continue throughout 2012. We have recently published the 2012 collection of case studies on professional liability claims against CESA member firms and will disseminate those booklets to member firms throughout the 2012 PI renewal process. The collection of case study booklets for 2013 will be published towards the end of next year.

The Broking and Legal Risk Management Service to the CESA members will continue to be undertaken by our Professional Risks division. Aon South Africa will maintain its support to the members of CESA through the following services:

1. Representation on the Quality and Risk Management Committee
2. Representation on the Supply Chain Management Committee
3. Representation on the Construction Regulations Task Team
4. Representation on the FIDIC Risk and Liability Committee
5. CESA legal Forum
6. Risk Management to Individual Firms
7. Quarterly reporting on claims experience
8. Collaboration with the school of Consulting Engineers
9. Participate and advise the Business Integrity Task Team (BITT)
10. Identifying, formulating and disseminating Case Studies on professional liability claims.
11. Assisting the CESA with the revision of advisory notes when required
12. Sponsorship of the Excellence Awards and CESA Conference
13. Place and pay for the sole practitioners run-off policy

Broking Services

The broking services team dedicated to the CESA member firms comprises of:

Malcolm Padayachee (Manager and Principal Broker);
Nhlanhla Dube (Account Manager); and
Marubini Madilonga (Internal Broker).

Our services include but are not limited to the following:

a) Collating underwriting information for purposes of the renewal of the PI Programme during the Period of the Services.

b) Negotiating renewal terms with Insurers on behalf of member firms.

c) Advice on the structure of PI Programmes and policy coverage.

d) General insurance market advice, including insurance market developments, topics of interest and the financial security and service standards of insurers underwriting the insurance policies.

e) Presentation of proposals in respect of each renewal during the Period of the Services.

f) Placing cover on the agreed basis with Insurers and detailing arrangements to the member firm in question.

g) Furnishing confirmation of cover and letters of comfort on request from member firms.

h) Attending to preparation and submission of the policy documents.

i) Quarterly claims review.

j) Upon notification and instruction from member firms, process, negotiate and arrange settlement from the insurers/underwriters/loss adjusters, of all admissible claims.

k) Monitor the claims service of insurers/underwriters.

Claims Handling

Malcolm Padayachee will remain involved in the handling and facilitating of CESA member firms claims.

We are actively involved in the conduct of claims from inception to finalisation. We pro-actively engage with Underwriters to bring a speedy and amicable resolution to claims. We attend consultations with clients, Attorneys and Loss Adjusters and also attend site inspections when necessary. We ensure that our Clients are treated fairly by Underwriters and/or their representatives. We strive to ensure that no claims are rejected by Underwriters without sound justification.

Limits of Indemnity

The minimum limit of Indemnity required to be held by members was increased by CESA in 2007 to R2m each and every claim and that requirement still remains. We have found that due to the soft market cycle we are currently experiencing, together with the discounts offered on deductibles for QMS adherence, and contractual limitation of liability, the trend has been for member firms to opt for higher limits of indemnity which is available at cheaper prices and also opt for higher deductibles to get the benefit of the premium saving. As a consequence only 8% of member firms are on a R2m limit of indemnity, 35% are between R2,5m and R5m, 32% are between R5,5m to R10m, 15% are between R10,5m and R25m and 10% are above R25m. Member firms are therefore embracing the cost efficiency in procuring higher levels of protection.

Run off for Sole Practitioners

Glenrand M·I·B will continue to place and pay for the above cover in 2012. In line with the CESA requirement that the minimum limit be on an each and every claim basis, we have negotiated the cover with effect from 1 January 2012 as follows:

Insurer:	Santam Limited
Limit of Indemnity:	R2,5m each and every claim for any one retired sole practitioner
Deductible:	R25 000 each & every claim

Legal Risk Management Services

The Legal Risk Management Service (LRMS) continues to grow with the demand for the service, and consists of:

Meggyn Marot (Senior Risk Advisor);
Siva Naidoo (Risk Advisor); and
Samantha Jordaan (Risk Advisor)

The number of contractual queries dealt with has increased in 2011. In the last year LRMS has vetted in excess of 540 contracts for various consulting firms. These reviews have included issues such as appointments, joint venture and sub-consultancy agreements, signing duty of care undertakings to client's financiers and appointment of Consultants as OHS Agents.

In particular this year we have focused our efforts on collaborating with more private bodies which impact on the built environment professionals, in particular large corporations who regularly procure the services of professionals, the ensure that their documentation is appropriate whether in the Financial, Health or Mining sectors, and I believe we have been quite successful.

We have assisted in the drafting of a new CESA Sub-consultancy Agreement, and we have redrafted the CESA Short Form of Agreement which was published this year.

Several very important Advisory Notes were produced, including Limitation of Liability and Health & Safety, and we continue to be available to CESA's Contractual Affairs Manager for queries members may have, including those of a Statutory nature. To this end we also saw the creation of the CESA Legal Forum which is an effort to use the collective knowledge of various firms legal advisors to assist CESA in promoting good legal risk practices for their members.

LRMS continues to present road shows to various member firms with various risk awareness topics exposing hundreds of Professional Engineers to crucial risk management issues. The presentations are accredited with Continued Professional Development (CPD) points, and we will continue with these and new presentations on topical industry related subjects, going into 2012. A pertinent topic we have created awareness on is the new Consumer Protection Act.

Further to the above we continue to remain in touch with the industry through our involvement in various committees of CESA, FIDIC and the Labour Department.

LRMS have had an enormously positive response from members, who have found the information and service we provide, invaluable in their operations and Legal Risk Management Services remains one of the many advantages of being a CESA member.

For 2012 we are poised to take on the tremendous growth we experience each year with fresh approaches, through technologies available and annual seminars will be reintroduced in each major city centre and we aim to ensure that we reach each and every member of CESA.

Claims

Claims in excess of R500 000:

The four largest as at 30 September 2011 (2006-2010)

2010	Incurred	Paid
Design error – pipeline	R 2 099 811	R 2 055 651
Design error – commercial structure	R 1 643 859	R 1 211 283
Design error – beam failure	R 782 456	R 730 414
Failure of a retention wall	R 640 836	R 626 456
2009		
Design error – bridge	R 6 645 270	R 1 329 054
Design error - structure	R13 425 687	R 8 525 918
Design error - structure	R 7 317 796	R 6 978 887
Designe error – stormwater pipeline	R 3 562 107	R 3 562 107
2008		
Inadequate design of roof structure	R 907 261	R 907 261
Third party MVA claim	R 1 091 065	R 488 010
Cost overrun	R 2 288 361	R 1 396 755
Design error – electrical specification	R 578 392	R 578 392
2007		
Inadequate design of slab	R 5 286 796	R 5 286 796
Design error in block paving	R 1 623 755	R 1 623 755
Error in design of floor panels	R 757 361	R 757 361
Defective design of floor	R 2 917 587	R 379 447
2006		
Inadequate design of block paving	R 6 684 695	R 6 010 633
Inadequate design of a slab	R 2 801 717	R 2 801 717
Inadequate design of slab	R 1 916 389	R 1 916 389
Incorrect Geotech. report	R 1 781 288	R 1 781 288

Claims Triangle:

See Attached

Conclusion

Over the past six years we have seen continued softening of market conditions in the PI insurance sector and it has only bottomed out during the latter part of 2010 and continued throughout 2011. This was due to a relatively benign claims environment experienced over the past six years as well as increased competition in the market. We forecast that this state will persist certainly for 2012 and predict a slight hardening of the market in 2013 due to the increase in the cost of liability claims. Effective risk management will offer a solution in this climate and a renewed focus to formulate an effective risk management strategy to mitigate potential loss could prove a key factor in staying the onset of the PI hard market cycle. Insurers will definitely afford greater discounts to firms who demonstrate effective adherence to risk management policies within their companies.

I would like to thank all the Members of the CESA Quality & Risk Management Committee for their assistance during the past year and would like to wish you all the best over the festive season.

Malcolm Padayachee
Manager: Professional Risks
Aon South Africa