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Insights

CONSTRUCTION OF THE NEW NORMAL: THE EVOLVING INSURANCE LANDSCAPE

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SUMMARY

When COVID-19 hit, both insurers and the insured had to grapple with policy claims and whether a product responded to the crisis. This was no different in the construction industry where parties had to examine their policy language to understand if the damage sustained by the pandemic was the same damage they could claim for under insurance. This article takes a look at how some typical construction insurance policies have responded and further, how the insurance market may evolve post-pandemic and how stakeholders can re-look their risk management approaches and insurance solutions.

INTRODUCTION

When COVID-19 unleashed its fury, global business operations and supply chains were severely affected. The construction industry was no exception. The industry was held hostage by its ties to heavy on-site requirements and operations, supply of materials and equipment and labour continuity.

In Singapore, the pandemic stopped most construction works and we are only seeing a gradual resumption in recent months. Even so, it's been a slow return and the Government announced the S$1.36bn Construction Support Package on 27th June 2020 to give financial support to construction firms, maintain business sustainability, support businesses to be COVID-safe and to assist with cash flow.

Parties who want to resume works will need to comply with the COVID-Safe restart criteria issued by the Building and Construction Authority ("**COVID Restart Criteria**") and certainly, any further restart of works will look to balance speeding up activity and ensuring the safety of the workforce.

In the meantime, there is still the need to maintain the construction site from the point of view of security, statutory compliance and risk management, in addition to ensuring that construction goes according to plan. Safety measures implemented for the sites resuming construction might give workers and contractors a sense of protection, but from the moment work resumes, there will be a recontamination risk to manage and in practice this might create delay which in turn would question the sustainability of some projects.

With that in mind, this article looks at some of the construction insurance products and how that has responded to the crisis. We then go on to consider, in light of this pandemic, how the insurance landscape as a whole may evolve and how stakeholders can recalibrate their risk management approaches for the new normal.

CONSTRUCTION INSURANCE PRODUCTS IN THE SINGAPORE MARKET

In Singapore, the traditional suite of key construction project policies are the Contractor's All-Risk, Workmen's Income Compensation and the Professional Indemnity policies.

CONTRACTOR'S ALL-RISK POLICY (CAR)

The CAR policy is typically meant to cover physical loss or damage to the insured property. There is a wide range of endorsements that may accompany a CAR policy ranging from delay in start-up and construction schedule to damage to plant and equipment. However, it is important to note the exclusions in the policy, which may include partial or total cessation of works.

How this may have applied in the context of the pandemic is that the insured would have to show that (a) physical damage to the property or the loss of use of that property has occurred, (b) that this loss or damage resulted from COVID-19 and (c) that COVID-19 (or more likely a reference to a "pandemic" or "epidemic") is not an excluded cause. As we have seen, a lot of disruption resulted from a break in the supply chain for equipment and materials, or the shutdown of the site. This presents some difficulty as the losses incurred may not result from physical damage to the property but the factors mentioned above.

In the United States, there are states which have declared COVID-19 to be a "natural disaster" or which have issued emergency orders to shut down sites as the virus purportedly causes property damage due to "proclivity" to attach to surfaces for prolonged periods. This is language that could potentially trigger an insurance policy where parties may file claims based on or at least in view of the orders issued by government authorities.

In Singapore however, we have not seen language that helps the insured in that way. Having said that, it may be possible to argue that due to the inability to come on site to do requisite servicing and maintenance, that there may be a potential claim for damage to construction plant, equipment and materials. This would depend on the language of the policy.

CAR policies usually cover Third Party Liability ("**TPL**") or a principal's advance loss of profits. The latter covers loss of gross profit actually sustained due to the reduction in turnover and increase of working costs in the event the insured's works suffer loss or damage, thereby resulting in delay of commencement or interference with the insured's business. Again, this would depend on whether the presence of COVID-19 caused the damage to the property as defined under the policy.

As for TPL, this protects the insured against losses for accidental illness, bodily injury or property damage to third parties in connection with the performance of the contract. This could be important in the context of resuming work – as the workers return to site, there exists the possibility that an infected worker might result in a third party contracting COVID-19. Any failure to observe health and safety management practices may also result in property belonging to third parties becoming contaminated or damaged. Accordingly, it is important to understand the coverage of the TPL and when this can to be exercised.

At the time of writing this article, insurers have maintained the coverage construction companies enjoyed prior to COVID-19. However, some insurers are imposing specific Coronavirus exclusions like LMA5394.

WORKMEN INJURY COMPENSATION (WIC)

In Singapore, there has been a significant outbreak in the migrant worker population living in the dormitories. As at 28th July 2020, more than 42,000 construction workers tested positive for COVID-19. In a WIC policy, a clause typically provides that there is coverage if an employee sustains personal injury by disease or accident arising out of or in the course of his employment and the insured is liable to pay compensation under the Work Injury Compensation Act (Cap. 354) or under common law.

In this regard, it may be possible to claim that the construction worker had contracted the virus in the course of his employment (through being onsite and from living conditions) and that the employer is legally liable to pay for costs such as initial medical expenses and missed wages. Given the longer term implications of the virus, there may be liability for ongoing costs related to the disease and continued loss of earnings. This will be subject to the limit of liability in the policy, which may restrict common law claims to a certain amount for any one claim or series of claims arising out of one event. From 1 September 2020, employers must report all work-related medical leave or light duties to the Ministry of Manpower. In light of COVID-19, companies are greatly incentivised to ensure that safe measures are adopted at the workplace.

PROFESSIONAL INDEMNITY (PI) INSURANCE

Such a policy would typically provide protection against financial loss out of professional errors and omissions and is applicable to professionals such as architects, engineers, project managers and design-build contractors. In more recent times, such policies can cover both tortious and contractual liability. Optional extensions of the policy may also include economic loss and loss mitigation and rectification costs cover, where the insured incurs costs mitigating or rectifying a negligent act, error or omission.

With the resumption of work in mind, a party's failure to comply with the COVID Restart Criteria or take sufficient measures to prevent the onset or spread of the virus, thereby causing project delay or damage to property, could be considered an error and omission that triggers the policy. Where the policy has a loss mitigation and rectification costs cover, the insured may be indemnified against any costs of such measures taken to mitigate the initial omission – if not, such costs would likely have to be borne by the relevant party.

Going forward, it remains to be seen how consultants' obligations will be affected by this pandemic – for example, would the COVID Restart Criteria or at least some of the guidelines contained therein begin to creep into the consultants' terms? Would the sequencing or planning of works take on a more onerous angle in order to ensure safe distancing? There may be other shifts in contractual approaches, such as collaborative contracting and the introduction of more technological platforms to manage and monitor labour and the supply chain, which would impact the coverage and premiums payable under a policy.

Also, depending on the size of the project and the contractor's / consultant's PI policies, the owner may choose to take out a single project PI policy which responds and indemnifies the owner and all parties that are part of the construction project against third party claims due to errors or omissions made by the parties. This provides a level of security and reduces the possibility of disputes in terms of costs, coverage and responsibility among the contractual parties.

There are obviously other insurances purchased for larger construction projects, such as terrorism and pollution insurances, which we will not go into detail for the purpose of this article. In the next section, we will touch on the potential implications for the construction insurance market.

CLAIMS AND A CHANGING INSURANCE MARKET

The construction insurance market started changing in late 2018 and early 2019 after strong growth over the past 10 years with plentiful capacity. This longest soft market period to date stopped following damages caused by hurricanes Harvey, Irma and Marfa (now referred to as HIM). Insurers very quickly implemented rate rises for construction projects in the affected areas with no discernible changes outside of these geographies. The profitability of the construction portfolio then got significantly eroded by an unusually large number of major claims around the world, such as the flooding of the Hidroituango hydropower dam in Colombia in 2018 during construction (currently projected to cost insurers in excess of S$2.5bn), Auckland Convention Center fire in 2019 (costs estimated at more than S$500m) and the Grenfell Tower fire in London caused by faulty cladding (ACM panels) to name a few.

These large losses in terms of quantum, alongside large numbers of attritional losses, have caused many insurers to take draconian approaches to correct the portfolio of business. Whilst some have favored rate increases and tighter underwriting as a remedy, others have decided to withdraw from the class completely.

Whilst Singapore and in general Asia has seen more limited claim activities historically, local clients are not experiencing severe difficulties like in Australia or in London. This is particularly true for Professional Indemnity insurance where some clients are either unable to purchase a policy because of cost or because insurers have been unwilling to even offer renewal terms! In Asia, the branches or subsidiaries of major insurers have had to amend their appetite to recognize the state of the market. We are not experiencing such a dramatic situation, but capacity will continue to come at a premium in the future. If the upcoming hurricane season proves to be costly for insurers, the rate in Asia could be forced even higher.

As such, providing detailed information is now more critical than ever. Insurers are reviewing these in great detail which is taking a lot more time. Internal referrals are now common and insurers are paying specific attention to the quality and experience of all contracting parties and their financial viability. With the need to have multiple insurers involved to provide the required policy limit for larger projects, early collaboration between owner/principal, project manager and their insurance broker is critical in order to achieve the best outcomes. Endorsements that used to be provided automatically and for no additional premium are now requiring additional and satisfactory underwriting information and premium before being granted. Sub-limits have also been reduced to more appropriate levels. It is also important to note that specific exclusions for cyber risks have been introduced, which may require further discussion to assess the potential reliance on technology for the completion of the project and therefore the potential associated risks.

With policies that may not have responded as desired to losses arising out of COVID-19, the insurance market is assessing how it can respond in case of either a second wave or further pandemics. Special attention should be paid to risk management to be as prepared as possible and to mitigate the impact. Such will be the prudent steps taken by a lot of businesses, but construction clients like in all other industries are now very interested in reviewing epidemic risk solutions covering specific risks including business interruption, temporary site closure, and prevention services. Governments in some countries have forced the insurance industry to take steps toward addressing such risks, and these products which are in their infancy will require tailored discussion in order to design specific solutions for large projects.

Whilst the current situation is not likely to change anytime soon, we have to recognize that the construction industry has always been and will be a key industry to stimulate growth and employment in due course. The new norm will impose new working methods with the increased usage of technology, and such new risks will require specific attention to contractual relationships and also how to mitigate such risks.

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