

Plan Credit eliminated for 2017. Premium Increase of 5%...up from scheduled 2½%

Steady increase in defence costs, growth in number of claims and increasing length of time to reach settlements and regulatory requirements create a “perfect storm”.

PLAN CREDIT ELIMINATED

Results for 2016 ended in a loss of \$1,740,000. This is the first operating loss recorded in the history of the program. It was occasioned by a significant actuarial adjustment to reserves for unsettled claims. The major issues noted by the actuary were:

- continuing growth in total claims costs, in particular defence costs;
- increase in number of claims; and
- increase in the time it takes to reach a settlement of claims.

These concerns triggered a reassessment by the actuary, increasing the amount to be set aside as reserves for the payment of defence costs and damages for previous years. Prior to the actuarial adjustment the program showed an operating profit. However, the actuary's adjustment to reserves for claims for past years resulted in the net loss for the year.

As a result of the adjustment and recorded loss, there is no surplus to be returned as a Plan Credit.

Graph 1 on the following page shows the results for 2016 and prior years for comparison. It illustrates why volatility in claims has become a major concern to Pro-Demnity in recent years. Annual fluctuations in the number and cost of claims have significantly affected the Company's financial results, and the volatility is expected to continue.

The Plan Credit is based on the net profit for the last year after allowances for the retention of capital recommended by our independent actuary. The amount is then distributed to policyholders in accordance with their pro-rata contribution towards that year's premium.

2017 PREMIUM INCREASE: 5%

In response to the concern evidenced by the actuary's adjustment, the Board has decided that an increase in premiums of 5% is required this year, to be reviewed on an annual basis.

This is necessary to address the potential for fluctuations in claims up to \$12.5 million from any year of insurance. It is anticipated that the 5% increase may need to be in place for several years until the aggregate premiums are sufficient to address the increased potential claims exposure.

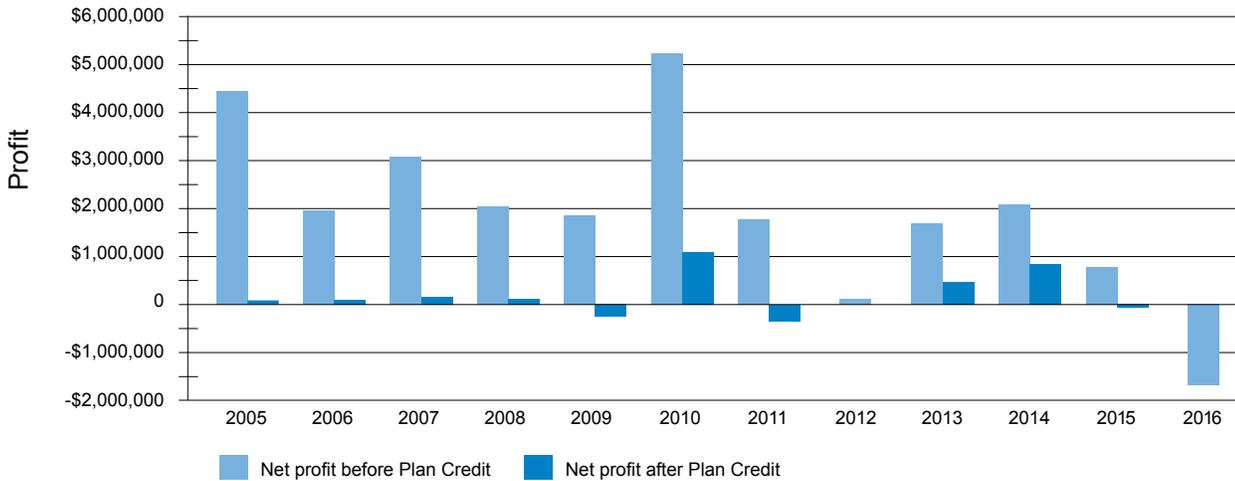
This approach will allow us to pay normal claims through annual premiums, and for catastrophes by means of reinsurance and capital.

Regardless, annual surpluses will continue to be returned to policyholders, as Plan Credits, unless these funds are required to be retained by our actuary, auditors or insurance regulator.

The purpose of this Bulletin is to show policyholders what is happening in the claims portfolio and to explain why fluctuations in annual claims and profits affect the Plan Credit, and premiums.

GRAPH 1: NET PROFIT COMPARISON

Key facts: Profits have fluctuated dramatically in recent years. 2016 shows the first loss before Plan Credit in the 30-year history of the program.



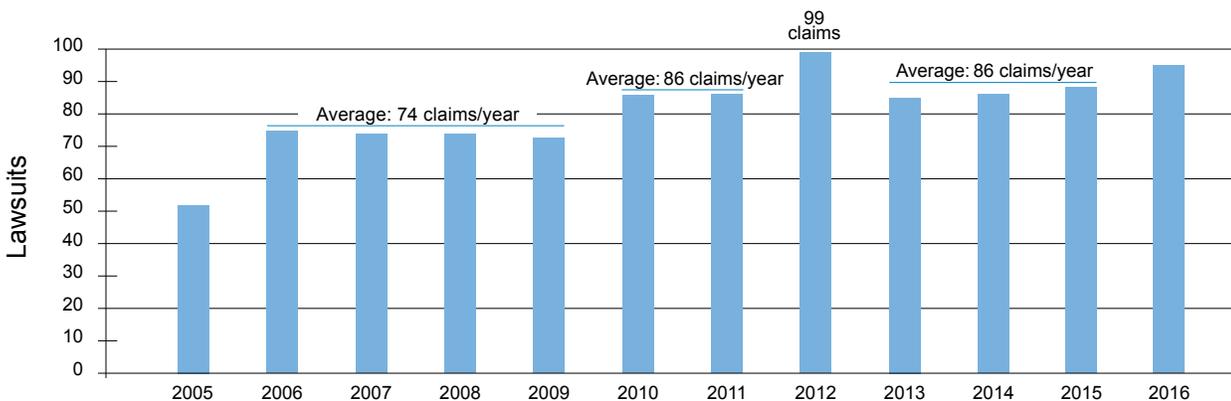
The Graph shows that in several prior years (2009, 2011, 2015) the funds allocated as a Plan Credit resulted in a minor loss; however, in each year there was a profit before the Plan Credit was determined. These minor losses were offset by similar minor surpluses after Plan Credit in other years.

In 2012 there was no Plan Credit due to minimal net profit and for 2016 there was an operating loss and accordingly, there is no Plan Credit.

Key facts about claims numbers & costs

GRAPH 2: NUMBER OF LAWSUITS

Key fact: Despite a spike in numbers in 2012, the number of lawsuits had been relatively constant since 2010. However, 2016 saw an increase to 95, the second highest in our history. Combined with the past four years the trend now appears to be rising, a factor impacting the actuary's assessment.

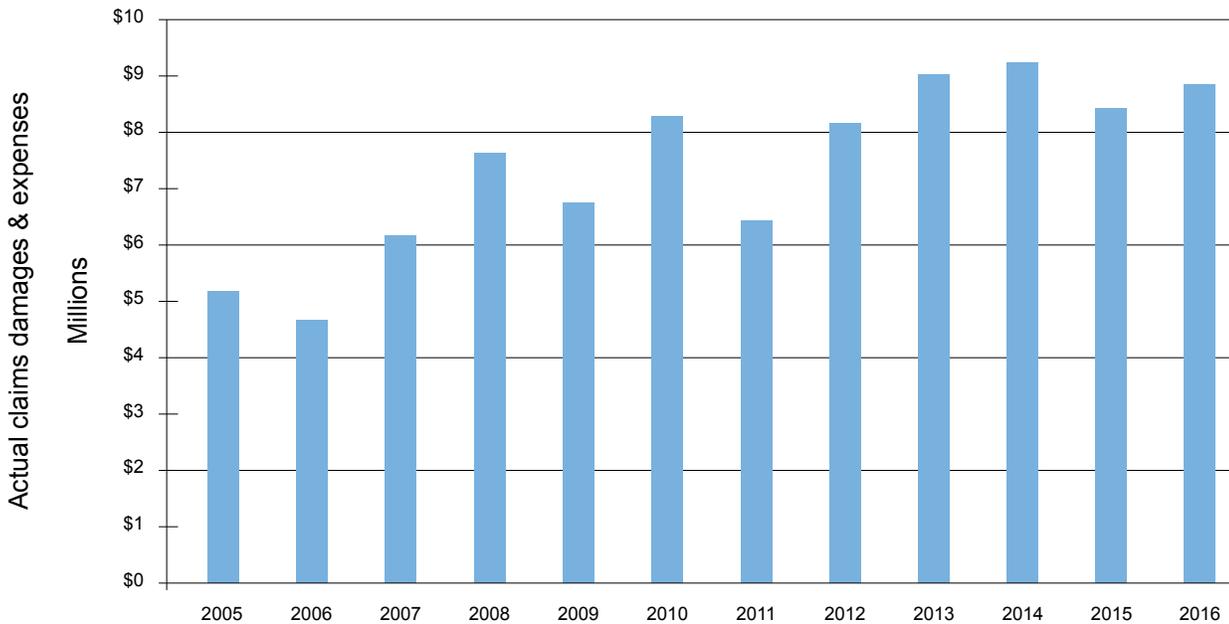


As you can see in Graph 2, in 2016 the number of lawsuits against policyholders increased by 10% above the average for the previous three years. The number of lawsuits has increased steadily, in steps, and is now almost double the number in 2004 and 2005 and is about 30% higher than a decade ago.

There are significantly more lawsuits per policyholder over the last dozen years – and a significantly smaller increase in the number of policyholders paying premiums.

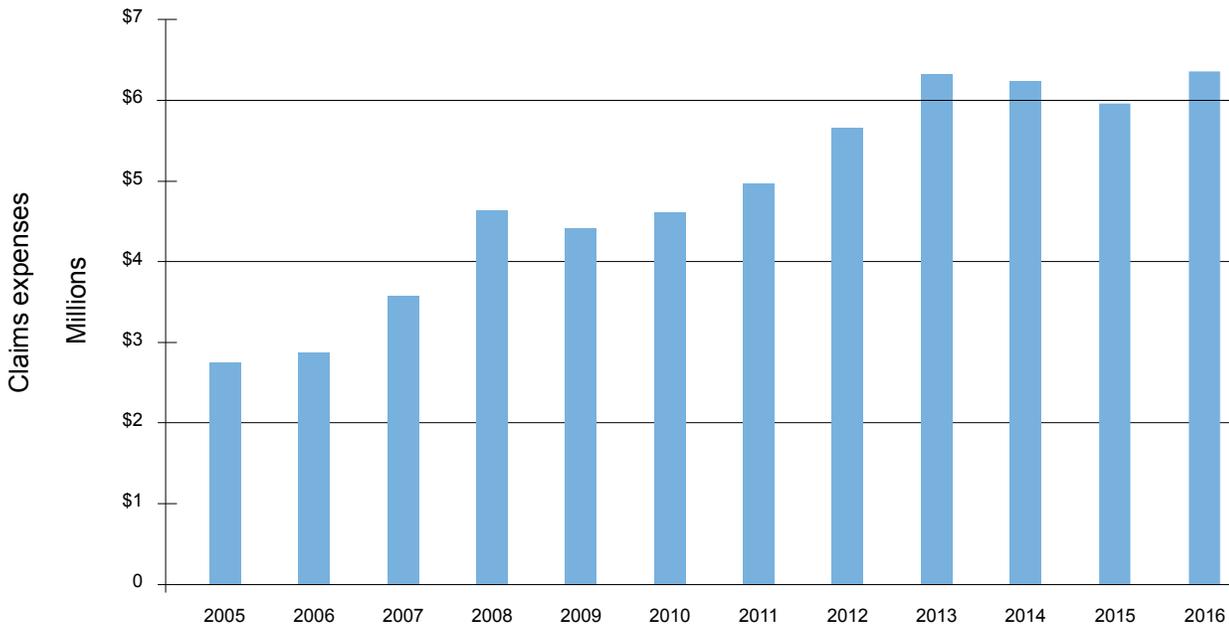
GRAPH 3A: COMBINED DAMAGES & CLAIMS EXPENSES PAID

Key fact: After a dip in 2015, actual payments of damages and claims expenses again increased in 2016, resuming the upward trend seen for the last dozen years.



GRAPH 3B: ACTUAL CLAIMS EXPENSES PAID

Key fact: After a dip in 2014 and 2015, actual payments for claims expenses reached an all-time high in 2016, resuming the upward trend over the past dozen years.



As Graphs 3A and 3B illustrate, actual payments for damages and expenses in 2016 were third highest in history, just shy of the peak in 2014, and claims expenses alone were the highest in history, continuing

the long term trend in evidence over the last dozen years. It is assumed that these trends will continue for the foreseeable future.

Why defence and expert costs keep rising

The Bulletins addressing the Plan Credit for 2013 and 2014 included extensive explanations of some of the factors that are contributing to the increase in defence costs borne by your insurance program. These include:

- Impacts of the two year discoverability period under the *Limitations Act, 2002*
- Projects are larger and more complex; expenses and damages are higher
- New technologies and approaches mean less experience and knowledge
- Stress in the construction industry means design and construction expertise have been spread very thin

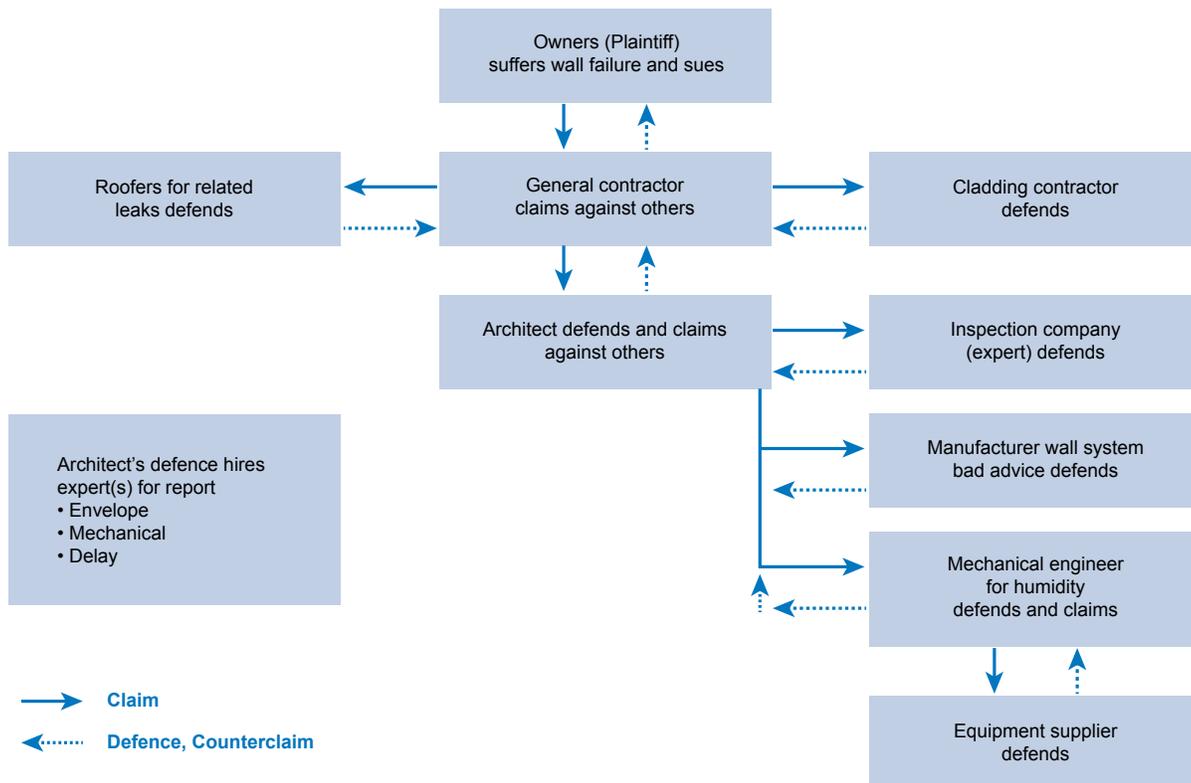
- “It’s someone else’s fault” mindset, notably for delays and cost overruns
- Litigation has become more complex.

The full explanations of these factors are contained in the 2014 Plan Credit Bulletin. It can be located in the Pro-Demnity section of the OAA website (www.oaa.on.ca) or via a link to the Pro-Demnity Bulletins and Notices on the Pro-Demnity website (www.prodemnity.com). Member log in is required.

Why defending a claim is so complex and costly

ANATOMY OF A LAWSUIT

Key fact: Each statement of claim (lawsuit) sets in motion a chain reaction involving multiple parties, cross-claims and defences. Below is a snapshot of a recent claim.



EXPLANATION

In this real-life example, there are eight sets of pleadings, each having defences and several having counterclaims. All pleadings (minimum 16) are relevant and must be read and analyzed.

Each party must produce all documents related to the action. In this example, the architect had over 1,000 documents, the general contractor had more; other parties had less.

Each party is subject to cross-examination at Discovery, a process that may last a year or even longer.

In this example, because there was an allegation of delay caused by remedial work against the architect, our defence required a delay analyst.

TERMS:

- 1st party: Plaintiff (owner)
- 2nd party: First named defendant (general contractor)
- 3rd party: Defendants named by Second Party (architect, roofer, cladding contractor)
- 4th party: Defendants named by Third Party (inspection company)
- 5th party: Named by Fourth Party (equipment supplier)

A pleading is a statement prepared by counsel and deposited with the court and given a court file reference. It is then circulated to parties named as defendants who respond with defence pleadings. They may also add counterclaims in which they allege damages against the claiming party.

Cross-claims are claims in which co-defendants (named parties in the same action) claim against each other as well as defend the action.

Third- and fourth-party claims are claims in which defendants claim against a party who has not been named in the action for contribution to damages, if any.

Questions you may want to ask us

Do you expect the trend of increasing costs to continue to rise?

Yes. Although there will be spikes and dips from year to year, the trend is up.

As identified by the Company's actuary, we expect to see more claims and higher costs as the increased number of claims works its way through the litigation and settlement process.

In the long term, even if there is a downturn in activity, we expect it will be some time before we would see a related decrease in claims reportings and costs.

What can policyholders / architects do to help bring down the cost of claims?

Unfortunately there is no simple answer. Some factors are out of the architect's control. However, architects can help themselves by being more attuned to the factors that they can impact. The following suggestions reflect some of the "lessons learned" from 30 years of experience defending claims against Ontario architects.

1. Read and become familiar with the content of the booklet: *Architects Insuring Architects... The Ontario Architects Professional Liability Insurance Program*. The booklet provides essential information about your professional liability insurance and addresses many common issues and questions.
2. Familiarize yourself with the content of your Pro-Demnity policy. It is your contract with Pro-Demnity, and governs the relationship between yourself and your insurer.
3. Many architects can adopt more effective and proactive risk management activities in their own practices. Since 2005, Pro-Demnity has been delivering loss prevention events and seminars across Ontario. We also provide advice to architects on insurance and liability considerations daily. But advice is only useful if it is acted on.
4. Adopt defensive practice approaches to protect yourself and your practice from avoidable circumstances that promote claims. Insist upon:
 - an adequate scope of services;
 - reasonable fees commensurate with the required services for design, construction documents and construction phases;

- realistic schedules providing adequate time for delivery of the professional services;
 - adequate budgets for both design services and construction;
 - realistic contingencies ...in the schedule and budgets.
5. Invest in continuing education sessions that emphasize the fundamentals of enclosure design and control of water. Utilize the services of a Building Enclosure specialist to reinforce your own capabilities when dealing with unfamiliar applications, technologies, products and systems.
 6. Pay careful attention to the coordination of activities of consultants during the construction phase – particularly respecting Certification of Progress Payments (where applicable) and the processing of Change Orders.
 7. Read and act on the Notices and Bulletins provided by Pro-Demnity and the Practice Tips and other tools provided by the OAA. Feedback and response to questions at recent loss prevention seminars suggests that many architects are unaware of the information, support materials and advice provided to them. Some acknowledged they had not opened their mail from Pro-Demnity (regular mail or e-mail).
 8. Beware of substitutions or changes made to your design. Adopt the measures included in the Pro-Demnity Bulletin: *Dealing with Substitutions to your Design* (December 31, 2016).
 9. Pay careful attention to the professional liability insurance maintained by an engineering or specialist consultants you retain. Insist upon adequate insurance as outlined in Pro-Demnity Bulletin: *You Have Insurance...But What About the Engineering Consultants?* (April, 2015).
 10. Manage your client's expectations. Pay careful attention to the contracts you sign with both clients and consultants. Do not agree to contract terms that are not compatible with your role as a professional advisor or your capability to deliver.
 11. Utilize the "Notwithstanding Clause" to modify any "indemnity" provision included in a client authored contract. Refer to Pro-Demnity Bulletin: *Indemnification Clauses* (March, 2015).
 12. Do not agree to contract terms with a consultant that limit the consultant's liability to you, or do not mirror the terms in the Prime contract between yourself and the client. Read and adopt the advice provided in the Pro-Demnity Bulletin: *Engineer's Standard Terms of Engagement*" (April, 2015).
 13. Adopt a "Go / No Go" check list for assessing potential projects and clients. Recognize "red flags" and be prepared to say "No!" to a potential client or project where there is concern that your interests, the public interest and the client's interests are not aligned.
 14. Retain a lawyer who is familiar with unique nature of an architectural or professional practice. The legal aspects of architectural practice are increasingly complex and architects should arrange for access to legal advice they can call upon as issues arise. The time to identify a suitable lawyer / advisor for your practice is "now"... before you need assistance.