Potential Indicators of Risk: Continuing Education, Business Practices, and Professional Licensure
Purpose
Underwriters and actuaries look at a number of factors in assessing a firm’s potential risk. Professional liability underwriters assessing design and construction professionals look at various indicators that may include a firm’s size, billings, geographic location, clients, professional services provided, and project types. Actuaries have been able to collect data on these claims indicators that help predict a firm’s risk exposure.

However, professional liability underwriting is as much art as it is science. Unlike auto, home, and other property and casualty risks where there is an abundance of actuarial information for underwriters to use based on nearly identical incidents (i.e., because of the number of similar instances you can determine the theft risk of a certain make, model, and color of an automobile based on the zip code of where it is garaged), there are many factors beyond those noted above that underwriters should consider in assessing a firm’s risk. Many of these additional factors are hard to track, and there is little to no actuarial data to help in the underwriting process. However, they are important factors that underwriters can consider beyond just the “numbers” because they can be indicators of influence that may affect a firm’s overall performance and risk exposure.

We conducted this limited study with the purpose of determining what other factors underwriters can look to when assessing a firm’s potential risk.

Methodology
The study began by developing a consensus of what additional factors beyond those that underwriters typically use may be considered in assessing a firm’s potential risk exposure. After consultation with risk managers and underwriters as to what factors may influence a firm’s overall performance and risk exposure, the following broad categories were agreed upon:

- internal continuing education;
- business practices;
- licensure of staff; and
- financial parameters.

The next step was verifying if any of these factors could be an indicator of a firm’s potential risk. Over a two-year period Schinnerer’s risk managers collected data on the firms that requested and were provided in-house presentations or webinars. Underwriters also identified several firms with “acceptable” to “outstanding” ten-year loss ratios, as well as several firms that had “problematic” loss ratios. Schinnerer risk management staff conducted personal interviews with the leadership from these firms on the topics listed above to get more information than the data collected from in-house seminars and webinars.

It is very important to note that data was collected from an extremely limited number of firms, and the firms were not diverse in terms of size, services provided, or geographical location. Also, despite our best efforts, most of the information was collected from firms that fit the acceptable/outstanding category, and only a few from the problematic category. One firm noted, “Firms that do a good job of managing risk are going to be the ones that use your website and
request in-house seminars and webinars. The firms that you don’t hear from are the ones that may be having some problems because they do not use the resources that may be available to them to manage their risk.”

So it is important that whatever is stated in this white paper be taken in this context. These are not actuarial conclusions, but rather suggestions of what other factors may be indicators of a firm’s risk.

**Internal Continuing Education**

Over the two years of this study, Schinnerer’s risk managers collected data on participants in in-house seminars and webinars (principals, CFOs, general counsels, project managers, staff professionals, administration staff, etc.). Risk managers also looked at the percentage of the overall staff that attended the presentation. The interviews focused on the process, commitment, and philosophy regarding a firm’s approach, if any, regarding continuing education. Once all the information was collected, a comparison was done between the firms with acceptable/outstanding loss ratios and firms with problematic loss ratios.

**Firms in the Acceptable/Outstanding Category**

The majority of firms in the acceptable/outstanding category demonstrated a real commitment to continuing education. Most of the firms had some sort of formal continuing education plan that incorporated not only internal training, but facilitated external training as well. Some firms also had plans to help new employees get acclimated to the firm’s culture and procedures. Many of the firms identified, planned, and scheduled appropriate continuing education opportunities for the year. For example, one firm that was transitioning to building information modeling (BIM) had a product representative present on the technical aspects of BIM. The following month they had an attorney and an insurance representative discuss the professional liability exposures of BIM. The third month, the firm’s principals presented a plan to the staff on how the firm was going to transition to BIM.

Most of the firms in this group also had principals that actively participated in the planning and in-house presentations. As one risk manager noted, “Of the firm’s five principals, four were in attendance, and the one that was not was out of the office on business. The four that attended not only asked questions and provided feedback, but also shared with the staff how the topic being presented applied to the firm either in a negative or positive fashion.”

For those firms that had multiple offices, there was a conscious effort to have the other offices participate in the live presentation either via a video or audio connection, or later via a recording of the presentation.

Finally, many of the firms in this category had a higher percentage of their overall staff attend the presentations. Most had 30% of their staff attend, and a few had above 50% of their staff attend.
Firms in the Problematic Category

Conversely, firms in the problematic category gave no indication of a commitment to continuing education. Although only a few were in the study, those that we were able to collect data from did not have a formal continuing education plan, and there seemed to be no commitment to continuing education from firms’ leadership (principals, CFOs, general counsels). Also, most of these firms had a very low percentage of their overall staff attend the presentations, often with the percentage of attendance being 10% – 20%.

Business Practices

Most of the information related to this topic was gathered during visits and interviews with individual firms. A host of business practices were discussed during these conversations, but issues related to succession planning and procedures related to contracts were the two that were most often discussed.

Succession Planning

As with many of the factors in this study, it is practically impossible to draw a correlation between succession planning and successful risk management. However, most of the firms in the acceptable/outstanding category conveyed a belief that a succession plan that was well thought-out and executed was an important component. Most firms indicated a strong desire to groom future firm leaders from within the firm as opposed to hiring from outside. This group felt that an individual that had worked their way up through the ranks had a built-in knowledge and appreciation for the firm’s history and culture, what factors have contributed to the firm’s success, and what the firm had learned from past challenges.

However, there was also recognition that need or opportunity may require leadership that had not come up through the ranks. In such cases, firms indicated that a strong commitment from all members of the firm was required to “indoctrinate” new leadership into the firm’s culture.

In some cases, new leadership doesn’t work out. One firm relayed a story about a firm that brought in new leadership in an attempt to “breath new life” into the firm. The new leader made what some considered radical changes in the firm’s structure and services offered. Unfortunately, with the slowdown in the economy a likely contributor, the firm experienced severe financial hardship resulting in substantial downsizing. The opinion was expressed that if the firm had leadership that possessed an appreciation for the firm’s history and culture, but could also “breath new life” in a planned and organized way, the firm would have been better positioned to manage the economic slowdown.

Contracts

Contracts are a key component of a firm’s business and risk management practices. Therefore, a firm’s procedures regarding the negotiation and implementation of professional services agreements can be a strong indicator of the its risk exposure. Firms we interviewed indicated a variety of procedures for negotiating and approving their professional services agreements. The
most universal comments involved limitations on who can negotiate and sign an agreement on the
firm’s behalf, procedures for reviewing contracts both internally and externally, and sharing
information.

Firms in the Acceptable/Outstanding Category

Most firms with acceptable/outstanding loss ratios indicated a belief that it is important to have
procedures in place to negotiate and approve contracts. One firm had an extensive “sign-off”
system that not only included review and sign-off by the project managers, but depending on the
fee amount and risk, would also include the firm’s CFO, general counsel, risk manager,
and possibly others, and the firm’s external legal and insurance advisors. The review process was seen as an
opportunity to take advantage of multiple eyes looking at different aspects, and the sign-off process helped convey the importance of
contracts.

This group also felt a strong commitment to making sure the
project team was well aware of the firm’s commitment in the
contracts. Therefore, contracts (often with the payment provisions
omitted) were often distributed to the project team.

Firms in the Problematic Category

Conversely, the firms we spoke with that carried problematic loss ratios often did not have a
procedure for the negotiation or approval of a contract. In fact, they frequently did not have a
signed contact in place prior to the start of professional services. Firms in this group did not
indicate any formal procedures for follow up if there was no contract in place. They would leave it
to the individual project managers to not only negotiate the provisions, but to determine to what
extent a contract with the client should be pursued.

Most firms in this category did acknowledge the need for contracts with their clients, but some
expressed concerns regarding potentially offending a client with contract negotiations.

Licensure of Staff

Of the factors looked at in this study, the information we received regarding licensure of staff
as a key risk management component produced the most surprising results. Our assumption at the
start was that the greater the percentage of staff that had obtained the appropriate professional
licenses, the lower the claims frequency would be. However, the data and interviews collected did
not necessarily support that assumption.

It is true that many firms with a low claims frequency had a high percentage of licensed staff.
But it is also true that many firms with a high claims frequency also had a high percentage of
licensed staff. The same trend seems to apply to firms with lower percentages of licensed staff.

Even those firms that had formal procedures to promote licensure such as reimbursement for
study and exam costs (some granted paid time off for each), or tying professional licensure to
promotion, acknowledged that they had highly competent staff that, for whatever reason, was not

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licensed. The comment was made that “licensure was only one component of what should be considered when evaluating staff competency.”

Licensure did seem to be more of a factor in a firm’s leadership and succession track. But even here, the licensure issue seems to be more of an “image” consideration than an indicator of individual potential leadership capabilities.

Based on the data collected and the interviews conducted, no correlation between a firm’s loss experience and the percentage of licensed staff could be drawn. Licensure appears to be more of a future leadership and “image” issue than one of managing potential risk.

**Financial Parameters**

Financial health was the most difficult of the factors to relate to a firm’s loss experience in any substantial way. Also, financial matters were factors that many firms were not comfortable discussing. But the interviews did reveal several factors that some firms felt were important.

**Adequate Fees and Contractual Provisions**

Firms that we talked to stressed the importance of obtaining adequate fees for the services provided. Firms also stressed the need to continue to evaluate their fee structure as the employees providing those services and the technologies they use change. One firm even stressed that they felt that it was important to change the fee structure based on the delivery method.

Contractual clauses that allow for adjustments to the fee due to changes in scope, time, or other factors not known when the contract was signed were also important for many of the firms we talked to. They also mentioned that this only works if you have a signed contract.

**Payment Procedures**

Firms that did discuss some financial matters indicated that accounting procedures such as timely invoicing and collection were in their opinion a vital component, not only of the firm’s financial health, but also in managing risk. As one individual noted, “If you are feeling a financial crunch you may be tempted to rush through the services or not assign the most qualified staff to other profitable projects.”

Firms indicated that it was equally important to follow-up on unpaid invoices and to use appropriate contractual remedies such as suspension of services. The firms we spoke with also noted that contrary to the belief of some, most clients understand the need to pay for services rendered, and if the firm is professional in the services provided and in their accounting and billing procedures, clients will usually pay.

**Line of Credit**

Related to payment procedures, firms noted that how often a firm has to use their line of credit may be an indicator of potential risk. One firm noted that they rarely use the company’s line of credit, but that they were aware of other companies where regular use of the line of credit was standard. The belief was expressed that if a company is using its line of credit on a somewhat
regular basis, that was likely a sign of cash flow issues, which can lead a firm to make risky business decisions in order to manage cash flow.

Financial pressures can be an influence on how a firm manages risk. A firm that is financially stable will not feel the pressure to “cut corners.” For example, a firm that has a healthy cash flow is likely to be less tempted to take on a job for less than an appropriate fee or to assign less than qualified staff in an attempt to control costs and remain profitable.

Conclusions

As stated earlier, the limited scope and constraints of the methodology of this study do not allow any definitive conclusions to be drawn based on the information gathered, but some conclusions can be inferred from the data collected.

A commitment to a system for internal continuing education appears to be a vital component in managing risk. Firms that foster an environment of continuing education on a range of technical, business, management, and professional liability subjects generally had lower loss ratios than firms that did not demonstrate the same level of commitment to continuing education.

Firms with financial and project management business practices that included reviewing contracts and charting the future of the firm through succession planning also generally had low and acceptable loss ratios.

However, the percentage of a firm’s staff that had obtained professional licenses did not seem to be a factor in a firm’s potential risk. This is not to imply that firms did not value and promote their staff members that obtained appropriate licenses, but our limited study did not find a correlation between the percentage of licensed staff and the loss ratio.

What can be done with this information? For underwriters, this information can be considered in addition to the data they currently use in evaluating a firm’s potential risk exposure. For design and construction firms self evaluation is important, and this information may help them benchmark themselves against other firms. In particular for firms that have had some costly loss experience, it may suggest changes that could be implemented to help minimize risks in the future. Implementation and a commitment to continuing education, business practices that include proper contract negotiation, review, and implementation, succession planning, and financial management will help firms minimize their risk and provide a foundation for present and future business challenges.
Schinnerer’s Risk Management Resources

Visit our risk management website at www.planetriskmanagement.com in order to access resources that can help your firm with the issues discussed in this paper.

Contracts

- Our new online contract review guide is a useful resource for policyholders and brokers as they review and negotiate professional services agreements: www.Schinnerer.com/risk-mgmt/Pages/Contract-review-faq.aspx

Financial Management

The following management advisories can help firms with their financial management:

- “Preventing Fee Disputes” www.Schinnerer.com/risk-mgmt/Documents/ManagementAdvisories/Preventing-fee-disputes.pdf

Continuing Education

Schinnerer can help firms continue their education with a variety of resources, including our Voluntary Education Program (VEP) and webinars.

Our VEP program is a flexible, self-structured continuing education tool that firms can customize and incorporate into their in-house training curriculum. This self-reporting program is available to policyholders at no charge. Some firms may even qualify for premium credits when a majority of their professional staff successfully complete VEP. All course materials are available at www.Schinnerer.com/Risk-Mgmt/Pages/VEP-access.aspx.

We conduct webinars where participants can listen to risk management experts while viewing a PowerPoint presentation via the Internet. For our newer webinars, streaming Flash files are available, and CD-ROMs are also available until supplies run out. Visit www.Schinnerer.com/Risk-Mgmt/Pages/Webinars.aspx to see which presentations are available in either format.

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