

Making the Transition to Running Your Own Firm

Professional Liability Insurance
and Additional Insurance
Coverage Issues and Products
for Professional Practices

Brought to you by The AIA Trust in
conjunction with Victor O. Schinnerer &
Company, Inc. and CNA Insurance, providers
of the AIA Trust Professional Liability
Insurance Program.

AIATrust

In operating a professional practice as a private business, a licensed design professional faces many risks. A prudent design professional entering private practice should consider insurance to cover certain exposures, including professional liability, cyber liability, commercial general liability, commercial auto coverage, and the risk of property loss. As firms grow, they may consider providing benefits to staff, such as health insurance, life & disability insurance, and retirement plans, among others. In addition, firms must consider how to manage these benefit plans. Sole proprietors should consider acquiring insurance to protect themselves and their families from injury or financial harm.

Although there are various project delivery methods, all projects are transient, one-of-a-kind endeavors initiated to satisfy the objectives of a particular client—a road for transportation needs, a park for recreation needs, a treatment facility for potable water needs, or a sanctuary for spiritual needs. Also, regardless of how basic or lofty the needs served, all projects are, essentially, investments—resources are allocated in the present in anticipation of favorable outcomes in an uncertain future. Because the future cannot be known, projects are inherently risky, and the management of risk is an essential value-adding activity in any project undertaking.

As a participant in the highly complex design and construction process, a design professional encounters a variety of risks that can result in financial losses to numerous people. Insurance is a means of managing those risks by transferring them to an insurance company in return for a premium payment. While not all risks that challenge a professional service firm are insurable, a new firm must identify, assess, and plan how its exposure to risk will be handled.

PROFESSIONAL LIABILITY INSURANCE

A key set of professional and business risks arises when harm is caused due to negligence in the performance of professional services. Negligence, when referring to the services of design professionals, is a legal term stating that the design professional breached an obligation to a client or others to provide services in a reasonable manner as required by a contract for services or by operation of law.

Negligent acts, errors, or omissions may cause damage to owners and contractors or other third parties. If liability is established, the firm may need to correct the damage. In buying a professional liability insurance policy, sometimes incorrectly called *errors and omissions* or E&O insurance, the firm is asking a broader financial entity—the insurance company—to absorb a portion of the costs of claims in exchange for a premium paid to the insurance company.

Not all design firms purchase professional liability insurance. This business decision is made as part of the firm ownership's overall approach to managing its practices and risks. Even those firms that do buy professional liability insurance retain the risk for expenses that fall within their deductibles or exceed their policy's limits of liability—or that are excluded from the scope of coverage.

BROKERS OR AGENTS SELL INSURANCE

Most design professionals purchasing professional liability insurance coverage do so through independent brokers. These brokers represent the interests of their client and not those of the insurer. By contacting a broker experienced in professional liability insurance for design firms, a design professional can 1) shop around for insurance, 2) usually obtain access to many insurance markets and, with the professional advice of the broker, 3) decide which carrier best fits its needs. That is the only way the Schinnerer program provides coverage—brokers selected by the prospective policyholder obtain quotes and place coverage.

Some insurance companies are represented by agents who are authorized to place policies on behalf of that company in a predetermined territory. These insurance agents represent the interests of the particular insurance company and may not have access to the entire insurance marketplace.

Regardless of whether a firm chooses an independent broker or an insurance carrier's exclusive agent, the firm will want to select its broker or agent in much the same way it selects its lawyer and accountant—with care and scrutiny of qualifications, services available, cost, and, not least, chemistry and commitment.

INSURANCE POLICIES DIFFER

In evaluating insurance options, design professionals will find that each professional liability insurance policy is different in some respects from all the others. The design professional must reconcile coverage and cost, but the variety of coverages available through endorsements, exclusions, and the core policies themselves makes reasonable cost comparisons difficult. That is one reason an experienced broker or agent is needed. It is important to carefully evaluate endorsement options, coverage limits, and deductibles. The added costs for some of these options, including increased limits, can be minimal.

In addition, the service and stability of the insurance carrier must be considered. Many carriers offering professional liability insurance enter and leave the market quickly. At times, this is to gain premium by underpricing coverage (“burning into the market”) and to assure profitability by exiting the market before claims erode reserves. In the insurance industry, carriers enter and leave the professional liability arena as business conditions change. The Schinnerer program began writing coverage at the request of the AIA and NSPE as their commended program in 1957. During the last 60 years, Schinnerer has worked with CNA, an American insurance company, which takes on the risk and provides claims resolution services.

Services provided by professional liability insurance companies range from extensive educational and management assistance programs, such as those offered by the Schinnerer program, to little or no information, advice, or guidance. Some design firms are content to simply buy an insurance policy while others prefer to work with a carrier that provides a total risk management program that includes professional liability insurance coverage.

While it is often difficult to rank competence and service above the cost of coverage, the “low cost” insurer may be quite like a “low bid” contractor. The attraction of a lower initial premium cost should be weighed against the potential of future significant rate increases and the risk that the carrier might not continue to offer professional liability insurance. In addition, because there are no standard professional liability insurance policies, some carriers might define the coverage to provide only minimal protection or exclude from coverage all but the basic services provided by design professionals.

Design firms should look at professional liability insurance as a facilitator of practice. An insurer that understands the current standard of care for design professionals and anticipates their preferred futures can enable a new firm to provide both traditional and innovative services.

ADMITTED COMPANIES ARE REGULATED BY STATES

States permit insurance companies to sell their products on either an admitted or non-admitted (also called excess and surplus or E&S) basis. Companies that sell insurance on an admitted basis subject themselves fully to the oversight of the state and must have their rates, coverages, and policy forms reviewed, and, in many states, approved. In addition, admitted companies must contribute to a state guarantee fund to be drawn upon to pay claims should that company be declared insolvent and lack the financial wherewithal to pay the claim itself. This process protects the consumer and the public.

Non-admitted carriers are not subjected to such scrutiny; nor are they included in the state guarantee fund. Accordingly, they have an easier time moving in—and out—of the insurance market. For these reasons, many states require brokers to seek coverage from admitted carriers first, placing coverage in an E&S market only when admitted carrier coverage is not available for the specific firm. Some states even require brokers to warn the insured person or firm that they are placing their coverage with a non-admitted carrier by stamping the policy to that effect.

PROFESSIONAL LIABILITY INSURANCE IS CLAIMS-MADE

The possibility of encountering a limited number of admitted insurance carriers might leave the design professional in a difficult position due to the traditional *claims-made* nature of many professional liability insurance policies. Claims-made means the coverage had to be in effect when the negligence occurred and the policy must provide coverage at the time the claim is made against the professional—even though this can be years after services are performed and projects are completed. Claims-made policies are common to professional liability insurance and should not be confused with *occurrence* policies common to general liability insurance.

This distinction is important to understand. Under a *claims-made policy*, all coverage ceases when the policy is canceled or not renewed (by the firm or the insurer), even though the design professional may have been insured when the services were rendered. Under an *occurrence policy*, a claim filed after policy cancellation or renewal will be covered if the policy was in force when the incident that caused the claim occurred, regardless of whether the insured was covered when the claim was made.

The claims-made basis is used for professional liability insurance coverage because it makes costs to insurers more predictable. If coverage for professional liability risks were offered on an occurrence basis, the cost of such coverage would be prohibitive because the insurers would have to include contingencies for many more unknowns. Unlike the perils insured by other policies, with negligently performed design services, harm could be first identified many years after the services were performed. So if professional liability insurance were sold on an occurrence basis, the premium would have to be calculated for allegations of negligence for many years or even many decades. This distinction, however, means that firms that buy insurance as a risk management tool have to keep it in force on an ongoing basis for continued protection. When a firm remains with one carrier, the claims-made nature of the policy is not an issue. If a firm switches carriers, *prior acts* coverage, as described below, usually is available to cover the risks from the earlier period.

The claims-made feature raises the question of protection for firms that are merging, splitting up, or withdrawing from practice. Professional liability coverage is available in a few programs to continue the protection needed by design professionals who withdraw from active practice. Usually, this “tail” coverage is arranged by purchasing an “extended reporting period” for the policy. Some states require admitted carriers to provide some level of tail coverage at an extra cost to the insured.

For example, the Schinnerer program has a short extended reporting period built into the coverage and longer periods available for purchase by insured firms ending coverage. The extended reporting period does not provide coverage for any new services, but specifically includes the design professional’s negligent acts that occurred before the extended reporting period was purchased if a claim occurs during the extension of the reporting period. Coverage is similarly available to protect the estates of deceased design professionals if necessary.

POLICIES HAVE TO ACKNOWLEDGE PRIOR ACTS

Firms can buy coverage for professional acts and services that took place before they first became insured or when they were insured by another carrier. The scope and availability of this “prior acts” coverage varies from insurer to insurer. As an example, the Schinnerer program provides prior acts coverage (to the day the firm started practice) that is available to eligible small firms after they have been in the program for one year and to larger firms after two years. Firms that switch carriers—by choice or necessity—should be careful to obtain prior acts coverage so that there is no gap in their coverage.

POLICIES DEFINE THE COVERAGE GRANT

Generally, a professional liability insurance policy covers the insured firm’s liability for negligent acts, errors, or omissions arising out of the performance of professional services as a design professional, provided these services are performed within the territory defined in the policy. All policies cover the United States and some others are similar to the Schinnerer program in offering worldwide coverage in the basic policy. Others add worldwide coverage by specific endorsement.

Some policies, such as the one provided by Schinnerer, do not simply limit the coverage to “negligence.” The Schinnerer program states that coverage is for “liability in the performance of professional services,” which basically means coverage for any costs, losses, or other damages that are caused by the failure of the policyholder to meet the standard of care for the professional services provided. In those parts of the world where contract law replaces the determination of a standard of care, the coverage accommodates the differing establishment of legal liability.

A basic policy provides legal defense of claims covered by the policy and pays defense costs subject to the policy limit and deductible. Most insurance companies retain attorneys who are experienced in the defense of professional liability claims. When a defense attorney is selected and appointed to defend the policyholder, it is the policyholder—not the insurance company—that is the defense attorney’s client. Some firms, usually because of their high deductible obligations or significant self-insured retention, may be able to select their own defense counsel.

Broad policies insure not only the firm as the “named insured” but also any partner, executive officer, director, stockholder, or employee of the insured firm when that individual is acting within the scope of professional duties. This includes former employees for their actions while at the insured firm. Some lower-cost policies may not automatically provide such broad coverage. Because professional liability is a

“personal” exposure of the licensed design professional, policies that only insure firms leave the individuals responsible for the design or who sign and seal the documents in a precarious position.

ENDORSEMENTS VS. EXCLUSIONS

Policyholders and insurance companies can modify coverage through endorsements and exclusions. Exclusions are sometimes added to preclude coverage for identifiable risks. This can be done to reduce the cost of the policy (or allow coverage in situations where risks cannot be determined). Endorsements expand coverage and can carry an additional premium cost; sometimes they are included automatically at no extra cost. Firms should be assertive about having their broker or the insurance company’s agent check into expansions of coverage that fit into their practice management goals. Endorsements may include, for example, first-dollar defense, special project additional limits, expanded equity interest, and design/build coverage.

“PER-CLAIM” VS. “AGGREGATE” LIMITS OF LIABILITY

How much insurance a firm buys is a function of its financial needs (including those of its principals), its tolerance for risk, its confidence in risk management abilities, and the demands of clients. Minimum per-claim and annual aggregate limits of liability for errors and omissions insurance are usually set at \$100,000, with maximum limits running as high as \$25 million. Even higher limits can be arranged for special circumstances.

“Aggregate” limits of liability are available to pay for claims and associated legal expenses in a policy term. The costs of claims and legal expenses that exceed the limits must be absorbed by the firm. With most policies, the firm receives a new limit each policy year. Some insurance programs, such as the Schinnerer program, permit their policyholders to buy excess limits for specific projects or to buy “split limits” with one limit for each claim and another for the aggregate claims in a year that are eroded by each claim payment. The insurance company can determine the cost of these variations for the insured to consider (without an obligation to purchase).

DEDUCTIBLES ARE THE FIRM’S RETAINED EXPOSURE

To encourage risk management, insurance companies require a firm to have a deductible that the firm must pay to defend each claim or after each determination of negligence. Deductibles as low as \$1,000 can be available, but many firms increase their deductibles to lower their premium costs. As with most insurance, the higher the level of risk retained by the insured, the higher the deductible and the lower the premium cost. Determining the balance between the deductible, the premium, and the coverage basically requires weighing probabilities and finances and is best carried out by the firm with the advice of its broker. In making this decision, the firm will want to remember there is a new deductible obligation with each claim.

THE COST OF INSURANCE VARIES BY LOCATION AND PRACTICE

Each firm’s premium is calculated individually, based on such factors as the firm’s practice, project mix, claims experience, coverage needs, and resulting risks to the insurer. Hence, comparing premiums of different, but seemingly similar, firms is difficult at best. This is true because firms, just as insurance policies, differ from one another. Thus, a firm should pay attention to its application and work with a broker who can present the firm well to the insurance company. Because prudent insurers must increase the cost of insurance if risks cannot be clearly delineated, the more specific and unambiguous the information provided, the more likely the premium will be minimized. A prospective policyholder should also feel free to call the insurer (with the policyholder’s broker) to ask how the firm’s premium is determined.

POLICIES COVER SERVICES, NOT CONTRACTUAL LIABILITY

Professional liability insurance companies provide coverage only for the insured firm's negligence in performing or furnishing professional services. The firm has a duty to meet the standard of care for the services it has undertaken. Coverage for express warranties and guarantees—separate contractual promises—is excluded under most policies. Certificates that have the effect of warranties—for example those that do not state a known fact or express a qualified professional opinion—are excluded. Promises to absorb costs of errors and omissions, absent negligence, are excluded, too, because such promises have the effect of a warranty.

Insurability problems also arise when owners ask design professionals to contractually indemnify or hold harmless the owner. An extension of coverage is needed when a design professional agrees by contract, in writing or orally, to indemnify and hold harmless some other person, such as the owner or contractor—unless the design professional is indemnifying the other person for the design professional's own negligence, at which point coverage is automatic under many policies. In most contractual liability situations, such coverage may not be possible.

A hold-harmless (or indemnification) clause is essentially a contractual assumption of another's legal liability. Under many circumstances, the use of a hold-harmless clause is an acceptable and advisable practice as long as the contractual transfer of liabilities is not against public policy. However, the contractual obligation might not be within the scope of insurance coverage. Firms should seek to understand whether the contractual assumption of risk can be covered by insurance; if not, the risk will be funded by the firm's available assets.

For instance, in AIA Document A201, *General Conditions of the Contract for Construction*, a clause is included to require the contractor to indemnify and hold harmless the owner and the design professional for bodily injury or property damage claims arising out of the contractor's negligent performance of the work. This does not transfer risk to the contractor, but rather makes the contractor responsible for harm it has caused. Most professional service agreements published by the AIA and Engineers Joint Contract Documents Committee (EJCDC) do not include any specific indemnity provision protecting the client; the documents rely on common law rather than a contractual commitment. Many states have "anti-indemnity" statutes to regulate the use of indemnification clauses in construction contracts; some states prohibit these clauses completely if the provision requires one party to pay on behalf of the other party's negligence.

The design professional should take care to look for hold-harmless provisions before signing any contract for professional services. A clause that otherwise appears innocuous might contain such a provision. A design professional who finds or suspects such a clause should submit the provision to the design professional's attorney and insurance advisor.

A promise to indemnify may fall within the scope of professional liability insurance coverage if it is based on harm actually caused by the failure of the professional to meet the standard of care for the services performed, but care should be taken to avoid overly broad wording that cannot be covered by insurance.

CONSULTANTS AND VICARIOUS LIABILITY

A design professional routinely retains consultants. This relationship means that the design professional also has vicarious liability for any damage caused by the consultant's negligence. Insured design professionals will want to review their consultant's insurance status as they, for all intents and purposes, will serve as their consultant's insurer if that status is inadequate. Similarly, if a design professional contractually agrees to limit

the liability of a consultant, the design professional may find that the risk of the consultant's negligence has been shifted to the design professional and the design professional's insurer. That could mean that the insurer would consider such a limitation of liability as a contractually assumed obligation to pay on behalf of another and exclude any payment on behalf of the consultant from coverage.

At times, design professionals are sub-consultants to other professionals or subcontractors to construction contractors. Examining the prime design professional's coverage—or the professional liability coverage of a construction contractor through which the design professional is providing services to a client—can alert the sub-consultant design professional to gaps in coverage that could result in the sub-consultant becoming the only target of a claim.

PROJECT-SPECIFIC PROFESSIONAL LIABILITY INSURANCE

Project insurance covers the design team participants—even those who are otherwise uninsured. The policy covers the design professional and named professional consultants for the term of the project plus a predetermined discovery period after completion of construction. Depending on the insurance carriers of those firms covered by a project policy, coverage may then revert to the individual firms' professional liability policies.

Project insurance is intended to cover only one project and is usually paid for by the owner who wants coverage beyond that normally carried by the firms. Such insurance is also useful when the project is of such increased scope that it drastically affects the cost of basic coverage, and as a way to get coverage for underinsured or uninsured consultants. From the design professional's standpoint, the billings associated with a project-insured project (and the cost of any claims) do not affect the premium set for the firm's practice policy. A broker is necessary to compare coverage.

While project-specific insurance might seem a logical way to insure all projects, it does not spread the risk as broadly as practice policies that are renewed annually. Such coverage is sometimes limited in availability, and when offered on larger projects it can be very expensive.

EXPANDED PROJECT DELIVERY APPROACHES

Insurance companies have coverage for design professionals practicing in roles such as design/builder, construction manager, and land developer. While some companies offer endorsements for these services to the basic policy under some conditions, potential gaps should be investigated to prevent uninsured liability. For example, a construction manager (as advisor to the owner) is covered under most professional liability policies; the at-risk construction manager—one acting as a general contractor—is not. To encourage design professionals to take the lead on design-build projects, the CNA policy provided by Schinnerer includes rectification coverage that allows the design professional who recognized an error in the design to receive insurance assistance before the project is complete. The purpose of this coverage is to encourage correction of design errors as soon as they are known.

JOINT VENTURES

From a legal standpoint, a joint venture is quite similar to a partnership; the main difference is that a joint venture normally has a more limited scope or purpose. If a professional liability claim is filed against a joint venture, one or all of the members can be held liable for any judgment rendered against the venture. Broad policies—such as the Schinnerer program—provide automatic joint venture coverage. Some insurers exclude joint ventures from the basic policy; coverage for joint ventures with other design professionals may

be available by special endorsement for specific situations. This endorsement extends the coverage under the basic policy to provide for the insured's legal liability arising out of professional services performed on behalf of the named joint venture. However, coverage for other participating firms in the joint venture is not provided by this endorsement.

In any joint venture situation where firms rely on their separate policies, it is more equitable if the policies are all with the same carrier with the limits and deductibles in similar amounts for all firms. Otherwise, firms may find one serving as the “deep pocket” for the others—a situation neither the firm nor the firm’s insurer appreciates.

Securing a policy for the joint venture is far more practical, and more protective, for the interests of the joint venture than to be covered by a separate professional liability insurance policy. As a result, coverage disputes and internal indemnification or contribution obligations can be minimized.

The joint venture might be capable of obtaining a project policy. It is both possible and pragmatic to secure one policy for the joint venture’s participation on a specific project. This is especially helpful if the joint venture is organized as a separate business operation, such as a limited liability partnership or corporation. A project policy covers a prime professional and all other professional participants for a specific period of time. Contractual provisions can be used to allocate the deductible obligation among the parties so that if a claim does occur, the potential for conflict among design team members—and the eventual cost of resolution—is reduced.

If the joint venture is loosely organized, each member of a joint venture should obtain evidence from the other joint venture partner(s) that their policies have been properly endorsed, if necessary, to cover participation in the joint venture. This usually can be accomplished by obtaining a certificate of insurance and a copy of the joint venture endorsement.

STRATEGIC ALLIANCES NEED SPECIAL ATTENTION

Strategic alliances are business ventures. No matter how they are legally structured, attention must be given to how they are protected by insurance. Professional liability insurance should be of special concern. Clients, or other parties, claiming harm from the actions of a strategic alliance may be able to recover from any member of the alliance; from the injured party’s perspective, the alliance may be viewed as one integrated, responsible entity. Therefore, the insurance concerns of a strategic alliance should be the equivalent of any joint venture or partnership.

When the alliance comprises design firms, it might face a variety of claims. With regard to responsibility, all strategic alliance partners may be held liable for the actions of all, but each looks to the others to be responsible for their own areas of expertise and obligations. From a professional liability perspective, care must be taken to match final liability with eventual responsibility. Firms often rely on their practice policies of professional liability insurance to protect and defend them in loosely structured business combinations. This may not always be effective; firms should talk with their insurance brokers to determine if their individual policies will provide adequate coverage.

ALLIANCES WITH NON-PROFESSIONALS CAN CREATE SIGNIFICANT RISK

Design practice affects the life, health, and safety of the public. Design professionals must satisfy the licensing procedures that determine if they meet the standards of professional competence demanded by the scope of their practice. Where design professionals join with other professionals in a strategic alliance or joint

venture, it is fairly clear which portion of the responsibility each professional will assume and how that responsibility will be covered by separate professional liability policies, a policy for the joint venture, or a project policy. The same is not always true when a licensed design professional joins with a non-professional to produce a project. While it may be possible to secure a project policy (for example, for an integrated project delivery team covering both the design firm's professional liability exposure and the contractor's design exposure), thought must be given to how responsibility and liability are to be divided.

The evolution of the design and construction process has blurred the "bright line" that typically divides design services from construction work. With the increase of design/build—usually with a contractor as the design/build leader—design professionals should be aware of how the contractor on a project will cover its share of design liability exposures.

In many contractor–design professional joint ventures, little advance planning is given to a reasonable allocation of risk. The design professional, through licensure, demonstrates responsibility for the adequacy of the project design, thereby providing the required public protection. The builder, however, may not be required to be licensed by the state in the same manner. There is a general responsibility to avoid acting in a negligent manner in the pursuit of the work so as to prevent injury to the public, but when harm occurs, the responsibility may shift. And this shifting often is in the direction of the party with the appropriate insurance coverage. In fact, many design-build contracts have "skip-over" provisions where the agreement states that since only the design professional is licensed, even though the design-build entity has the responsibility for the design, the design professional will be the only party the client can look to for any problems that might have had their genesis in a design deficiency.

A strategic alliance with a contractor provides no additional protection as a "temporary partnership." For the purpose of rectifying harm to another party, it is characterized as a joint venture in which all partners are liable for the actions of all other partners in the context of the jointly assumed project. The design professional, therefore, may be jointly and severally liable for exposures it can neither manage nor insure. Likewise, a contractor's risk may extend to the design aspects of a project and be excluded from the contractor's normal coverage as a professional liability exposure. Certainly, a design professional does not want the other joint venture member to be "going bare" when design liability is such a great exposure. Whenever a contractor's responsibility and liability goes beyond construction to project design or construction management, the need for contractors to carry professional liability insurance—design liability coverage—intensifies.

CLAIMS HANDLING

How claims are handled is a basic test of professional liability insurance coverage. There are two common ways to define claims. The first is objectively defined: a demand for money or services with an allegation of a wrongful act. This definition produces a clear reference point indicating when the insured and the insurance company should intervene. It is broad enough to cover not only a lawsuit, but also an angry call from the client demanding that the design professional "fix it."

CIRCUMSTANCES

The second definition is subjective and requires alerting the insurance company to a potential problem or circumstance. Such a problem may not necessarily become a formal claim, but rather a threat of an action—

or just a very troubling circumstance. Careful review of policy terms is important as failure to report in a timely manner may jeopardize coverage.

Firms should always report any problem that might be related to their professional services. The Schinnerer program has “incident reporting” where a policyholder can report troubling actions that it thinks might lead to a future claim. By doing so, the policyholder receives assistance up-front at no cost. The policyholder is not responsible for their deductible unless an actual claim develops. Additionally, the policyholder’s decision to report such an incident and receive “pre-claim assistance” will not affect the availability or pricing of coverage in the future.

“HAMMER” CLAUSE

Most policies require the insurance companies to have the consent of the insured before settling claims. Although the Schinnerer program does not include any disincentives to force a policyholder to settle a claim that the policyholder does not think should be settled, many insurance policies include a “hammer” clause that forces the policyholder to settle for the amount the insurer determines is acceptable to the plaintiff or risk having to pay for any final judgment above that amount.

In these cases involving a disagreement between the insured and the insurance carrier on settlement, the insured may be liable for the cost of any judgment above the amount for which the insurance company *could have* settled the claim. Similarly, the insurance company may be liable for the cost of any judgment above the amount that the insured asked the company to settle. This checks-and-balance approach encourages both the insurer and insured to work together to manage claims.

Professional liability insurance policies are simple in concept—they cover a firm’s liability in the performance of professional services—but complex in detail, so an independent broker is a critical factor in acquiring appropriate coverage.

Professional liability insurance coverage is important to any firm that wants to protect its assets, stand behind the services it provides its clients, and protect the public, but professional liability insurance is usually not required by law. However, we find more and more that general liability insurance will ask you to carry professional liability coverage to be eligible for their program.

State governments often set insurance requirements for businesses. Most states require businesses with employees to pay for workers’ compensation insurance, unemployment insurance, and state disability insurance. And a state may require insurance of specific business activities. For example, if you own a car or truck and use it for business purposes, you may be required to purchase commercial auto insurance. Financial lenders or investors may require a firm to maintain life, business interruption, fire, flood, or other types of insurance to protect their investments in the firm.

HOME-BASED BUSINESS INSURANCE

Contrary to popular belief, homeowners’ insurance policies do not generally cover home-based business losses. Depending on the risks to your business and the specifics of your policy, a home-based business might be able to add riders to a homeowners’ policy to cover normal business risks, such as property damage or bodily injury to a business visitor. Homeowners’ or renters’ insurance policies are rarely adequate to cover the unique needs of a home-based business. They only go so far in covering home-based

businesses, and purchasing additional policies to cover other risks, such as your general liability exposure, is prudent.

Most homeowner policies tend to exclude business-related liability claims from persons injured on your property, and provide no protection to sustain the business during downtime associated with a property loss. That is why to close these gaps, it may be wise to purchase:

- a business owners policy or general liability,
- business property, and
- business interruption/continuation insurance.

For the many professional service firms that operate exclusively from their owners' homes, not understanding the differences between personal and commercial insurance liabilities can be costly. Owners who assume their personal insurance policies for home, auto, life, and health will automatically protect their business interests may be in for a financial shock.

The following describes some of the business insurances that a new firm—even if it operates as a home-based business—may need to consider.

CYBER LIABILITY INSURANCE

Professional service firms are facing an increased exposure to cyber liability. Many firms do not take the necessary steps to secure their systems, guard their digital assets, protect confidential client information, and maintain productivity. Each firm should have digital protection protocols that help avoid or minimize data breaches as well as a plan to manage any breach that might occur. And that plan should include insurance coverage should firm operations be compromised.

Creating a strategy for improving digital security can be challenging. In addition to appropriate firm practices—such as requiring secure password naming conventions and limiting internet access to many records—understanding the dangers of digital data security and the need to follow proper procedures is critical. If network integrity is compromised, sophisticated malware can create liability issues by using a firm's network to compromise and infect other networks that may be integrated on a continuing or project basis.

Cyber losses involve more than payouts to third parties injured by the wrongful disclosure of confidential information. Firms are also subject to providing *legally required* notices and meeting other regulatory obligations. Firms may face breach of contract, confidentiality, and other legal challenges as well. In addition, other costs will include up-front investigation, data restoration, business interruption, and public relations. Firms can insure against these operational risks with a cyber policy.

A protection package for professional service firms should include the following:

BREACH RECTIFICATION, INCLUDING DIGITAL PROPERTY REPLACEMENT COVERAGE

A policy should include coverage for business interruption and digital asset loss, including tools to get a firm back to productive service as quickly as possible and protecting the firm's reputation. Coverage that includes digital property replacement pays the reasonable and necessary cost to replace, restore, or reconstitute digital property from written or electronic records.

If a firm's plans are held for ransom, a disgruntled former employee corrupts digital project information, or a virus is introduced into a firm's business software preventing it from billing properly or paying vendors or sub-consultants, the damages to the firm could be extensive. Reconstituting models or any other digital instruments of service takes away billable time. Project delays could result in owner or contractor claims. And the damage to the firm's reputation—the one major asset of any firm—can challenge the very existence of the firm if not properly addressed.

BREACH LIABILITY, INCLUDING WEBSITE MEDIA COVERAGE

There should be broad liability coverage for any cyber loss, including privacy liability, regulatory actions, and website media liability, such as intellectual property infringement and personal or advertising injury from content posted on the firm's website or official social media presence.

Even small firms possess confidential information of clients. Notifying parties whose information has been compromised has to meet government, client, and financial system requirements. Even a small breach can result in tremendous costs. As firms attempt to build brand awareness through their website and social media presence, there is the danger of posting commercially disparaging information or commentary that could result in claims from former employers, clients, contractors, or even from the employees or consultants of another professional services firm.

DIGITAL CRIME, INCLUDING CYBER EXTORTION

Since firms are subject to digital crime, including cyber extortion and the deceptive transfer of funds, the policy should provide coverage for expenses used to prevent a network security or data breach event.

Cyber criminals could siphon funds from a firm's bank account or hijack a firm's billing process to issue improper invoices, payments, or financial transfers. And something as basic as a firm's communication systems could be tapped to provide income to hackers at the expense of the firm. As with instruments of service, criminals could extort payments from a firm because of the threat of devastating cyber crime.

CYBER BREACH RESPONSE TEAM

While not all policies include a response team, having access to one can mean the difference between being a long-term victim or a responsive professional. The Schinnerer program includes access to expert risk management tools that decrease a firm's exposure by providing industry-specific guidance. If an event occurs, an expert team provides legal services and technical support to assist policyholders who have identified a data security breach. The team works closely with the firm and, when necessary, with forensic and crisis management consultants to identify the cause of the breach, determine its scope, and formulate the appropriate response. In the event of a breach, a privacy attorney will be assigned to the case and promptly respond to and investigate any suspected or actual event. The team also assists the policyholder's management, in-house and outside cyber-security experts, law enforcement, and government regulators to accomplish compliant and timely public reporting as required. The policy defends insured firms during formal regulatory investigations and enforcement actions and in the event of litigation.

COMMERCIAL GENERAL LIABILITY INSURANCE

Liability exposures can arise from a design professional's office operations and non-professional activities at the job site. To cover such exposures, design professionals should carry a general liability policy. Most business owners purchase general liability insurance to cover legal expenses due to accidents, injuries, and claims of negligence. These policies protect against payments as a result of bodily injury, property damage, medical expenses, libel, slander, the cost of defending lawsuits, and settlement bonds or judgments required during an appeal procedure. Remember, homeowner's coverage probably does not provide adequate liability insurance to cover a home-based practice.

The following are elements of protection provided by a general liability policy:

COVERAGE IS HIGHLY SPECIFIC

A general liability policy provides coverage for claims against the named insured involving third-party legal liability, but it doesn't cover professional, automobile, and workers' compensation exposures. The basic general liability policy covers *only* the named insured; it does not protect employees, unless specifically endorsed to provide for such an extension of coverage.

LIABILITY LIMITS ARE BASED ON OCCURRENCE COVERAGE

General liability policies usually set definite dollar limitations on the amounts an insurance company is obligated to pay. These limitations relate to the type of claim (that is, bodily injury, property damage, or personal injury) and to the total dollar cost of all claims, also known as the aggregate limits. For bodily injury and property damage, there are two limits: (1) the dollar amount of the claim for each occurrence or accident and (2) the aggregate dollar amount for all claims. For personal injury—claims involving libel, slander, defamation of character, false arrest, and the like—the limit of liability is a single aggregate amount for all claims. Unlike professional liability insurance, the costs of defense are usually not included within the limits and do not erode the aggregate limit.

CONTRACTUAL LIABILITY COVERAGE SHOULD BE INCLUDED

In addition to professional services contracts, the design professional can encounter a variety of business contracts, including office leases, purchase orders, service agreements, and the like, any of which may contain a hold-harmless provision that will contractually transfer another's legal liability to the design professional. The design professional must be vigilant in checking all contracts, agreements, leases, and purchase orders for hold-harmless agreements. When these are found, the design professional should obtain a coverage extension if the general liability policy does not already have one.

Other extensions of the general liability policy may be necessary to reflect the individual needs of the firm. A careful review of the firm's liability situation should be made with insurance counsel to be certain the required coverage is being provided.

COMMERCIAL PROPERTY INSURANCE

Property insurance covers everything related to the loss and damage of company property due to a wide variety of events, such as fire, smoke, wind and hail storms, civil disobedience, and vandalism. The definition of “property” is broad and often includes lost income, business interruption, buildings, computers, company papers, and money.

Property insurance policies come in two basic forms:

- all-risk policies covering a wide range of incidents and perils except those noted in the policy; and
- peril-specific policies that cover losses from only those perils listed in the policy.

An example of a peril-specific policy is business interruption insurance. All-risk policies generally cover risks faced by the average small business, while peril-specific policies are usually purchased when there is high risk of peril in a certain area. It is critical that a new firm consult an insurance agent or broker about the type of business property insurance best suited for a new small business.

AUTOMOBILE/AIRCRAFT/WATERCRAFT INSURANCE

Comprehensive automobile liability protection is an essential part of a design professional’s insurance program. Firms that think they can rely on their personal coverage should check their policies closely.

While all auto insurance policies are similarly structured, there are important distinctions between personal and commercial vehicle coverage. Typically, commercial coverage carries higher liability limits and includes special provisions for rented and other non-owned vehicles, including employees’ cars driven for company business. If a vehicle is owned or leased most exclusively for business use, make sure the business name is listed as the principal insured. The policy also should name, as insureds, the individual design professional, all partners in a partnership, and all officers and directors of a corporation.

The firm’s insurance should be written with adequate limits of liability to cover the use of automobiles by the policyholder, by employees, or by others. Coverage should include owned, non-owned, hired, and newly acquired automobiles.

If a personal vehicle is used to conduct business, consider increasing your liability limits. Personal automobiles of individual design professionals should be insured with adequate limits of liability. Premiums likely will be higher, but having additional coverage to protect business assets will be beneficial in the event of an accident-related lawsuit.

Similar liability coverage is needed for aircraft and watercraft if their use is part of the design professional’s practice. And that includes any use of drones for site examination, project photography, or construction evaluation. Drone coverage is a special form of aircraft insurance; the liability of a drone—whether because of property damage, bodily injury, or personal injury such as invasion of privacy—is not covered by other policies.

EMPLOYERS' LIABILITY INSURANCE

As an employer, the design professional can be subjected to claims by employees for job-related injuries. In most instances, these claims are covered by workers' compensation rather than being treated as common-law actions. Situations may exist in which an employee's injury isn't covered under workers' compensation. In these instances, the employee may attempt to sue the employer. Employee suits are excluded both under general liability and workers' compensation policies, and a potential coverage gap exists. To avoid this gap, the workers' compensation policy is generally extended to cover what is called employer's liability.

EXCESS (UMBRELLA) LIABILITY INSURANCE

When higher limits of liability are required, certain underlying policy limits can be increased through the purchase of one additional policy—an excess or umbrella liability policy. This policy will provide higher limits in conjunction with underlying general liability, automobile, and employer's liability policies. Because it is an excess policy that is only tapped when the underlying policies cannot pay enough to satisfy a claim, the cost of an umbrella liability policy is not significant.

Usually, additional limits in increments of \$1 million are provided over the limits of the underlying policy. Professional liability is not commonly included. Coverage generally will be the same as the underlying policies when coverage is broader. It is important to know if the umbrella coverage "follows the form" of underlying coverages so that there are no gaps in what is covered and how it will react to excess defense costs. Claims are subject to a self-insured retention level (for example, \$10,000), similar to a deductible.

DESIGN PROFESSIONAL'S PROPERTY INSURANCE

The design professional's office building or the leasehold improvements where the design professional is a tenant should be insured by a standard policy covering named perils or by a broader all-physical-loss form, which is generally available. Careful attention should be given to establishing an accurate insurable value for the building or improvements. The amount of insurance always should be adequate to meet the requirements of any coinsurance clause (that is, any required fractional payment by the insured in case of a loss). Otherwise, the design professional could end up paying for a substantially larger part of any loss.

Consideration should be given to the purchase of insurance for the building improvements on a replacement-cost basis rather than on a depreciated-cash-value basis. All leases and mortgages should be reviewed as they frequently stipulate coverage requirements.

Package policies are generally available. These policies may combine several separate coverages, such as insurance for the building or improvements, office contents, and public liability—possibly at a lower premium cost than if these policies were purchased separately. The package policy should be scrutinized to determine if it fits the design professional's needs.

OFFICE CONTENTS

The design professional's office contents can be insured by a standard policy covering fire, windstorm, and other extended coverage perils. Separate burglary and theft insurance also can be written to cover office

contents. However, broader coverage of office contents is generally available to insure them against all risks of direct physical loss, except as excluded in the policy.

Such insurance covers drawings that are damaged, but only to the extent of the cost of labor and materials to produce the drawings. The policy does not cover the cost of the research that went into their preparation, although such coverage may be obtained by purchasing valuable-documents insurance.

Portable equipment that may be used outside the office can be insured under an all-risk floater policy. Money, securities, checks, travel tickets, and other negotiable instruments can be insured under a blanket crime or similar policy.

VALUABLE DOCUMENTS

This insurance is one of the most important property coverages sought by design professionals. It covers the total value of documents lost or destroyed by any of the means described in the policy and is generally an “all-risk” coverage. It is available on a scheduled form, a blanket coverage form, or a reporting form indicating periodic changes in value. Documents in storage as well as works in progress can be insured. Coverage is also available for clients’ documents in the custody of the design professional.

BUSINESS OWNERS POLICY PACKAGES (BOPS)

Insurance companies selling business insurance offer policies that combine protection from all major property and liability risks in one “package.” Small and mid-sized businesses often buy a business owners policy (BOP), an insurance cluster of policies that typically includes property, business interruption/continuation, and liability insurance. BOPs do not cover professional liability, auto insurance, workers’ compensation, or health and disability insurance.

BUSINESS INTERRUPTION INSURANCE

Business interruption insurance reimburses the design professional for continuing fixed expenses and for loss of profits in the event fire or other casualty interrupts normal business operations. This insurance can be written to cover fire, windstorm, extended coverage perils, computer crashes, and other hazards.

Coverage is available for an agreed sum or for actual gross earnings based on the firm’s history. Options are available to reimburse the design professional for the extra expenses of continuing business at another location while the damaged premises are being repaired.

FIDELITY BONDS AND CRIMINAL LOSS INSURANCE

Usually, all persons involved with the custody or disbursement of funds, management of firm finances (receivables and disbursements), authorization of payments to subconsultants or others, purchasing, and other activities requiring the use of funds or liability for the misuse of funds of others should be bonded. A blanket form of bond covering all employees is typically recommended.

Money, securities, checks, and other negotiable paper may be insured both inside and outside the insured’s premises under a broad-form money and securities policy to include loss by robbery, burglary, theft, and disappearance or destruction by fire or other causes.

Comprehensive bonds or blanket crime policies are available. These combine coverage for loss of money, securities, and other property under a blanket fidelity bond and a check forgery bond. The design professional's professional liability policy does not cover claims and losses from the dishonest acts of associates or employees.

DIRECTORS AND OFFICERS LIABILITY INSURANCE

As a firm grows and assumes a more formal form, it has to closely follow the requirements of its form of business entity. With corporations that means the firm not only has to meet the legal requirements set out by state law, but also protect those who owe a duty to the business entity. Directors and Officers (D&O) coverage provides protection for leaders of a firm established as a corporation against claims alleging breach of duty, negligence, error, or misrepresentation.

In handling the affairs of a corporation, directors and officers must exercise such judgment and care as a reasonably prudent person would exercise in similar circumstances. Directors and officers are responsible for knowing how the firm is operating and making policy and managerial decisions that are intended to benefit the shareholders. All directors and officers must carry out their duties with the best interest of the organization in mind. This means avoiding conflicts of interest and keeping the trust of the company. While these duties of care and loyalty are owed primarily to the organization, there is a duty of obedience to other parties to follow the company's by-laws. Increasingly, those who assume the duties of directing the operations or overseeing its function as directors are targets of lawsuits.

FIDUCIARY LIABILITY INSURANCE

The Employee Retirement Income Security Act of 1974 (ERISA) is a federal law that sets minimum standards for pension plans in private industry. ERISA does not require any employer to establish a pension plan. It only requires that those who establish plans must meet certain minimum standards. The law requires accountability of plan fiduciaries. ERISA generally defines a fiduciary as anyone who exercises discretionary authority or control over a plan's management or assets, including anyone who provides investment advice to the plan. Fiduciaries who do not follow the principles of conduct may be held responsible for restoring losses to the plan. So this liability insurance provides protection for fiduciaries against liabilities that arise from their administration and oversight of any employee benefit or pension plan.

HR MANAGEMENT

HR functions are time consuming and may force your architectural firm to stop designing to spend time administering. A Professional Employer Organization (PEO) can help you to manage critical HR administration and ever-changing regulatory issues along with every aspect of the employee life-cycle including payroll, benefits administration, human resources tasks such as hiring and training, workers' compensation, compliance, and 401K administration. Whether you have 2 or 50 employees, outsourcing HR services can help you as a firm owner navigate the murky waters of running a business.

EMPLOYEE INSURANCE

Design professionals with employees must face the prospect of additional insurance coverage for their employees. Some of this coverage is mandated by statute; some is at the firm's choice. Businesses with employees are usually required by law to pay for workers' compensation insurance, unemployment insurance, and, depending on where the business is located, disability insurance.

WORKERS' COMPENSATION INSURANCE

By statute, an employer is required to carry workers' compensation insurance. Sold by commercial insurance companies (or, in some states, available through state-run facilities), workers' compensation policies provide protection for work-related injuries. Benefits are prescribed by statute and include medical expenses, lost wages, and death benefits. These benefits are provided regardless of employer or employee negligence. Employees are precluded from suing their employers for injuries covered by workers' compensation.

A workers' compensation policy is rated, based on the firm's payroll, to cover various classes of employees. A full-time field design professional performing construction contract administration services will have a higher rate than a design professional who does not perform these services. Care should be exercised in the classification of employees to ensure proper coverage and rates applicable to the hazards involved. Improper classifications can result in much higher premiums.

Owners of a firm should understand how the state defines "employee" as it relates to workers' compensation insurance and what coverage the firm may be required to carry.

UNEMPLOYMENT INSURANCE TAX

Businesses with employees are required to pay unemployment insurance taxes under certain conditions. If your business is required to pay these taxes, you must register your business with your state's workforce agency.

HEALTH INSURANCE

Health insurance coverage is a major, but costly, consideration for both employees (the beneficiaries of the coverage) and employers (whose professional livelihood, to a great extent, depends on a productive and healthy staff). The Patient Protection and Affordable Care Act (also known as the ACA) passed in 2010 reformed the health insurance market in many ways. The law is complex and it is important for employers to stay abreast of new requirements as regulations are issued and provisions are interpreted. The AIA Trust offers numerous resources about employer and employee health insurance issues which [may be found on the AIA Trust website by clicking here](#). As legislation and the concept of health insurance exchanges changes, finding and evaluating health insurance will be more difficult.

Flexible healthcare spending accounts, authorized under federal tax laws, allow participants to make pre-tax contributions to a special employer-managed account and then to be reimbursed from this account for out-of-pocket health care costs. Contributions are exempt from FICA (social security), federal, and in most states, state income taxes. A health flexible spending account (FSA) may be established as part of the employee benefits package to allow employees to use pre-tax dollars to pay for eligible health care expenses for themselves and eligible dependents. Commonly such plans are combined with a dependent care spending account, which permits an employee to pay for work-related child care expenses with pre-tax dollars. Regulation of such accounts is an especially fast-moving field; advice from your firm accountant is essential.

LIFE INSURANCE

Life insurance is most often viewed as a personal, non-business concern. Since small professional practices often cease to exist once the proprietor dies, a life insurance policy can be viewed as a business continuation policy. Avoiding life insurance may present significant risks for a practice that is a partnership. One way to help secure the firm's future and protect it as an asset is "Key Person" life insurance. This type of policy names each partner in the business as beneficiary on the other's policy. If a partner dies, the other can use the life insurance payout to buy out the deceased partner's heirs, pay off outstanding loans or other obligations, or continue operations until a replacement employee is hired and trained.

Design professionals considering a business partnership should look into "Key Person" life insurance before forming the company. Doing so early helps mitigate risk. When considering this life insurance, be sure to think about staff beyond the business owner. This type of coverage typically focuses on any person without whom the business would cease to exist. This principle can also be applied to long-term disability insurance, such as business owners' expense coverage, for the key person(s) in a firm.

In addition, life insurance coverage may be offered as an employee benefit and a form of income protection for the employee's beneficiaries. Group term life insurance is commonly provided to all employees as a fixed-dollar amount per employee or as a multiple of salary.

DISABILITY INSURANCE

According to the Social Security Administration, one in four workers will suffer a long-term disability before they reach retirement. With this risk, many workers are looking for disability insurance as part of their employee benefits package. Therefore, if an employer offers Long Term Disability Insurance coverage as part of the firm's employee benefits package, it may help to recruit and retain valuable employees while staying competitive in today's marketplace.

Long Term Disability Insurance helps cover monthly bills and out-of-pocket medical expenses when a disabling injury or illness prevents the firm owner or employee from working for a long period of time and minimum benefits are fixed and prescribed by statute. This coverage protects against extended disabilities, often until the employee recovers or reaches age 65. A third party is often needed to determine the continuance of disability benefits. For architects, it is important that the test of disability be their ability to practice their chosen profession – this is the test used in the AIA Trust policy. The AIA Trust offers several forms of long term disability coverage, including individual and firm (or employee) insurance coverage.

Business Overhead Expense disability benefits are similar to long-term disability benefits except it protects business-related expenses in the event of total disability of a business owner. Benefit periods range from 12 months to 24 months, and this low-cost insurance helps a business owner cover on-going business expenses such as rent, mortgage interest, utilities, and employee salaries. This valuable insurance coverage allows a disabled owner to maintain the business viability or avoid a "forced-sale" of the business should the disability condition be long-term or permanent so business owners or partners should consider this type of coverage.

In addition, short-term disability insurance coverage protects against absence from work of short duration, typically three to six months. Small employers as well as large employers often self-insure against the risk of short-term disabilities through a sick leave program, although it is possible to buy insurance for this purpose. It is frequently purchased as an add-on to long term disability coverage, or it may be purchased separately.

RETIREMENT PLANS

In times of increased life expectancy, retirement plans take on added significance. These plans can take different forms and offer many variations and options. They are important to consider for yourself, and for your employees as an employee recruitment and retention tool.

Defined contribution plans start with an annual contribution based on earnings. The amount received at retirement is based on total contributions made and the performance of the investment options selected by each employee. Firms have a choice of several types of defined contribution arrangements:

Profit Sharing plans allow a variable contribution annually. On an overall plan basis, they can generally range from zero to 25% of the total plan compensation. Each year, the amount of contribution is totally flexible, and generally may be as low as zero. The individual contribution limit for 2017 is the lesser of \$54,000 or 100% of compensation. Employers with demographics that include generally older highly compensated employees may want to consider using the cross-testing plan option to potentially provide for a higher percentage of the overall plan contribution.

Pension plans, which mandate annual contributions, according to the contribution level chosen on an adoption agreement, are now all but obsolete since you can now reach the maximum 25 percent limit in a Profit Sharing plan and retain the flexibility to contribute between 0 and 25 percent each year. *Traditional 401(k)* plans allow individuals to defer a part of their salary over and above contributions the firm may make. Contributions made by employees are on a before-tax basis, and this plan is a good way to have employees share in the cost of saving for retirement.

Regarding IRS and federal pension plan requirements, the IRS has rules relating to "qualified plans," SEPs, Simple IRAs, Roth IRAs and IRAs which direct firms with retirement plans to establish eligibility criteria, vesting schedules, contribution allocation formulas which may include integration with Social Security benefits.

401(k) Plans have limits, set by the IRS, as to how much employees may contribute. The firm must satisfy IRS 401(k) non-discrimination testing and minimum contribution requirements. The percentage of salary that can be deferred by highly compensated employees is dependent on the average deferral rate of the non-highly compensated employees. The salary deferral limit for this plan type, subject to discrimination testing, is \$18,000 for 2017.

Catch-up contributions, for participants age 50 or older, can be made in any of the 401(k) plans up to the IRS limit which is currently \$6,000 for Traditional and Safe Harbor 401(k) plans in 2017 and \$3,000 for SIMPLE 401(k) plans. These contributions are over and above the regular 401(k) contributions and are not counted against a participant's total contribution limit.

SIMPLE 401(k) plans allow individuals to defer a part of their salary. The firm can adopt a SIMPLE 401(k) without being subject to "discrimination testing" or minimum contribution requirements. The firm must offer eligible employees who defer part of their salary a dollar-for-dollar matching contribution up to 3 percent of compensation or give a 2 percent contribution for all eligible employees regardless of participation. The firm must also provide an annual notice to all eligible employees at least 60 days before the beginning of each year. The notice provides the employees with information on the SIMPLE plan including whether the firm will make the matching or non-elective contribution in the coming year. SIMPLE plans do not allow for any other

types of contributions. Although the maximum salary deferral limit is lower in a SIMPLE 401(k), (\$12,500 for 2017), the lower contribution cost is attractive to many firms.

Safe Harbor 401(k) plans allow individuals to defer a larger part of their salary than a SIMPLE 401(k). The firm chooses one of two contribution requirements — either a 3 percent non-elective contribution or a matching contribution based on the following formula, dollar for dollar up to 3 percent of compensation and 50 cents on the next 2 percent of compensation. The firm must also provide an annual notice to all eligible employees at least 30 days, but not more 90 days before the beginning of each year. The notice provides the employees with information on the plan including whether the firm will make the matching or non-elective contribution in the coming year. There is no nondiscrimination testing as long as the contribution and notice requirements are met. With a Safe Harbor plan the firm can also contribute to a Profit Sharing plan.

Owner's 401(k) plans are for a sole owner with no employees or owners who employ only family members. The impact of increased contribution limits and deduction rule changes allow the owner to use a 401(k) plan, typically used by larger firms, to increase drastically his or her contribution. Roth 401(k) option is available to employers in any of the 401(k) plan options above. This option allows participants to make contributions from their salary on an after-tax basis and if certain requirements are met be able to withdraw them tax-free.

Defined benefit plans specify, at the outset, the annual benefit at retirement for each participant. Actuaries calculate the annual contribution required to reach this goal. These plans can be expensive to maintain but usually allow for larger contributions for older employees than defined contribution plans. They are well suited for older owners/partners with younger employees, since they can accumulate retirement savings faster as they near retirement age.

Simplified employee pension plans or SEP plans are retirement plans in which firms establish individual retirement accounts (IRAs) for employees. The contributions to the SEP have limits similar to a profit sharing plan. Firms may be required to cover more employees than in a defined contribution or defined benefit plan, and therefore the SEP may be more costly. However, administration of a SEP may be simpler than some defined contribution or defined benefit plans.

SIMPLE IRA plans work the same way as the SIMPLE 401(k) plans described above except the contributions are made to employee IRAs. It offers many of the same advantages as a SIMPLE 401(k) with generally *lower costs* and *no annual government filing requirement*.

Individual Retirement Accounts (IRAs) are set up by individuals on their own behalf. Individuals are able to make relatively low annual contributions to an IRA. These contributions may not be tax-deductible, depending on income and whether the individual participates in a retirement plan. Earnings on the IRA accumulate on a tax-deferred basis until withdrawal at age 59 1/2 or later. Withdrawals at an earlier age carry a penalty.

However your retirement plan is designed, the key for firms as well as for individuals is to *start early*. Demographics (such as increases in the retirement age) and political necessity (taxing benefits for a growing number of people) have already caused major reductions in Social Security benefits. In today's challenging economic times, it pays to contribute as much as you can afford to a retirement plan now – even lower amounts help you to reach your retirement goals sooner.

SUMMARY

A professional practice, like other businesses, requires firm leaders who take the time to identify, assess, and manage risk. Insurance is just a part of that risk management methodology. Yet, it is an important vehicle for transferring the risk of financial loss so that a firm—especially a newly formed firm—can focus on building a practice and delivering responsive and valued professional services. The AIA Trust is continually developing and offering resources and tools to offer AIA members insights and pragmatic tips to practice successfully. Visit the [Practice Resources](#) page of the AIA Trust website for the latest information.

If you're starting a firm – or considering it – be sure to visit the webpage "[Architects Starting a Firm—New in Practice](#)" on the AIA Trust website.

If you're running a firm, however seasoned you may be, find out what programs and resources the AIA Trust may be of assistance to you by visiting the webpage, "[Established Architects—Running a Practice](#)".

For more information about professional liability insurance vital to managing a firm successfully, visit the AIA Trust [Professional Liability Insurance Database](#) site by clicking here – or simply find out more about [the Schinnerer/CNA insurance program by clicking here](#).

New Firm Owner Checklist

What You Need to Know

Check this list to consider vital insurance coverage and other important products needed to help make you & your new firm successful!

For Every New Firm Owner Starting Out:

- ☐ **Professional Liability Insurance** (aka errors-and-omissions or E&O insurance) defends and pays on behalf of the architect for claims alleging negligence in the performance of professional duties. Even with professional liability coverage, a firm continues to retain some risk such as deductibles, costs exceeding policy limits, or costs for claims excluded from the scope of coverage. Principal reasons to consider professional liability insurance are: business survival, continuing operations, contract requirements, and social responsibility. [Click here for more details about professional liability insurance.](#)
- ☐ **Business Owners Policy Packages (BOPs)** combines protection from all major property and casualty risks in one “package” and can include property, business interruption/extra expense, automobile, and general liability insurance (not professional liability, workers’ compensation, or health/disability insurance). [Click here to read more about BOPs.](#) Other methods of providing the necessary protection include:
 - ☐ **Commercial General Liability Insurance** covers liability from *incidents* that occur on or off the policyholder's premises and the three basic coverage areas of this type of policy are property damage, bodily injury and personal and advertising injury (such as libel, slander, or copyright infringement); also included are premises and completed operations liability, medical payments and contractual liability.
 - ☐ **Commercial Property Insurance** protects against loss of or damage to essential pieces of the business such as documents and equipment.
- ☐ **Umbrella or Excess liability policies** for both a corporate and individual level, provide higher limits in conjunction with underlying general liability, automobile, and employer’s liability policies, usually in multiples of \$1MM; however, they generally do not apply excess of a professional liability policy.
- ☐ **Home-Based Business Insurance** for those operating out of a home office. An endorsement would be required to a Homeowners policy which normally excludes business property or liability claims arising out of business pursuits.
- ☐ **Commercial Auto Coverage** protects against accidents while vehicles are operated within the scope of employment whether a personally-owned vehicle, a firm-owned auto or employees using their own vehicles. Auto liability limits should not be overlooked and umbrella liability should be purchased in excess of the primary auto limits.
- ☐ **ACORD Certificate of Insurance** summarizes essential information about your insurance policy, such as coverage types, policy numbers, insurance limits, and effective and expiration dates – and is especially important for clients as well as for other business interactions to ensure coverage. [Click here for more information.](#)

☐ **Business Interruption/Extra Expense Insurance** reimburses for additional fixed expenses and loss of profits in the event of fire or other covered perils, such as computer crashes which interrupt normal business operations.

☐ **Cyber Liability Insurance**, also known as cyber, privacy breach and network security insurance, covers a business' liability for a data breach in which customer data is exposed or stolen by a hacker who has gained access to the firm's electronic network. Policies cover a variety of expenses associated with data breaches, including: notification costs, credit monitoring, costs to defend claims, fines and penalties, and loss resulting from identity theft. [Click here for more details about cyber liability insurance.](#)

☐ **Design Professional's Property Insurance** for an owned office building or the leasehold improvements in leased locations using an all-physical-loss form. This coverage can also be provided as part of a Business Owners Package policy or Commercial Property Insurance as described above.

☐ **Flood Insurance** needs may impact offices, homes, and client properties. The federal government offers flood insurance through the [National Flood Insurance Program](#) (NFIP) run by the Federal Emergency Management Agency (FEMA) and policies may be sold through private insurance agents. Depending on your location, flood insurance may be required by the government and/or your mortgage lender. [Click here for more details about flood insurance.](#)

☐ **Retirement Plans** are vital for your future; options are now available for sole practitioners, such as an Owners 401(k) which combines the benefits of profit-sharing and 401(k) plans without costly set-up charges, enabling you to defer more than other types of plans. [Click here for more details about retirement plans.](#)

When You Have Partners & Employees

☐ **Employers' Liability Insurance** protects against claims brought by employees that are *not* covered by workers' compensation. The coverage is written as part of a Workers Compensation policy and is used for infrequent bodily injury claims by employees when such claims fall outside Workers Compensation.

☐ **Employment Practices Liability** (EPLI) covers non-bodily injury claims like discrimination, sexual harassment, wrongful termination, etc. It is generally written on a claims-made basis with an overall aggregate limit and is a separate policy from Employers' Liability.

☐ **Fidelity Bonds** cover all employees involved with custody, disbursement, or management of funds, payments, purchasing, etc. and can cover and include ERISA bonds.

☐ **Directors and Officers Liability Insurance** coverage provides protection for leaders of a firm established as a corporation against claims alleging breach of duty, negligence, error, or misrepresentation.

☐ **HR Management** via a Professional Employer Organization (PEO) can help manage critical HR administration and regulatory issues and the employee life-cycle including payroll, benefits administration, human resources tasks such as hiring and training, policies & procedures, workers' compensation, compliance, and 401K administration. [Click here for more details about PEOs.](#)

☐ **Workers' Compensation Insurance** is required by law to protect for work-related injuries including medical expenses, lost wages, and death benefits regardless of employer or employee negligence.

☐ **Unemployment Insurance Tax** is required under certain conditions and if taxes are required, you must register your business with your state's workforce agency.

☐ **Key Person Life Insurance** is vital for small professional practices that may cease to exist once the proprietor dies. A life insurance policy can serve as a business continuation policy to protect a firm's future as an asset, naming each business partner as a beneficiary on the other's policy so the life insurance payout can buy out the deceased partner's heirs, pay off outstanding loans or other obligations, or continue operations until a replacement is hired and trained. [Click here for details about Key Person coverage.](#)

When You Have Employee Benefits

☐ **Fiduciary Liability Insurance** provides protection for fiduciaries against liabilities that arise from their administration and oversight of employee benefit or pension plan since ERISA, a federal law sets minimum standards for pension plans or 401(k) plans in private industry and requires accountability of plan fiduciaries who exercise discretionary authority or control over plan management or assets

☐ **Health Insurance:** The Patient Protection and Affordable Care Act (also known as the ACA) passed in 2010 is complex and requirements are changing. [Click here for resources about ACA issues and requirements.](#) In addition to medical coverage, dental & vision coverage should be considered.

In addition, flexible healthcare spending accounts(FSA) may be established to allow participants to make pre-tax contributions to be reimbursed for out-of-pocket health care costs. A similar dependent care spending account may also be offered for employees to pay for work-related child care expenses with pre-tax dollars.

☐ **Life Insurance** coverage may be offered as an employee benefit to protect employees' beneficiaries. Group term life insurance is commonly provided to all employees as a fixed-dollar amount per employee or as a multiple of salary and often includes AD&D, which can also be purchased separately. Consider Key Person life insurance coverage for partners and key employees.

☐ **Disability Insurance** helps cover expenses when a disabling injury or illness prevents one from working.

- **Long-Term Disability** provides benefits for an extended time until recovery or reaching age 65. It can be an important part of an employee benefits package and may help to recruit and retain valuable employees.
- **Business Overhead Expense (BOE)** is similar to long-term disability insurance except it protects business-related expenses in the event of total disability of a business owner for 1-2 years to allow a disabled owner to maintain business viability and avoid a "forced-sale" of the business. [Click here for details about BOE and Disability insurance.](#)
- **Short-Term Disability Insurance** coverage protects against absence from work of short duration, typically three to six months and may be separate or an add-on to long term disability coverage and may include maternity leave.

☐ **Retirement Plans** take on added significance with increased life expectancy and have many different variations available such as plans for sole practitioners, employee groups, profit-sharing – along with options for various employee/employer contributions. Retirement planning is extremely important to consider for yourself and as an employee benefit. [Click here for more details about retirement plans.](#) [For financial and retirement planning tools, click here.](#)

☐ **Supplemental Executive Benefits** may not be offered to all employees but newer firms may consider adding them as they grow. In addition to above named benefits, they include personal coverage for long term care, Medicare supplement, hospital indemnity, identity theft protection, and trip and travel insurance.