



Project Management Development – Practice and Perspectives

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MICROECONOMICAL IMPACT FACTOR IN PROJECT MANAGEMENT - PROFESSIONAL LIABILITY (INDEMNITY) INSURANCE FOR PROJECT MANAGERS

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Abstract

Project managers have a great deal of responsibilities, whether it's overseeing production, ensuring key objectives are met or working to complete projects on time and on budget. A project manager, however, could also be held responsible for any errors or omissions that a client feels you may have made during the course of your duties.

Many project managers and companies have Commercial General Liability Insurance in place. Unfortunately, these types of policies typically don't cover professional services or advice. As a result, project oriented organisations and project managers' could face legal action and be held personally responsible for any financial damages to the client.

Paper analyse professional liability (indemnity) insurance types and impact factors in project management as risk cost reduction as well as insurance environment in the European Union member state – Latvia. Empirical research and insurance companies' survey shows that there is still different approach of defining project management practices and project managers' responsibility giving their professional services. That leads also to problems what causes by lack of regulatory framework of project management recognition as professional service.

Key words: *Project management, project manager, professional liability insurance, risk management.*

JEL code: *D80, G2, G32, O22.*

Introduction

Risk management is one aspect of project management and like quality management, environmental management and safety management it is about the project or the service we deliver to our clients. Liability management on the other hand is about managing the impact of claims for loss on our business. Project management is described also as activities what implemented in risk environment, what requires to take appropriate management steps to reduce risks at micro-economical level in each project.

Paper analyse project management micro-economical aspects as risk limitation factor choosing professional indemnity insurance for project managers. As a case study author analysed professional liability insurance environment in EU member state – Latvia.

Relevant provisions depend on the nature of the project. However they are usually governed by the conditions specified by the forms of 'model' contracts/agreements issued by professional bodies or those in common use in the construction industry. Typical examples of insurances applicable to construction projects include:

- Contractors' all-risk (CAR) policies, usually covering loss or damage to the works and the materials for incorporation in the works; the contractor's plant and equipment's including temporary site accommodation; the contractor's personal property and that of his employees (e.g. tools and equipment). The CAR policy is normally taken out by the

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contractor but should insure in the joint names of the contractor and the client (employer). The subcontractors may or may not be jointly insured under the CAR policy.

- Public liability policy – this insures the contractor against the legal liability to pay damages or compensation or other costs to anyone who suffers death, bodily injury or other loss or damage to their property by the activities of the contractor.
- Employers' liability policy – every contractor will have this either on a companywide basis, covering both staff and labour, or on a separate basis for the head office and for each site separately.

Professional indemnity (PI) – the purpose of this is to cover the liabilities arising out of 'duty of care'. Typically, the consultants (including the project manager) will require this policy to cover their design or similar liabilities and liabilities for negligence in undertaking supervision duties. In the case of a design and build contract, the contractor has to take out a separate PI policy, as designing is not covered by the normal CAR policy (Code of Practice for Project Management for Construction and Development).

Insurance types and projects

General liability insurance is designed to provide coverage for the insured's legal liability for bodily injury and property damage. Such claims are usually the result of accidents or other fortuitous events. These are commonly referred to as "occurrences." Coverage under these general liability policies are triggered at the time the occurrence takes place. Any resulting claim from the "occurrence" for bodily injury and property damage will likely be subject to coverage under the policy that is in force at the time of the "occurrence" and frequently respond to claims for "economic damages" where there has been neither bodily injury nor property damage. General liability policies usually have exclusions for any bodily injury or property damage that arise from specific activities and services which the underwriter may view as being professional in nature. These exclusions can vary from policy to policy depending on the underwriter. However, the broadest often exclude coverage for not only engineering, architectural and land surveying as a service for others, but can also exclude specifically as a professional service the preparing, approving, or failing to prepare or approve maps, shop drawings, opinions, reports, surveys, field orders, change orders, drawings, or specifications. The most frequent exception to this exclusion is services within construction means: methods, techniques, sequences, and procedures employed by the insured in connection with the insured's operations in their capacity as a construction contractor. There is another exclusion that may be included under some general liability policies called Construction Management Errors and Omissions. This exclusion often applies to claims arising from inspections, supervision and quality control services when then construction work is performed by someone other than the insured or one of their subcontractors.

Professional liability

Professionals are people who, through specific training, education, and experience are recognized as experts in their field. Certain professionals, such as architects, are required to be licensed or registered in order to practice their profession. However, registration or licensing is not a prerequisite for one to be recognized as a professional in all fields. Anyone or any firm that holds themselves out as experts in a particular field can be held responsible for the work,



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advice, and counsel provided to others in a professional capacity. A professional is expected to perform their services with a degree of knowledge, care, and skill of an average professional peer, in good standing, and under similar circumstances. This is frequently referred to as the “Standard of care.” A failure to perform to this standard constitutes negligence. Any damages incurred by the professional’s client and potentially others that result from such negligence may be deemed to arise from professional liability.

Professional liability insurance

Commonly known as errors and omissions insurance, professional liability insurance is designed to provide coverage for claims for damages alleged to be the result of the negligent performance of professional services for others defined in the policy. These “claims made” policies can provide extremely broad coverage that may be triggered simply by a demand for money or services alleging a negligent act, error or omission in the performance of professional services. Professional liability policies are usually designed to provide coverage to the insured for both the cost of defending the claim as well as the alleged damages. Claims for professional liability frequently involve an “economic loss” without the existence of any accident or occurrence causing injury or physical damage.

- Covers any liability, whether in contract or through a civil code, that arises out of the professional services of the organisation insured under the policy, including consequential losses.
- Policy triggered by Professional Negligence - Reasonable Skill & Care is the usual standard used to determine whether a professional firm/individual has been negligent.
- Losses claimed could include:
 - Cost of Redesign (in construction industries).
 - Cost of Repair/Rectification.
 - Direct Losses.
 - Indirect Losses such as financial, consequential and economic losses.

Certain **financial, consequential and economic losses** can only be insured under Professional Indemnity Insurance, and there are other areas where Professional Indemnity Insurance would be the sole policy for certain losses after the construction and maintenance period. It should be noted that Professional Indemnity insurance limits can be eroded by the **legal costs and expenses** often necessary in order to prove that professional negligence has occurred and these expenses can be for significant amounts. For these reasons author believes that a broad form Professional Indemnity Insurance has an important part to play in the **risk financing armoury of any Project oriented organisation.**



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Research

Professional insurance environment in Latvia

Table 1

Insurance market in the EU member state - Latvia					
Item	4 quarters 2014	1 quarter 2015	2 quarters 2015	3 quarters 2015	4 quarters 2015
Number of insurance companies	7	7	8	8	8
Number of non-life insurance companies	5	5	6	6	6
Number of foreign insurance companies' branches	14	14	14	14	14
Number of foreign non-life insurance companies' branches at end of period from					
Sweden	1	1	1	1	1
Estonia	4	4	4	4	4
France	2	2	2	2	2
Poland	1	1	1	1	2
Lithuania	1	1	1	1	1
Estonia	3	3	3	3	3
Poland	1	1	1	1	0
Lithuania	1	1	1	1	1

Source: Author construction based on The Financial and Capital Market Commission (2016) available data

As we can see in the Table 1 insurance market in the Latvia is considered as small. Market share in Latvia is small as overall business environment in comparison of other EU shows moderate activity of business sector. Meanwhile insurance as risk limitation tool in any economy field just recently increased its significance. Main players by the beginning of 2016 are only 6 non-life insurance companies following by 10 international company branches.

Table 2

Insurance gross premium written and gross claims paid in Latvia (in thousands of euro)

Item	4 quarters 2014	1 quarter 2015	2 quarters 2015	3 quarters 2015	4 quarters 2015
Broken Down by Class of Insurance					
Gross premiums written, incl.	326 915	102 129	179 207	256 864	331 960
• accident insurance	6 773	2 524	4 111	5 762	7 538
• health insurance	32 147	15 608	23 064	31 594	37 254
• land vehicle insurance	65 518	17 311	34 186	51 961	70 152
• railway rolling stock insurance	344	87	122	313	367
• aircraft insurance	202	58	84	84	88
• ship insurance	603	271	445	742	946
• goods in transit insurance	1 973	690	1 054	1 392	1 866
• property insurance, incl.	66 607	26 611	40 160	52 177	66 088



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• against fire and natural elements	41 366	19 695	29 407	37 701	48 004
• against other losses	25 242	6 916	10 753	14 476	18 084
• transport ownership liability insurance	84 180	20 625	39 474	58 093	74 174
• aircraft ownership liability insurance	423	101	375	517	614
• ship ownership liability insurance	95	20	33	52	88
• general liability insurance	15 211	4 802	8 706	11 910	15 520
• credit insurance	426	126	275	355	409
• suretyship insurance	8 227	2 223	4 696	7 128	9 907
• insurance against miscellaneous financial losses	518	243	335	467	590
• legal expenses insurance	22	6	14	21	26
• assistance insurance	9 011	1 972	4 399	7 310	9 535
• motor vehicle third party liability compulsory insurance	34 472	8 817	17 596	26 896	36 689
• accepted reinsurance	163	33	80	90	108
Gross claims paid, incl.	183 589	48 855	96 453	146 834	197 997
• accident insurance	2 262	608	1 292	2 023	2 636
• health insurance	22 268	6 754	13 891	20 010	27 087
• land vehicle insurance	46 232	12 318	23 192	36 071	48 553
• railway rolling stock insurance	107	0	0	0	1
• aircraft insurance	21	0	6	6	17
• ship insurance	1 004	83	81	114	164
• goods in transit insurance	1 773	440	553	624	739
• property insurance, incl.	23 040	5 088	13 484	22 791	31 059
○ against fire and natural elements	17 221	3 303	9 344	16 215	21 566
○ against other losses	5 819	1 785	4 140	6 576	9 493
• transport ownership liability insurance	54 478	13 683	26 881	40 294	54 602
• aircraft ownership liability insurance	0	0	0	0	0
• ship ownership liability insurance	0	0	0	1	1
• general liability insurance	2 238	409	1 125	1 780	2 352
• credit insurance	573	252	262	310	382
• surety ship insurance	869	572	731	1 489	1 354
• insurance against miscellaneous financial losses	68	35	75	90	134
• legal expenses insurance	0	0	0	0	0
• assistance insurance	1 765	610	1 111	1 658	2 169
• motor vehicle third party liability compulsory insurance	26 827	7 982	13 727	19 530	26 697
• accepted reinsurance	65	22	42	42	50
Broken Down by Type of Contract					
Contracts concluded with legal persons					
Gross premiums written	185 347	68 708	114 766	172 587	210 300
Gross claims paid	112 471	27 525	59 021	89 706	114 050
Contracts concluded with natural					



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persons					
Gross premiums written	141 568	33 421	64 442	84 277	121 660
Gross claims paid	71 118	21 329	37 433	57 128	83 947

Source: Author construction based on The Financial and Capital Market Commission (2016) available data

Table 2 shows insurance market share for 2015. As we can see the total premium written in Latvia in 2015 was 331 960 000 EUR. And claims paid was 197 997 000 EUR what describes overall insurance market as profitable. Meanwhile if analysing liability insurance we can see that mostly it's described by law regulated insurances for different professional services. Most project management insurances (mostly construction project management) is issued under general professional liability insurance were premium written in year 2015 was 15 520 000 EUR following by claims paid – 2 352 000 EUR.

Author analysed professional indemnity insurance environment in Latvia approaching insurance companies who manage professional indemnity insurances for different field. Currently there is 16 non-life insurance companies in Latvia what also issues professional liability insurance. According to empirical research results in 40% professional liability insurance for project managers is not an object for insurance. In 27.7% companies can issue a professional liability insurance based on individual evaluation case by case and insurance rules elaborated individually for each insurance case. Meanwhile 33.33% applies general rules for professional liability insurance (Fig.1).

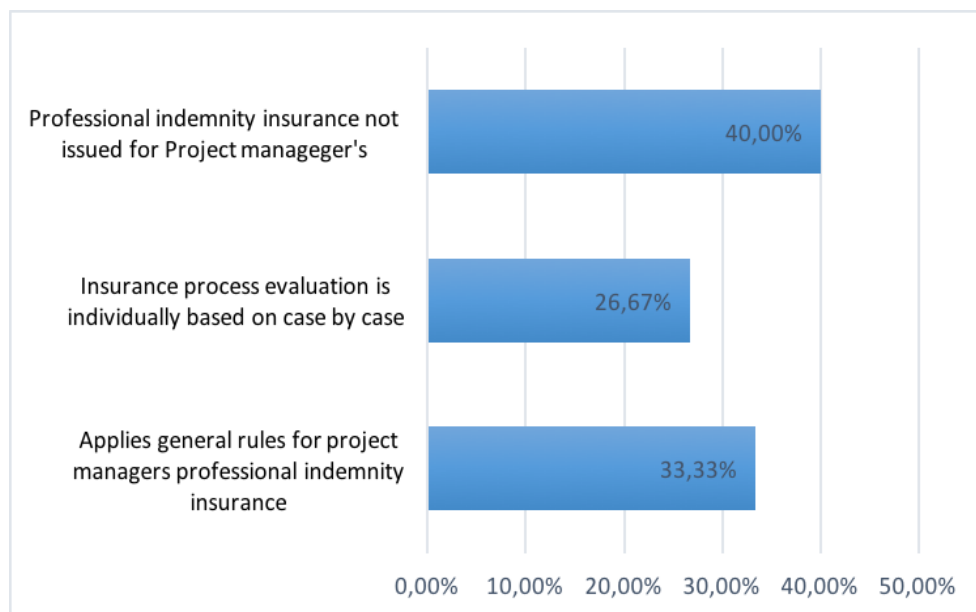


Fig.1. Project managers' professional indemnity insurance environment in Latvia (n=15)

Source: Authors construction based on empirical research

To analyse above mentioned figures author concludes that in most cases there is lack of understanding of professional indemnity also in insurance industry. According to expert interviews only in view cases was referred that insurance is issued for project managers outside



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construction industry and most of professional liability insurance cases (33%) is related to the construction projects).

This leads to deeper analysis of legislative framework and practical application of professional liability insurance as a micro-economical tool and aspect for a risk limitation activity in the project implementation. Common aspect is that professional liability insurance applies to professional services and there is still no common understanding and regulation whether project management is professional service or not.

In this case there is no problem for construction industry as that is defined as professional service and recognised by the laws and regulations:

- On the Regulated Professions and the Recognition of Professional Qualifications
 - Construction law
 - Regulation on construction specialists and constructors' professional liability insurance
- Construction Law section 20 regulates insurance according such rules:

- A performer of construction work has a duty to insure its civil legal liability for harm caused to the life or health of a third party or losses caused to the property as a result of its activity or failure to act. If a construction permit is necessary for the performance of construction work, the civil legal liability of the performer of construction work shall be insured for the whole term of performance of construction work.
- A contract regarding insuring civil legal liability shall be entered into either in relation to all construction objects and renewed each year, or anew, or also in relation to each individual construction object.
- Losses caused to the property of the third party are evaluated in conformity with the laws and regulations regarding insurance. The amount of the insurance compensation shall be determined by agreement of the parties.
- The issuer of the construction permit shall verify existence of the mandatory insurance of the civil legal liability of the performer of construction work.

Meanwhile law On the Regulated Professions and the Recognition of Professional Qualifications regulates overall requirements for regulated professions (also those - defined as a professional service).

The following additional requirements may be put forward in the law or Cabinet regulations for the commencement of work, independent activities in a profession or for activities in the status of a self-employed person for individual regulated professions:

- 1) the giving of an oath or solemn declaration;
- 2) the observation of the professional code of ethics;
- 3) an appropriate reputation, a person does not have a criminal record, he or she has not been imposed administrative fines or disciplinary measures in relation to violations of the norms of the relevant professional activities;
- 4) adequate health;
- 5) insurance against civil legal liability or financial risk;
- 6) an appropriate level of knowledge of the official language;
- 7) regular repeated professional certification (re-certification) or attestation, which is performed after a specific period of time; or
- 8) additional provisions for activities in the status of a self-employed person, including the necessity of a special licence for separate types of activities.



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Also if temporary professional services in the regulated profession in the Republic of Latvia are provided, using the professional title or the title of the professional qualification of the home country, the provider of the temporary professional services has a duty to provide the following information to the recipient of services:

- the registration number of the service provider or an equivalent means of identification in the Commercial Register of the home country or equivalent state register, indicating the title of this register;
- the title and address of the supervisory authority of the service provider in the home country;
- the title of the professional association or register, in which the service provider is registered;
- the professional title or the title of the professional qualification of the service provider;
- the registration number of the service provider in the register of persons subject to value added tax in the home country, if the service provider is a payer of value added tax; and
- professional liability insurance or equivalent guarantee of professional liability.

These cases highlight the difficulties with classification of work as professional or general services when the negligent act in question does not definitively involve damages or injuries resulting directly from engineering, design, or management work, but instead involves damages arising from other tasks performed by a professional that may (or may not) have a connection to its design, engineering, or management functions. Conversely, as the prevalence of “professional services” exclusions in general liability policies issued to contractors’ attests, parties not formally charged with the project’s design or engineering responsibility often face serious “professional services” risks, which are exacerbated by newer delivery systems. So, how should the prudent insured address these risks? A key starting point is to understand how “professional services” and “wrongful acts” can be defined in policies available to insureds, as discussed next.

As project manager profession is not regulated by laws or regulation also Latvian court has difficulties in their cases recognize project management as professional service even if there is law regulated standard of project manager profession. As a conclusion of analysis of professional liability insurance application for project managers author elaborated impact environment model for project management.



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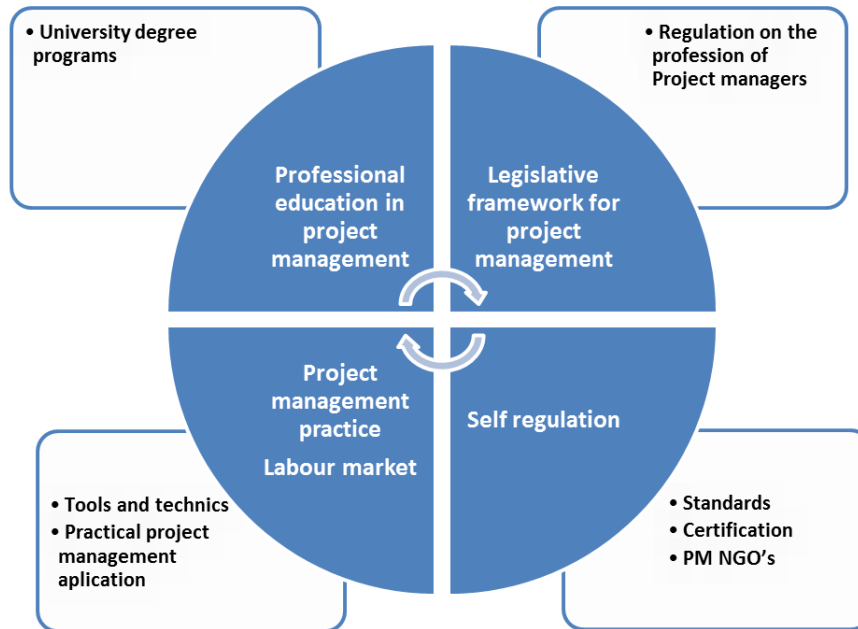


Fig.2. Project management as a professional service recognition impact environment

Source: Author constructed model

As author analysed before (Pulmanis 2011, 2013) one of the impact factor for professional liability insurance usage is whether project management is defined as professional service. To fully develop professional project management system in any country there is several conditions and rules what should be implemented to meet all criterions for further project management recognition as professional service.

First there should be well development educational system for project management – university degree programs in project management. Currently in Latvia project management studies are linked with profession standard of project managers making project management studies as 5th level higher education – professional master degree in project management.

Second professional organisations, social partners and responsible government organisations should develop legislative framework for project management and/or project manager's profession. As author analysed in his earlier publications one of approach could be inclusions of project manager's profession in the Law on the Regulated Professions and the Recognition of Professional Qualifications. As above mentioned law initially was aimed only to fulfill European Union common regulation on the labour market free mobility within EU and nowadays approach is to decreases limitation for labour mobility this law can't be a tool of project managers' profession recognition. Following development activities of different industries and their recognition processes one of solution could be elaboration of special law for project management, like "Law on professional activity of project managers" where would be described all project management services and professional aspects of project managers' work. At the moment by the laws and regulations in Latvia is regulated professional standard of project managers' profession and project management specialists in the construction industry (construction law, Cabinet of Ministers regulation on construction specialists' professional



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liability insurance requirements).

Third, as project management still considered as self-regulated profession and project management professional organizations has elaborated many standards, developed trainings programs and certification systems, professional community of project managers should also make a step forward to recognize our services as professional. This could lead to serious lobby actions in public discussion with governmental entities.

Fourth is practical application of project management tools and methods as well as understanding raise in employers'. Very often many business entities use project manager profession name for the positions what actually is not close to what normally project manager do. This problem especially arises in marketing industry. Project managers' profession name is attractive to many employers' and sometimes its sounds better than marketing specialist, PR specialists or etc.

Professional liability insurance is specifically intended to protect against liability from errors and omissions that are committed while carrying out "professional services," including, depending on the policy definitions, those identified above. Certain policies define these errors and omissions as "wrongful acts," others classify the conduct as "professional negligence," and others contain no particular definition for conduct that is outside the realm of acceptable work other than to call it a negligent act, error, or omission in the performance of professional services. "Professional services" may be defined as any services performed in certain capacities, including:

1. Architect
2. Engineer
3. Land surveyor
4. Landscape architect
5. Construction manager
6. Scientist

Recognizing the limit in availability and lack of certainty for principals in relation to the insurance contract terms of the consultants, the principal may wish to consider initiating insurance policies themselves. These policies may cover either all consultants involved in an individual project or those involved in a program of projects. In these models, the principal has control over the determination of the scope, excess, etc. of the insurance policy. Such a system may relieve the principal from the requirement to check the currency and policy cover of individual consultants except where a basic level of insurance is provided by the consultant. As public sector principals are believed to have a lower level of events leading to claims on consultants' PI policies compared with commercial sector clients, this should be reflected over time in the premium cost for such policies. The lower level of events reflects the other risk management processes that public sector contract principals have in place such as pre-qualification of suppliers and well established contract procedures (Australian Procurement and Construction Council).

Even if there is still market and companies what offers professional liability insurance for project managers, there is no increasing demand sign from industries which implements projects and programs. That could be described because of additional expenses what insurance costs, but not always project owners and managing staff understand that insurance could be as factor for risk cost reduction.

The use of the titles of the regulated professions specified in the Law and the specialties, sub-specialties or additional specialties thereof is only permitted in cases where the relevant



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person has an adequate evidence of education and formal qualifications specified by law. As a project managers' profession is not regulated and considered as self-regulated there is no any protection of using project managers' title in positions what actually is far away from that what really project manager shall do.

Conclusions

The liabilities facing contractors are ever-changing with new and evolving project delivery methods, technologies, regulations, and customer needs and expectation. It is now extremely difficult for a contractor to avoid exposures to professional liability that may or may not have been anticipated. It is also likely that yesterday's risk management and insurance programs may not adequately address the exposures in today's environment. Accordingly, it is imperative that a contractor seek advice from a team of risk management and insurance needs. Expert knowledge of the contractors business and industry is essential in order to craft risk management and insurance solutions that include professional liability.

Meanwhile there is big discussion regarding whether project management is considered as professional service as it's not regulated by laws or regulations. To increase professional liability insurance usage in project management we should first recognize "professional service" aspects in the project management.

This leads also to general application of project management tools and methods, as well as wide usage of project managers' profession title in sectors and positions what is far related to project management or to duties what project managers shall do according to professional project management standards. Also project management field should increase their demand for professional indemnity insurance as it could be tool for risk cost reduction.

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