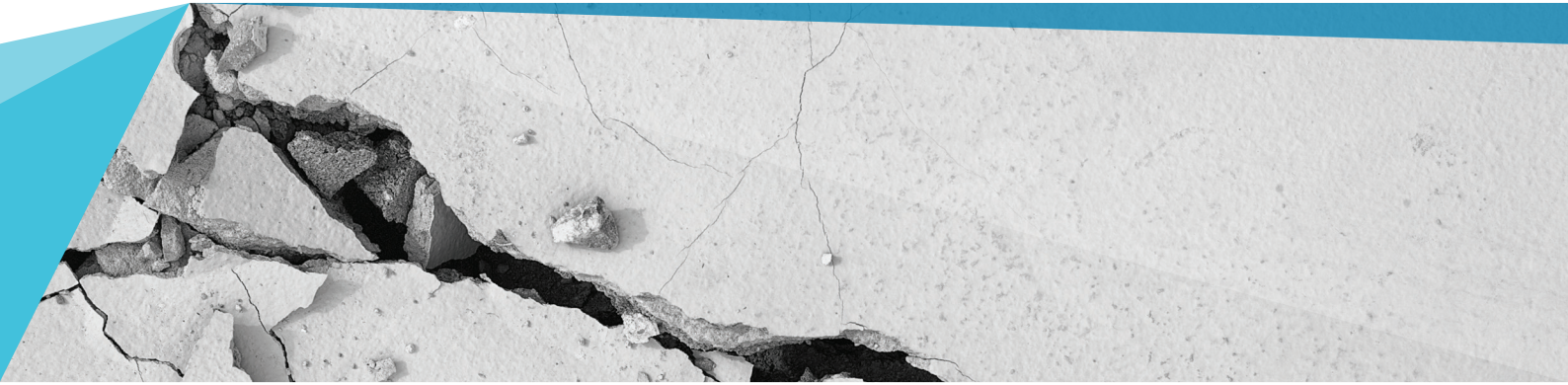


INHERENT (OR LATENT) DEFECTS INSURANCE (IDI)



BACKGROUND

During the construction phase of a building, loss or damage is normally insured under an “all risks” contract works insurance policy, which provides funds for the repair or damage. Following completion of construction, a property “all risks” policy is usually arranged, although this policy normally provides no protection for damage arising out of an inherent or latent defect in the building.

Because of this exclusion in traditional property damage insurance, a building owner or tenant may be faced with serious problems upon discovering a defect in its building. These problems will be aggravated if the building cannot be used and:

- Funds will need to be made available to meet the cost of repairing the damage and making the building stable.
- It may be impossible to recover the cost of remedial work from any other party. Even when recovery is possible, such recovery is likely to be difficult, time consuming and costly.

Insurance against inherent defects in buildings is designed to overcome these problems. It is an insurance that covers the cost of repairing a building should

an inherent defect in the structural works (deemed to be the load bearing structures, external walls, and roofing) cause damage, or threaten imminent collapse, during a period of up to 10 or 12 years following practical completion of construction.

COVER

Some of the features of the insurance that will benefit a building owner and tenant are as follows:

- It is a “first party pay” policy – insurers will meet a legitimate claim before seeking to establish responsibility for causing the defect, offering speedy reinstatement and avoidance of the legislation process.
- Policy periods are usually 10 or 12 years from the date of practical completion.
- Once a policy has been issued, it is non-cancellable.
- Where rights of recovery exist, they will be considered by the insurers at their own expense, not by the building owner or tenant.
- The insurance is assignable to subsequent owners or tenants.
- Removal of debris, and costs and legal professional fees incurred in carrying out remedial work, can be included.
- The sum insured is usually indexed to automatically provide for inflation.

- Changes in the method of repair required to comply with local authority or similar regulatory requirements can be included.
- Consequential damage to non-structural elements of the building can also be included.

ADDITIONAL COVERAGE OPTIONS

- Loss of profit or revenue.
- Loss of rent.
- Additional costs of alternative accommodation.
- Mechanical and/or electrical failure of key components such as air-conditioning, heating and ventilating equipment, and lifts.

PRINCIPAL EXCLUSIONS

- Defects known or discovered prior to inception.
- Abnormal use or overloading.
- Inadequate maintenance or wear and tear.
- Non-approved alterations or modifications.
- Change in colour or ageing process.
- Items not signed off under the technical audit.

ADVANTAGES

- There is no requirement for the policyholder to establish fault, negligence, or liability of the party(ies) to the construction contract.
- Costly, burdensome, and time-consuming litigation does not need to take place before repairs can be carried out, which enables the structure to be returned to use speedily and with the minimum of interruption.
- The policy is assignable to future owners and/or tenants of the building who, in current market conditions, are increasingly reluctant to assume the risks associated with building defects and can be more attracted to a building where IDI has been arranged than to one where this protection does not exist.
- The technical audit process may detect defects prior to practical completion, allowing such defects to be rectified before the owner/developer takes over responsibility for the structure from the contracting parties. This independent audit during the construction phase ensures not only quality but also compliance with plans and specifications, as well as the ultimate availability of IDI cover.
- There is no need to worry about the contractors and/or professional team still being in existence at the time the defect manifests itself, as this is a first party policy.

UNDERWRITING PHILOSOPHY

- A completed application form is required, detailing the physical factors that will determine the premium rating and deductible level.

- Underwriting information will need to be given to insurers prior to the commencement of work on site.
- Insurers will provide a quotation based on the information provided, which will be subject to it being satisfied with the technical audit.
- A non-refundable deposit premium is required to cover the cost of an audit of the design and construction.
- Upon completion of the audit process at practical completion, insurers will provide an official offer of cover. In most cases, the offer will mirror the terms provided at the quotation stage. However, any unresolved issues may be excluded from the policy cover.
- The proposer then has 90 days within which it must decide whether or not to proceed.

TECHNICAL AUDIT PROCESS

Insurers do not expect to provide IDI without a technical inspection service (TIS) provided by an independent consulting engineer as appointed and remunerated by the policyholder or the insured.

The purpose of the TIS, whose appointment must be made prior to construction site activity and be approved by the insurer, is to advise the insurer regarding the quality of the construction, i.e. that it has been built according to proper and relevant standards, using appropriate materials, and taking due care and attention.

The TIS is required to give impartial technical advice. Therefore, it must be independent of the owner, the construction companies, the architect, the design office, or site management. In addition, the TIS should not act as a loss adjuster (if damage occurs) on a building it has checked.

Based on the coverage offered by insurers, the activity of the TIS applies in the following areas:

- The design (calculation hypotheses, specifications, and drawings).
- The materials (specifications, test certificates, and implementation methods).
- The work on the site (construction methodology).

TYPES OF CLAIMS

- Deficient weatherproofing/waterproofing as a result of:
 - Defective cladding/walls.
 - Badly-fitting windows.
 - Defective roofing.
- Inadequate basement/underground lining allowing seepage.
- Subsidence which can cause severe damage to structural elements of the building such as walls, floors, pillars and beams.
- Defectively designed, or defective installation, of floor slabs which can cause movement and/or cracking.

MARKET CAPACITY

There are a limited number of insurers who will consider an IDI risk, due mainly to the long and non-cancellable nature of the insurance period.

These insurers are some of the world's largest insurers and reinsurers, and have considerable experience in the IDI field.

If the market capacity based on a Probable Maximum Loss (PML) basis is below the value of the building, it is likely that the market could provide a "first loss" limit policy, rather than the full estimated project reinstatement value.



The information contained herein is based on sources we believe reliable and should be understood to be general risk management and insurance information only. The information is not intended to be taken as advice with respect to any individual situation and cannot be relied upon as such.

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