RISKALLIANCE

# NAVIGATING RISK.

## A modern view for architectural practice leaders.

PRODEMNITY

# RISK IS GOOD

Very little would happen in the world of architecture or the built environment without some element of risk: no innovation, no new materials, no new concepts in efficiency, and likely less action on sustainability.

Taken to the extreme, we would never cross the street, travel, leave the house, or design new structures. We never would have figured out how to use fire safely, as there is always the risk of a burn.

**Risk** and its partner, **Reward**, are an inevitable, inherent part of life and of architectural practice.


# NOT UNDERSTANDING RISK IS BAD

As anyone with a young child will attest, not understanding the risks involved in crossing the road or playing in the street leads to dangerous situations. Once your child understands the risks and knows how to manage and mitigate them (by crossing at a crosswalk, for example), then risk moves back to an acceptable level. (Though that might not stop us parents from still worrying!)

For architects, the general rule about risk is the same. Since risk is inherent in your practice, **it is necessary to learn about risk and know how to manage, mitigate, reduce, avoid, transfer – and, sometimes, accept – risk.**

The key is in understanding the risk, and, once you have decided to accept that risk as your own, understanding the consequences of that decision.

As the architects' professional liability insurer, we tend to think of risk as ***Insurable*** and ***Uninsurable***, although there are many other ways of considering risk:

- Project managers tend to think of risks in terms of "budget" and/or "schedule".
- For business leaders, there is often a risk/reward trade-off and, often, the bigger the potential reward the greater the acceptable risk.
- Contract negotiators look at risks they can control (and are willing to be accountable for) versus those they cannot control (and are unwilling to be responsible for, especially if someone else is able to control that risk).

In all the above scenarios, as in others you face as a practice leader, there are limits to acceptable risk.

> ***"Some risks that are thought to be unknown, are not unknown. With some foresight and critical thought, some risks that at first glance may seem unforeseen, can in fact be foreseen. Armed with the right set of tools, procedures, knowledge and insight, light can be shed on variables that lead to risk, allowing us to manage them."***
>
> \- Daniel Wagner, The Risk Management Society

# WHAT IS RISK?

There are many different definitions of **"risk,"** but all involve the same concept:

Risk is about the possibility of an unplanned, sudden, and unforeseen occurrence.

It might cause physical, financial, reputational, or other types of loss or outcome.

Virtually everything involves risk; unless the probability of an outcome is 0% or 100%, there is always a chance of an unexpected outcome.

Almost without thinking about it, we have created systems and introduced methods to deal with this inherent uncertainty. For example:

- Regular reports allow us to spot deviations and correct them quickly
- We allow tolerances to accommodate variation
- We build in contingencies, we buy insurance, we have back-ups, etc.

Not all risk is the same, and the consequences – and our actions towards them – differ by individual and by circumstance.

**There are two fundamental dimensions to risk:**

The **probability** of risk affects our perception of it, as does the impact of that risk (i.e., financial, reputational, emotional etc.).

**Timing** is also a factor, commonly included in the impact analysis: for example, the impact of something happening today tends to overshadow the risk of something happening 50 years from now, even if the 50-year event will ultimately have a much greater impact. For architects, timing is a big issue, which we will return to in a bit.



Using **impact** and **probability** as our variables, we can identify four basic risk categories for consideration:

IMPACT OF RISK

PROBABILITY OF RISK

### Low impact, High probability

Risks in this category will probably happen and therefore, deserve some thought and consideration. Since they are low impact, the risks should be easy to cope with. Sun burns and mosquito bites tend to fall into this category, and sun block and insect repellent will typically handle these risks.

### High impact, High probability

One example of this type of risk is hail to a car dealership in Alberta. There will be hail this year and every unprotected vehicle outside will be damaged (e.g., the June 13, 2020 hailstorm in Calgary caused $1.3 billion in insured losses). If you know that you are very likely to suffer from an event and that the impact will be significant, it is imperative you take action to reduce the severity of the risk. In this example, car dealerships might pay close attention to weather alerts and warnings, and they might install tents, hail nets, or canopies, or store cars indoors.

### Low impact, Low probability

These are risks that rarely materialize, and if they do occur, have little effect on our lives. For example, paper cuts can happen on a jobsite but they tend to be infrequent and rarely require treatment.

### High impact, Low probability

The COVID-19 pandemic has taught us something about this category: most of us do not get seriously ill from COVID-19, but a few of us may die or suffer long-term, possibly permanent symptoms from post-COVID syndrome (PCS). More generally, these risks can be devastating when they occur, but they are rare. Since the consequence can be significant, prudent managers take action to reduce the magnitude of impact.

Non-architecture related examples, as above, provide a simplified illustration of the variables. The concept can be applied to your architecture business and the unique situation your firm might be facing.

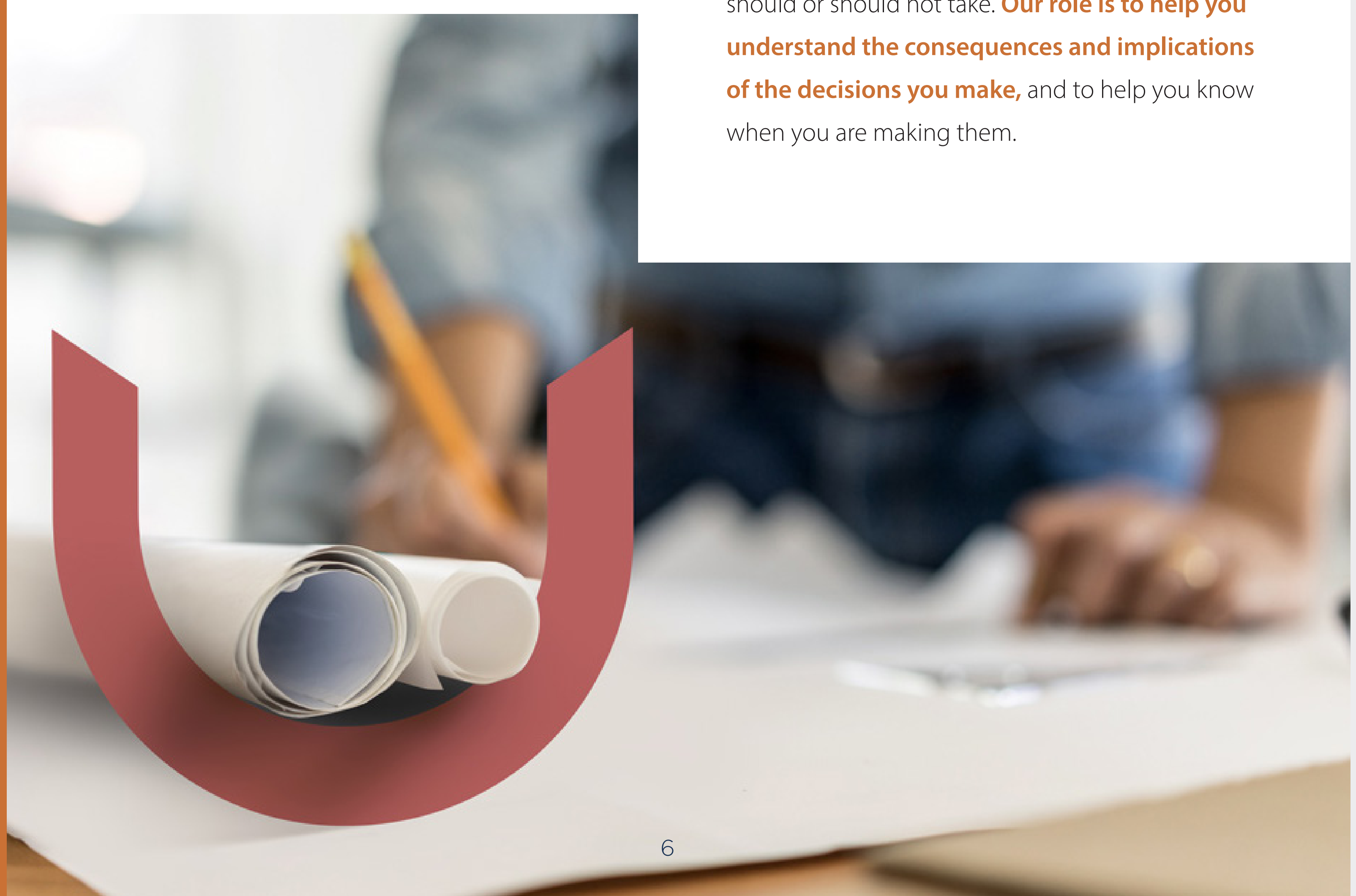
# AND THE POINT IS...

Risk is inherent. Inevitable. Not always obvious. But oftentimes identifiable.

Simply, what you do not know can – and probably will – hurt you. And it will hurt the rest of your architect colleagues through higher insurance premiums, lower fees, and more onerous contracts. We increasingly see more liabilities and indemnities dumped on architects.

We see architects more frequently being named and blamed on issues that have no clear architectural connection, and we see financial and competitive pressure placing architectural practices in increasingly precarious situations.

Ultimately, if you understand the risk, if you understand the consequences – including what is insured and the growing areas of risk being assumed that are not insured – and if you make the business decision to take those risks and bet your lifetime's work on the outcome, then that is your choice. Our role is not to tell you what risks you should or should not take. **Our role is to help you understand the consequences and implications of the decisions you make,** and to help you know when you are making them.





# HOW RISK IS CHANGING

**We see increased risk arising on several fronts:**

Increased **competition** among practices, the relentless pressure of RFPs, the fear of missing out, and changing relationships between architects and clients are all shifting architects' behaviour and creating more risk for them.

*"Everything from underpricing to acceding to unreasonable conditions introduced after the start of negotiations all lead to risky behaviour*

- Too little fee means you will not be able to afford the resources to properly manage risk, increasing the potential for problems.
- The cold, calculating approach of RFPs and the growing role of third-party consultants and legal advisors – often skilled in real estate and ignorant of architecture – turns the client-architect relationship more adversarial and less relationship-based.
- The late introduction of contract clauses and conditions contribute to the feeling of "I have to, or I'll lose the job" (and increase the chance of you losing everything you own if something goes wrong).

As projects become larger, more complex, and more expensive, there is an increasing *"cast of characters"* who **influence** and/or **control** the actual client.

- The rise of third-party financing arrangements, external project managers and risk consultants, potentially multiple owners of land and structures, government funding, and so on, all create a more complicated network of expectations and demands. And each party increasingly wants zero risk attached to its potential rewards.
- Governments, in particular, are both legislatively barred from taking on additional risk – which they often interpret as meaning they can take no risk – and have managers and administrators with little incentive to be flexible and great incentives to be perceived as hard-nosed. This combination often results in unreasonable expectations and demands,

and the creation of indemnity and liability clauses that far exceed anything that can or will be covered by professional liability insurance.

- In our conversations with some of these entities, they just do not care about being unreasonable: as long as they can tell their boss (or Council or the Deputy Minister) that they are not taking on risk, they are happy. And no civil servant will ever be fired for being difficult in negotiations, but they might get fired for taking risk.

The **diminishing use of contingencies** and the increased perception that insurance limits are part of the project budget also cause risk and significant litigation. In the long run, insurance is about the most expensive way to pay for contingencies, but increasingly owners and their representatives seem to be so fixated on "winning" this negotiation, that they do not care about the long term.

Although the above trends are couched in terms of larger-scale projects, we see the same trends in smaller projects too, where it is increasingly considered "smart" to be unreasonable and force your partner (that is, the architect) into taking accountability for factors they cannot possibly control.



# WHAT YOU CAN DO ABOUT IT

Obviously, the first thing you should try to do is avoid some of these riskier situations. But assuming you are out looking for business, that piece of advice is likely of limited value.

## HERE ARE A FEW OTHER IDEAS

1

Think about your (or your firm's) risk profile. What is your capacity for risk and what is your tolerance for risk?

- **Capacity** is the ability to absorb a loss or setback without it affecting your lifestyle, physical health, or mental stability. If you have employees, you might think about how much you can absorb without having to part ways with them. Before voluntarily assuming a risk, you should always ask, "Can I afford the loss if it occurs?"

- **Tolerance** is more about attitude: how comfortable are you taking risks? Generally, our willingness to assume a specific risk reflects our knowledge of the uncertainties associated with it. The more we know, the better we understand, and the unknown becomes known. The danger here is that thinking you know and understand more than you really do can lead to poor assessments of risk and false tolerances. Ask more questions. Keep inquiring until the potential risks are revealed so as to better assess your tolerance for them.

2

Understand the basic risk management concepts of avoid, mitigate, reduce, transfer, and accept.

- **Avoidance:** Eliminating your exposure to a particular risk. There are two main problems with avoidance as a tactic. First, there is a tendency to simply substitute one risk for another (for example, avoiding the risk of flying by driving instead). Second, avoiding risk can sometimes be impossible or highly undesirable.

- **Mitigate / Reduce:** Reducing the probability of risk and lessening the impact (think back to our impact and probability matrix) can be effective methods of managing risk.

- **Transfer of risk:** The role of insurance and the impacts of indemnity clauses. Keep in mind that the transfer of risk can be from you or to you. Be wary of accepting more risk than you would normally have under common law: it is almost always uninsured risk you are assuming, which means you are paying the bills if something goes wrong.

  Plus, being held accountable for risk you do not control can be a frustrating, expensive proposition, especially if whoever *is* in control of the risk - now finding themselves free from the financial consequences of their actions - starts "behaving badly."

- **Acceptance of risk:** Some risks cannot be avoided, reduced, or transferred (terrorism and war are two common examples), and other risks are extremely unlikely or too impracticable or expensive to manage (imagine trying to insure a paper cut or sunburn!).

  Innovation is inherently risky – you are doing something that has not been done before or has been done infrequently – and often the nature of that risk is just something that has to exist in order to move forward. (The good news for you is that this kind of risk, as it relates to your practice and professional services as an architect, does generally get transferred to Pro-Demnity as it is an insurable risk.)

  In accepting a risk, you need to understand not only the probability and impact, but also your capacity and tolerance. We all know stories of those who "bet big and won," but we tend to overlook those who bet big and lost (they tend to be quieter about their outcomes, even if they are still around).

Price the project scope in accordance with the risks it presents.

Ultimately, what risks you choose to accept, mitigate, reduce, transfer, and avoid are your decision.

***"We believe it is important that risk-related decisions are informed and deliberate so that you consciously decide your path forward.***



## We started off by stating that RISK IS GOOD, and we truly believe this.

We humans continuously manage everyday risk, often instinctively: it is part of who we are and what we do. But taking a risk does not have to be a bet-the-bank activity every time.

Looking at those who participate in high-risk extreme sports and activities, psychologist Eric Brymer comments, "They're actually extremely well-prepared, careful, intelligent, and thoughtful athletes with high levels of self-awareness and a deep knowledge of the environment and of the activity."

Risk is an inherent part of **architectural business and practice; it is fundamental to the profession** and to the activities in which you are engaged.

***Knowing what to avoid, mitigate, transfer, or accept can be the difference between long-term success or failure, between a prosperous, growing practice and one that struggles.***

At Pro-Demnity, we understand this, and we recognize that architects will sometimes knowingly choose to take on uninsured risk. **That is your right.** For those insured risks you do transfer to us, however, for those contracts that do not assume liabilities beyond your common law duty, our pledge is to protect and defend you - to be your **Ally for Protection.**

RISKALLIANCE

A new dedicated offering established solely to educate Architects on how to recognize, manage, and mitigate **RISK.**

**Recommended Reads:**

- Do your fees adequately reflect project scope and risk?
- 25 things within an architect's control
- Six ways to reduce risk
- Client-authored indemnification clauses
- Lenders' undertakings

For more on insured risks, risk management, and risk mitigation, visit Pro-Demnity's Thought Leadership Library.