5 RISK TRANSFER OPTIONS FOR OWNERS AND DEVELOPERS

AND THE EMERGING USE OF GL WRAPS FOR SMALLER PROJECTS

CONTACT

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Owners and developers involved in construction projects must deal with the inherent risks involved with such projects. Their options are typically limited to avoiding (not move forward with the project), assuming (accept the risk and hoping for the best), controlling/mitigating, or transferring the risk. This article addresses the most common risk transfer options.

CONTRACTUAL RISK TRANSFER

The simplest method of risk transfer, whereby the owner is indemnified by the General Contractor (GC) under contract and typically the GC is required to provide Additional Insured (AI) status to the owner under the GC's program.

Drawbacks:

- The owner has no insurance limits of their own and must rely on GC's coverage (quality of carrier, adequacy of limits, adequacy of coverage)
- The GC's limits could be exhausted by payment of claims unrelated to owner's project
- Typically, the owner's sole negligence is not covered and potentially, contributory negligence may not be covered
- From a completed operations standpoint, even if coverage is required by contract, there is no guarantee that GC's coverage will be available to the owner in the future

OWNERS & CONTRACTORS PROTECTIVE (OCP)

A limited type of liability insurance purchased by the GC on behalf of the owner. In addition to contractual risk transfer and AI status (although sometimes an OCP is used in lieu of AI status), an OCP provides the owner with their own dedicated policy with its own limits.

Drawbacks:

- Coverage is limited to the vicarious liability and general supervision of the designated contractor (e.g. no coverage for sole negligence and potentially no coverage for contributory negligence)
- No contractual liability coverage
- No products completed operations coverage

PROJECT SPECIFIC OWNER'S INTEREST GL

Full General Liability (GL) coverage purchased in the name of the owner only, providing the owner full GL coverage (e.g. premises & operations, contractual, products & completed operations and, if desired, extended completed operations, should the owner have the intent of selling the property). Coverage is limited to the designated project with dedicated limits. The coverage is underwritten by the insurance carrier largely based on the type of project and venue, the quality of the GC involved and the strength of the contract with the GC (e.g. indemnification agreement and insurance requirements, including limits). It is much more expensive than an OCP, but much less expensive than a project-specific GL policy covering both the owner and the GC.

Drawbacks:

- The owner has limited control over the cost of insurance that is loaded into the GC's bid
- The owner has limited control over the quality of the GC's coverage (which could expose owner's GL program/limits to loss)

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PROJECT-SPECIFIC OWNERS/GC GL (MINI WRAP)

Full GL coverage purchased in the name of **both** the owner and the GC, providing them full GL coverage (e.g. premises & operations, contractual, products & completed operations and, if desired, extended completed operations). Coverage is limited to the designated project with dedicated limits. The coverage is underwritten by the insurance carrier largely based on the type of project and venue, the quality of the GC involved and the strength of the GC's sub-contract agreement (e.g. indemnification agreement and required insurance). It is much more expensive than an OCP and an owner's interest only GL, but less expensive than an OCIP/Wrap project-specific GL policy covering all enrolled contractors on a project.

Drawbacks:

- The owner and GC share limits
- The owner and GC have limited control over cost of insurance loaded into the sub-contractor's bids
- The owner and GC have limited control over quality/limits of the sub-contractor's coverage (which could expose owner and GC's GL program/limits to loss)
- Sub-contractors may have difficulty obtaining necessary coverage for certain types of projects and in certain venues (e.g. condos, Construction Defect [CD] states, etc.)
- Vetting sub-contractors' insurance programs to ensure adequacy may require significant effort in terms of time and expense

OWNER-CONTROLLED INSURANCE PROGRAM (OCIP/WRAP UP)

A comprehensive GL project-specific program purchased by the owner and intended to cover both the owner and **all contractors** (i.e. enrolled contractors) involved in the construction project. These programs provide full GL coverage (premises & operations, contractual, products & completed operations and, if desired, extended completed operations). Coverage is limited to the designated project with dedicated limits. The coverage is underwritten by the insurance carrier largely based on the type of project, venue and the quality of the GC involved.

Traditionally, wrap programs had been utilized for only the largest and most complex of construction projects. However, owners and contractors have increasingly come to appreciate their advantages for smaller projects. As recently as 2012, it was not uncommon to hear insurance professionals indicating that the minimum project size for a wrap was $100M in hard costs. These old rules of thumb no longer apply, at least in regard to monoline GL wraps. These GL-only wraps have become increasingly popular, even for projects as small as $10M - $15M in hard costs. In fact, many carriers have stepped up to offer competitive programs with GL minimum premiums starting under $100,000.

Advantages:

- **Adequacy of Coverage:** Ensuring that downstream contractors have adequate coverage is often challenging, particularly for residential projects or projects in CD states. Often, the owner or GC must rigorously review downstream contractors insurance policies for coverage restrictions, which may be hidden in multi-purpose endorsements. With a wrap program, this vetting is largely unnecessary, as all enrolled contractors share the same limits and breadth of coverage, which is typically higher and broader than they could secure on their own.
- **Cost**: Under a wrap program, the rating is often substantially better than the individual members can secure on their own. Additionally, "insurance cost" becomes much more transparent than when the GC and sub-contractors attempt to estimate the charge within their bid as an estimate for the project in question. Any incentive for "padding/mark-up" of insurance cost is also eliminated, since the contractors recognize that the insurance costs will be removed by change order if the contract is awarded under the wrap.
- **Claims Handling**: Rather than multiple carriers being involved with differing insureds/motivations, all enrolled contractors are covered, thereby increasing consistency and efficiency, while simultaneously reducing claim-handling delays.

Drawbacks:

- Perceived as more complex to arrange
- Typically requires utilization of a wrap administrator as well as a third-party peer review provider, which increase cost (although any additional costs are frequently offset by the cost savings in bid deductions)
- May require engagement of a TPA to handle claims if a self-insured retention (SIR) is involved

Another variation of a wrap program is a "rolling wrap," which is similar to a GL wrap but is written to cover multiple projects that "roll" into the program as they come online. To ensure a successful "rolling wrap," the types of projects should be homogenous and the GC and venue involved should be consistent. A major issue with this type of wrap program is that, unless limits reinstate on a per-project basis, each project is exposed to limit erosion from losses unrelated to the project in question.

OCIP's are complex programs that require experienced agents and brokers. The advantages and drawbacks detailed above only scratch the surface of issues to be addressed, which may include SIR allocation, offsite coverage concerns and bid-process insurance cost handling (e.g. gross or net) considerations. Nevertheless, it is important to note that OCIP's **are increasingly the most cost-effective method for insuring construction projects in the current environment**.

This article has only touched upon the basics of these types of risk transfer options. Contact your AmWINS casualty broker for further details and a discussion of the intricacies involved.