

Managed Contractors Insurance Programs

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Programs (also known as Contractor Controlled Insurance Programs, Owner Controlled Insurance Programs, Wrap-Ups, and Consolidated Insurance Programs) have recently become commonplace in the construction industry, and are expected to be used more frequently in the future. Presented here is a discussion of the use and application of these programs as they apply to the bidding and construction processes currently being utilized in construction work. Personal interviews with construction executives and insurance industry representatives were conducted to obtain background and descriptive information on the programs. Application of the programs to actual construction projects were investigated to determine the feasibility of the programs. The information obtained indicates that properly managed controlled insurance programs can yield significant insurance cost savings and broader insurance coverage. Additionally, the controlled insurance program can be properly administrated by a program safety consultant who would ensure the establishment of a loss prevention program that yields additional profits.

Key Words: Contractor Controlled Insurance Program, Owner Controlled Insurance Program, Wrap-Up, Program Safety Consultant, Loss Prevention Program

Introduction

Common insurance coverage objectives for owners, contractors, and subcontractors on construction projects are to preserve human life, reduce accident rates, reduce the level of injuries to workers to the lowest possible rate, prevent property damage, and maintain timely completion of the construction project. In the traditional standard construction contract, the procurement of insurance coverage is a fragmented process. In the traditional insurance procurement arrangement, all contractors (prime and tier subcontractors) are required to purchase Public Liability, Statutory Workers' Compensation, and Employers' Liability Insurance. All contractors involved in the traditional insurance coverage include in their bids the cost of insurance coverage, resulting in high duplication of costs.

A new type of program has been developed in the past several years that seeks to distribute, share, and manage risk at construction sites. This type of managed program is referred to as a Controlled Insurance Program (CIP) and is known by various names including Contractor Controlled Insurance Program (CCIP), Owner Controlled Insurance Program (OCIP), Wrap-Up, or simply a Controlled or Consolidated Insurance Program (CIP).

Controlled insurance programs differ from the traditional, fragmented insurance coverage in that an injury or accident is reported to a single insurance carrier that is responsible for all entities involved in the project. The insurance carrier for the project provides information in the form of

a manual to the contractor and subcontractors outlining the administrative procedures and containing the forms to be used in the CIP.

To carry out CIP objectives, the owner and contractors at a construction site implement a comprehensive safety program. The comprehensive safety program is typically monitored by the insurance company that is providing coverage for the construction project.

Additionally, each successful bidding contractor and all tier subcontractors at the site are required by the owner to develop a Loss Control Program, Accident Reporting Procedures, and other information that pertains to the operation of the program.

How a CIP works

The fundamental principle of the CIP is that the owner or contractor will furnish insurance coverage as stipulated in the contract documents for the project. This insurance coverage is related to the exposures of the project in question for the protection of the owner, the contractor, and all tiers of subcontractors.

The owner makes insurance payments directly to the insurance carrier. Bids are obtained from contractors on an “ex-insurance” basis. That is, bidders are instructed not to include the cost of insurance in their bids because the cost of the insurance is being provided by the owner.

Most CIPs include Workers’ Compensation, Employers’ Liability, General and Umbrella Liability (excluding Automobile Liability), and All Risk Builders Risk/Installation Floater (excess liability). The controlled insurance program provides a method of ensuring that the contractor and all tiers of subcontractors are provided this insurance.

Controlled Insurance Programs are currently being used on many major construction projects throughout the United States including the San Francisco International Airport, and the Intel Fabrication Plant in Phoenix, AZ. Many large contractors are acquainted with the concepts of CIP.

Benefits

A summary of the benefits of CIPs is presented here.

1. *Bids meet contractual requirements.* CIPs assure that the coverage included in the bid meets the standards prescribed in the bid documents.
2. *Accurate insurance information.* CIPs assure correct project insurance information, and eliminate the possibility of errors and omissions from the reviewing and accepting of certificates of insurance that are inherent to the traditional, fragmented program.
3. *Broader insurance coverage.* In the typical application of CIP, the insurance coverage and limits provided are broader and more comprehensive than what are normally available through traditional, individual contractor’s programs. The insurance coverage

available to all contractors and subcontractors at a construction site is broadened in scope. This increase in insurance coverage for the same cost can be considerable.

4. *Uniform policy limits.* CIPs provide an extended, completed operations coverage, and uniform policy limits for all contractors at the project. A CIP can provide multiyear insurance rates for contractors. Insurance policy limits then can become uniform for contractors at the jobsite.
5. *Claims management.* CIPs improve claims management and provide single, coordinated loss control and claims handling program management for all parties at the project site. The program assures thorough investigation and supervision of all claims. Settlement of claims can be made on an aggressive basis. The potential for litigation among different carriers at a jobsite is eliminated when there is a single carrier.
6. *Use of a single carrier.* The use of this single carrier eliminates the possibility of confusion and conflict among insurance carriers in the event of a loss.
7. *Reduces project costs.* CIPs reduce the total cost of a construction project. The reduction in project costs is made possible through the volume of project-wide buying power. Savings are achieved by the elimination of redundant coverage, premiums, and insurance premium add-ons. CIP can provide all insured contractors at a project with the best possible insurance coverage at the best possible price.
8. *Eliminates litigation.* Extensive litigation among companies at a jobsite in order to determine ultimate responsibilities for accidents and safety can be highly time consuming and costly. Adjacent property losses such as foundation defects, movement of buildings, etc., can be settled efficiently and expeditiously due to one insurance carrier handling the project. Improved claims management reduces the litigation costs between carriers.
9. *Provides a competitive tool.* A properly managed CIP can give a contractor a competitive tool in the highly competitive construction market.

Contractors' experience modifier (EMR) encourages contractors to improve their safety performance while allowing the insurance industry to collect the required funds to pay for the losses. The insurance premium savings offered through the experience rating plan will almost always outweigh the expense needed to improve safety performance. In other words, safety does indeed pay. Owners use the EMR to gauge the safety performance and experience of the general contractor or prime contractors, and the general contractors use it to gauge the safety performance and experience of their subcontractors. An experience modifier of .80 means that the contractor will receive a 20 percent discount on its workers compensation premium. A contractor with an experience modifier of 1.20 will pay a 20 percent surcharge on its workers compensation premium.

An EMR is more of a reflection of past safety performance than current safety performance. The EMR is calculated by three full years of payroll and loss information, ending one year prior to the effective date of the modifier. A contractor might experience good safety performance in the past, but has let the safety process lapse, and will not see the effects for perhaps 1 or 2 years.

Under a traditional CCIP or OCIP, the employer's experience rate will be the rate the employer has with the state for that particular policy year as written by its carrier of record. Under a wrap-up, one EMR rating will be established for the entire project and the experience shall be determined by loss picks conducted by the insurance carrier that is writing the policy. This rating

will not *travel* with the employer, it will only be used for the wrap-up project. In one instance, it will travel, and that is if there are subsequent phases of the same project.

In setting up a Controlled Insurance Program on a project, it is noted that a substantial amount of detail is necessary in these programs. How these details are administratively handled tends to dictate the success of the program. If set up properly, the following can also be considered beneficial due to implementation of a CIP:

1. *Administrative improvements.* CIP programs provide a system for tracking insurance credits, payrolls, and financial reporting on a construction site. In addition, certificates of insurance do not have to be checked for each contractor at the jobsite, eliminating the possibility of making errors in checking the certificates of insurance for each contractor. CIP also allows for a system for keeping track of a contractor's experience modifier (EMR). With a CIP, there is only one certificate of insurance, thereby eliminating confusion.
2. *Improved project safety.* The use of CIP enables the operation of an efficient, cost effective, and results-oriented safety program. This is made possible through the use of a coordinated approach to project safety, typically through the use of a Program Safety Consultant. In addition, smaller subcontractors may not be able to provide sophisticated loss control programs on their own. By using the CIP, the smaller subcontractors can take advantage of highly technical skilled safety managers and loss control personnel.
3. *Proactive.* CIP is proactive in that through better planning, property damage accidents can be reduced or kept from occurring while still facilitating the timely completion of the construction project.
4. *Allows for competitive bids.* The primary benefit that CIP provides to an owner is by obtaining more competitive bids for their construction projects. This reduction in project cost is made possible by freeing the contractor and all tier subcontractors from the numerous and time consuming insurance related responsibilities at a construction site.

One type of CIP—the Wrap-Up

A wrap-up or CIP is essentially the same, the name differs in that the programs described thus far in this paper are sometimes referred to as Construction Wrap-Ups. A wrap-up is a risk management program specifically designed for owners and general contractors involved with a sizeable construction project. The name differs, but the programs are essentially the same. Wrap-ups are effective because insurance is simply another cost component which the sponsor can provide more effectively and more cost efficiently than the respective contractors and subcontractors can do separately at a construction site.

Types of Wrap-Ups

Types of wrap-ups that are available are presented here:

1. *Traditional Wrap-Up.* Traditional wrap-up normally covers a single site or a multiple site of similar construction.

2. *Rolling Wrap-Up.* A rolling wrap-up usually applies to a multiple site or to an on-going construction project. An owner's capital improvements program falls into this category.
3. *Gatekeeper Wrap-Up.* Gatekeeper wrap-ups normally are applied to maintenance programs where contractors are continually at the site expanding, maintaining, or repairing the facilities and property of the owner.

Benefits of Wrap-Ups

The benefits of wrap-ups are the same as those of the other CIP programs presented in this paper. The financial or cost savings are reported to range from 2 percent to 6 percent of the total contract hard costs. With a single program in place, under the direction of the project manager, the administration of the plan is much easier. Continuity and uniformity in the areas of coverage, insurer, claim handling, and loss control convert directly into reduced management costs. Historically, pure loss ratios on major projects using CIPs or wrap-ups have averaged 21 percent to 35 percent. Based on this experience, premium savings of up to 50 percent of standard premiums are not uncommon. Other risk financing considerations such as cash flow implications of periodic payments of premiums may further enhance the economic value of a wrap-up.

The most successful wrap-ups are those with labor costs of at least 25 to 30 percent of the total project costs, and with a total of at least eight to ten contractors. Because work-related injuries are the most predictable and controllable of all construction losses, the opportunity to reduce insurance costs is greatest in the workers' compensation line of coverage. If workers' compensation premium costs are high on an individual basis, the opportunity to reduce total project costs through effective loss control is great.

CIP case studies

Presented here are case studies of how selected firms and organizations have successfully applied the controlled insurance program type of coverage. Over thirty personal interviews were conducted with Contractors, Insurance Agents, and Owners using the questionnaire contained in Appendix A. The presented case studies were selected to represent different types and sizes of construction companies, large owners, insurance agencies, and insurance companies.

American Contractors Insurance Group (ACIG)

American Contractors Insurance Group provides complete insurance coverage to 30 construction companies. During the last seven years, ACIG has conducted three major controlled insurance programs. One project was in excess of \$1 billion. Based on the experience gained from these large wrap-ups, it was determined that almost all large construction projects are wrapped-up. Twenty years ago this was not the case. Insurance agents are pushing owners toward controlled programs to gain commissions. A large developer is building a \$50 million project that will require \$7 million in insurance premiums. Several insurance agencies may obtain insurance premiums through the various construction companies on the project. Under a controlled program, the commission is taken from the various contractors' agents and given to the owner's agent or the general contractor's agent.

The type of construction is significant due to the fact that applicable risk classifications will affect the rates that are applied to the manual premium. Projects involving underground work or steel construction require labor and liability classes that generate greater premiums based on the risk of the craft involved. Again, based on the CIP concept, these rates can be adjusted for the benefit of the contractor by reduced premiums.

The safety or loss control staff is an added benefit by providing the necessary safety training, education, investigation, audits, and inspections for all of the contractors on site. With one safety management entity that covers all project contractors, each contractor has to follow the same safety requirements on the project.

The benefits of CIPs are more profits for contractors, higher coverage limits to all contractors at the site, and one insurance carrier involved in all claims. The benefit of one insurance carrier results in the elimination of lawsuits. On large construction sites without CIPs, lawsuits typically are involved trying to figure out responsibilities for claims. These lawsuits frequently result in costs of legal fees of 75 percent of claims costs, or 75 cents for every 1 dollar paid. (*Pat Caldwell, Account Executive, Risk Management Division, personal communication, 1997*)

Eichleay Construction Company

This construction company's perspective says that a contractor's input is needed at the beginning of a project for a Controlled Insurance Program to be successful. For CIP to work, there needs to be a monetary incentive to give the program a goal. The incentive to work safely must result in the contractor earning some kind of bonus, to be paid out of premium savings. In addition, a negative incentive should exist in the form of loss or to incur additional premiums if safety goals are not met. The same rules must apply to all the subcontractors involved at all tier levels at the project. Projects that involved sharing of premium savings tended to result in success, while those that did not were not as successful. Projects need to be in the range of \$100 million, with around \$50 million in labor, to be large enough to successfully employ CIP. One of the largest areas in which savings can result is in the reduction in litigation. Claims are submitted to one organization and one attorney, resulting in the elimination of lawsuits. (*Dennis Wilson, Project Manager, personal communication, 1997*)

Brady Company, large sheetrock installer

Owners differ in the way they administer the CIP. The success of the CIP is based on this variance of management. If the contractor and the subcontractors pay premiums to an insurance company retained by the owner, which results in the owner receiving the insurance premium rebates, then the CIP holds no financial incentive to the contractors. The negative experiences of many construction companies not sharing in the premium rebates as a source of additional revenues has caused the current situation where the CIPs employing this feature are not used as much now as was in the early 90s. Contractor Controlled Insurance Programs were attempted, but were not as successful as CIPs. The lack of success can be attributed to the contractor not sharing the rebate savings with the subcontractors.

Currently, the better run controlled insurance programs are run by owners with revenue sharing features. For the CIP to be a success, the involvement of the owner and contractor is needed at all aspects of the project. Few owners finance the large projects out of their own funds. Money is borrowed to finance the project, therefore a lot of time pressure is placed on the project schedule. This creates a conflict between scheduled time and safety against the desire to make money. Thus CIPs need the involvement of all parties at the site with equal opportunity to share in the potential benefits of the program.

CIPs save money by offering the incentives of sharing insurance premium rebates and through partnering of safety management activities. Following these guidelines, there is a huge incentive to control workers' compensation at large construction sites. A project needs to have \$75 million in total insurance requirements to be a potential success for a CIP. (*David Dolnick, Manager, personal communication, 1997*)

The Wooditch Company

CIP is the current method in which most insurance is handled on large construction projects. The generic term for CIPs is wrap-up. An important issue for the usage of CIPs stems from the contractor and subs trying to bid with and without insurance. Contractors are only covered onsite, so they must make sure employees are covered when going off site or to another job. Contractors must check with their insurance agent to make sure they have complete coverage. On the other hand, contractors need to ensure they are not covered twice. All parties at the project site are covered in the insurance agreement under a CIP, since one policy protects all. Architectural and Engineering (A/E) firms may or may not be included, depending on how the CIP is arranged, however, a supplier providing materials under a PO may not be included.

A project should contain at least \$50 million in total insurance cost to make a CIP as feasible as a job cost. Another method to make CIP feasible is the use of rolling wrap-up, which involves using 3 or 4 projects to equal the \$ 50 to 100 million in total requirements. Rolling wrap-up requires no start or finish days and permits organizations to get away from the minimum revenue requirements. A contractor may be faced with minimum premiums on other jobs, and may be paying for premiums anyway. All parties involved in a CIP have to know what the minimum program premium requirements are.

In California the loss ratio is 68 percent of paid insurance premiums for typical construction projects. However, under wrap-ups, the loss ratio is only 38 percent of paid premiums. The utilization of a constant safety monitor (or site safety manager) helps achieve this reduction. Since CIP is loss sensitive, the opportunity to obtain insurance refunds exists on large construction projects. (*Cathy Tovatt, Account Executive, personal communication, 1997*)

Gulf States Construction Company

A Controlled Insurance Program allows complete coverage at a construction site for the protection of the owner and all contractors. CIP allows significant savings through bulk buying of insurance which yields lower premium rates. The experience with a large industrial owner can be described as *the time spent on safety issues and improvements cost money but yielded*

significant savings. The problem was that the savings went back to the owner, not to the contractors on the site. The owner receiving all the savings from the premium rebates in a CIP is the primary drawback of CIP. This case is similar to a previous case in the Brady Company.

All parties must be sold on safety itself or no benefits can be obtained with a CIP. The difference a CIP makes may not be directly seen or measured, unless the owner helps put a measurement of the EMR into the insurance program at the site. When the expected loss ratio is met, then a shared savings can be utilized at the site. If it is not, the affected contractor pays an additional premium.

Currently, the large industrial owner has an incentive that goes to the workers, not the contractors. A twenty-five-cent-per-man-hour incentive for all workers is available at this project site. If one worker in a company gets the incentive, they all get it. The incentive is received when the goal of maintaining the EMR is met. When a contractor at the site is charged with a recordable accident and the contractor does not meet the EMR goal, then the contractor does not receive the incentive. However, the other contractors at the site are still eligible to receive the incentive provided they are not charged with an accident, and have met the EMR goal. However, this system does not help the contractor in a monetary fashion.

Rolling wrap-up can be used for maintenance, turn around work, and capital improvement construction projects. All contractors at the jobsite are covered although several construction and maintenance projects are involved. (*Frank Douglas, Project Manager, personal communication, 1997*)

San Francisco Airport Project

The largest current CIP in the United States is being utilized and is working for the expansion project of San Francisco International airport. Employing normal insurance procedures for this project would result in insurance premiums of about \$100 million. Utilizing CIP resulted in actual paid premiums of \$40 million. These insurance premiums covered workers' compensation, general excess liability, and builders risk. By placing the order for insurance themselves, the owner was able to obtain a much more reasonable price.

In addition to premium savings, the CIP was able to obtain expanded coverage in the amount of \$500 million for each event. Through normal bid processes, coverage in the amount of \$1 to \$2 million would have been realized. The huge difference in insurance coverage is a significant factor in risk management for a project the size and complexity of the San Francisco Airport project. The expanded coverage is needed to cover the risk involved when dealing with the operation of commercial aircraft adjacent to construction operations.

The \$30 million in workers' compensation premiums the airport is paying still represent possible savings. The airport believes that it is possible to recover \$10 million in rebates if safety goals are met. The project has been in the CIP program for three years and is experiencing a loss ratio of 30 percent. The average loss ratio for projects in the California area is 60 to 65 percent. By maintaining a fulltime safety director at the project site, the owner, insurance carrier, and contractors have been able to manage safety, reduce the accident rate, and produce the 30 percent

loss ratio. Maintaining this process for the duration of the project will result in an anticipated rebate.

The airport insurance manager felt that a project needs to have a total cost of \$150 million for a CIP to work. Projects less than \$150 million are not feasible for CIPs. (*Marge Layne, OCIP Administrator, personal communication, 1997*)

American Contractors Insurance Group, Inc. (ACIG)

ACIG is a group captive insurance company, meaning that the policyholders share the risk of their operations among the others in the group. In essence, it is a self-insurance program, where the policyholders own the company and have various levels of equity built up within the organization. Two major components of ACIG's program is being appropriately staffed, and having the expertise to provide contractors and their subcontractors the benefits of a Controlled Insurance Program. Most of the statistical data regarding the two very large CIPs that ACIG provides are confidential, but it can be revealed that ACIG has experienced outstanding results with these types of programs. Included in these programs are substantial cost savings in insurance premiums, very few fraudulent claims, good quality work in place, and a better run and managed construction project. From an administrative standpoint, the workload is much less due to less paperwork. On ACIG projects, there is a full-time CIP administrator that tracks all of the paperwork associated with the program. The individual is located on the construction site and has access to any of the contractors' representatives. This method has proven very successful. Teamwork is another concept that has worked well on these projects. All of the contractors, subcontractors, owner representatives, insurance personnel, and owner consultants are able to meet onsite and discuss any necessary issues that do arise.

While some projects are clearly more suited to CIPs than others, almost any large project can achieve a cost savings for the owner from a well run CIP. (*Mike O'Neill, Senior Vice President, personal communication, 1997*)

Boone & Rogers Company

Most projects with costs exceeding \$100 million are typically suited for a CIP. We are currently involved in a rolling wrap-up with ACIG on the East coast involving the Baltimore Ravens football stadium, Baltimore police facility, and two other projects in Massachusetts. Most insurance companies will not become involved in a project generating less than \$3 million in annual premium. One key component to any CIP is loss control and loss prevention. While most wrap-ups present a higher risk due to the complex construction process of the projects, they also represent the greatest opportunity for cost savings if the losses on the project can be controlled. One position on the project that needs an experienced individual is the safety director or manager position. This individual should possess construction experience as well as insurance experience. A lot of the administrative work is accomplished up front by reviewing the certificates of insurance and verifying and confirming the coverage for the project. In addition, there is a benefit of having one insurance carrier responsible for handling claims once a loss does occur. (*Paul Newman, Vice President, personal communication, 1997*)

Conclusions

The following conclusions and summary statements that relate to CIPs are presented:

1. Significant insurance cost savings and broader insurance coverage can be produced through a well-designed and administered CIP.
2. Contractors generally must make significant adjustments in their business practices to successfully participate in CIP construction project.
3. Most construction companies, possibly acting as a subcontractor, have the opportunity to participate in CIP construction projects when they are involved in large construction projects.
4. CIP creates an economy of scale by centralizing the purchase of insurance coverage.
5. CIP streamlines insurance project management by placing a number of insurance functions such as loss control, safety management, security, and recordkeeping under a single authority.
6. The key to a successful CIP is the control of required project insurance lines like general liability, workers' compensation, builders risk, and in some cases, architects and engineers professional liability.
7. The control of a successful CIP requires the control of all subcontractors in all tiers through their contracts to control site security, loss-prevention programs, and claims management by a single owner or prime contractor.
8. CIPs are usually successfully employed on projects in excess of \$50 to \$100 million dollars.
9. Cost savings of 1 to 2 percent of total project costs can be realized with CIPs.
10. Financial considerations aside, other benefits are derived for subcontractors, e.g., competitive position improves due to excellent safety performance. Contractors can add CCIPs and OCIPs to their profiles and *resumes* of work, therefore, benefits flow back to them in ways other than project savings.

Recommendations

Since the value of controlled insurance programs is reflected in the bottom line profits in construction work, all students in construction education should be taught the concepts of the various forms of controlled insurance programs. Learning the design of a construction insurance program will allow students to better understand the owner's, insurance carrier's, and broker's perspectives when bidding and putting together specifications for a project. Students gain knowledge in an area of construction that normally is not addressed at the academic level. Managers of construction operations should possess a working knowledge of controlled insurance programs.