THE RISK MANAGEMENT LETTER

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Best Practices For Owner-Controlled Insurance Programs—Part I

A few years ago, The Risk Management Letter published an article concerning some of the many aspects of owner-controlled insurance programs (OCIPs). Now we take another look at OCIPs—and offer a detailed list of 30 best practices for owners and project managers. Giving consideration to and adopting one or more of these best practices can make an OCIP more efficient and help maximize the potential benefits such programs offer.

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Owner-controlled insurance programs (OCIPs), also known as "wrap-ups," are increasingly popular alternatives to the insurance management techniques used on most construction projects. In a traditional program, the contractors, subcontractors, engineering consultants, architects, construction managers and owner all provide their own separate insurance. In an OCIP, the owner[1] of a large construction project purchases comprehensive insurance that covers the owner, contractors and all other parties involved. By having the owner control the insurance purchasing, broad and uniform coverage with high liability limits can be provided for all contractors and subcontractors under a master program.

The Advantages

There are two principal advantages of an OCIP: improved coverage and potential cost savings. Because of the typically large size and premium volume of OCIPs, the project owner's representatives and broker can negotiate with underwriters to obtain high liability limits; coverages tailored to the construction risk; cash flow plans that give credit for the insurer's investment income; and insurance placed for the duration of the entire project. An OCIP also enables disadvantaged or minority businesses to participate in the project by automatically including them under the owner's insurance program.

Potential cost savings[2] are achievable in several areas, including premium credits for volume purchasing of insurance by the owner, elimination of contractors' markups for overhead and profit on their insurance costs, the owner's ability to assume large deductibles and, particularly, any workers' compensation dividend or retro-premium return resulting from favorable loss experience. The latter result is enhanced by the owner's ability to establish coordinated safety and claims programs to prevent and manage job-site injuries more effectively.

In order to realize all of the benefits of an OCIP, the owner must effectively manage the program. Effective OCIP management requires careful attention to the following areas: (1) planning, (2) marketing, (3) contractor bidding, (4) safety management and (5) administration. To help risk and project managers accomplish these tasks, a list of OCIP best practices for these five areas has been compiled and presented below. "Best practices" is a popular term to describe the optimal way of doing something. Best practices typically consist of processes or steps that improve performance, usually resulting in higher quality, lower cost or greater efficiency. For OCIPs, best practices are those techniques that help project owners achieve the benefits of improved coverage and cost savings through the most effective combination of internal and external resources.

OCIP Planning

1. Conduct A Feasibility Study

OCIPs can be implemented in most jurisdictions[3] by both public and private project owners. The minimum project size for a successful OCIP is generally between $50 and $100 million in construction costs. OCIPs are particularly suitable for labor-intensive projects that generate over $2 million dollars in workers' compensation premiums. Construction projects of such large magnitude[4] are required to enable the owner to achieve the necessary economies of scale and attract insurer interest.

An OCIP may not be suitable for every construction project, and contractor-provided insurance may satisfy an owner's needs in many instances. Every large project needs to be evaluated on its own merits to determine the best approach to insurance. Prudent owners should examine several alternatives, including:

- Traditional programs in which contractors buy their individual insurance and name the owner as an additional insured
- An OCIP covering only certain contractors or providing only specified coverages
- A full OCIP providing workers' compensation, primary and excess liability, builder's risk and possibly professional liability coverages for all parties

To evaluate such alternatives, many owners conduct a feasibility study. The study can be made by the project planning staff, the risk manager or an independent consultant. The feasibility study should address the following issues:

1. Project risk profile
2. Risk management alternatives
3. Advantages and disadvantages of each alternative
4. Decision criteria and recommendation
5. Potential OCIP savings under different loss scenarios
6. Regulatory, legislative, risk control and community issues
7. Proposed coverages, limits and insured parties
8. Proposed budget, service requirements and action plan

The feasibility study should be completed well in advance of the anticipated construction date, which can mean several months or even a year or more prior.

2. Develop An Action Plan With A Timeline

Once the project's feasibility for an OCIP has been established, it is necessary to conduct initial planning, which should include setting target dates for:

1. Obtaining approval of the owner's management or governing board
2. Developing and adopting the OCIP budget

3. Satisfying regulatory requirements
4. Determining the scope of OCIP coverages
5. Designing bid and construction documents
6. Procuring the required services (brokerage, safety, administrative, etc.)

3. Establish OCIP Objectives

Early on, the project planning staff and risk manager should formulate several OCIP objectives. Reasons to do this include:

- Setting standards by which to measure the OCIP's success
- Justifying the OCIP budget
- Emphasizing the owner's commitment to safety

OCIP objectives could include such things as the project's ultimate loss ratio, total OCIP cost (premiums, retained losses and services) as a percentage of construction costs, target accident frequency and severity rates, and increased small or disadvantaged contractor participation. Determine how to collect information to measure progress toward these goals.

4. Anticipate OCIP Staffing And Service Needs

OCIP service needs vary depending on the project's complexity and the owner's internal expertise and resources. Some organizations hire an OCIP risk manager who is dedicated solely to the project. More commonly, the owner's project manager and risk manager rely on their chosen broker, insurer claims and safety specialists to carry out most OCIP functions.

OCIP participants typically include the project manager, construction manager or owner's representative; the owner's risk manager; the insurance broker and support staff; the insurance company underwriter, claims and safety staff; claims and information systems consultants; independent safety consultants; and the contractors' safety specialists. Some functions (e.g., drug testing, planning, marketing, implementing and oversight) will necessarily be performed by the project contractors or independent consultant.

OCIP Marketing

5. Qualify Brokers Before Marketing The OCIP

The owner's current broker(s) may not necessarily be the best choice for an OCIP program. The broker should be experienced in the nuances of OCIP design and implementation and be able to provide dedicated resources. Qualify the incumbent and alternative brokers through in-depth interviews, written service proposals or a formal request for qualifications (RFQ) process. The most important broker qualifications are the talent and experience of its dedicated local staff, the quality and availability of its OCIP services, and its insurance market relationships.

If the owner intends to conduct a multi-broker competition (see below), every broker should be qualified before markets are assigned for competition. An independent consultant sometimes is engaged to help manage the qualification process, minimize the owner's time involvement and expedite selection.

6. Conduct An Effective Marketing Competition

There are two methods for marketing an OCIP to insurance companies:[5]

1. Selecting one broker who is given access to the entire insurance marketplace
2. Conducting a multi-broker bidding competition by assigning markets to brokers

In the first case, the broker works with the project manager and risk manager to design and market the OCIP. The broker secures competitive insurer proposals, evaluates them and recommends the best one. This method improves owner-broker communication and lets the owner become more directly involved in the marketing process.

On larger projects, it may be common for owners to divide the marketplace among several brokers. The purpose is to sharpen competition by encouraging brokers to work closely with their preferred insurers. While this method can be time-consuming due to the need to deal with multiple broker/insurer teams, it helps ensure selection of the optimum candidate.

To make the marketing process more efficient, the owner should:

1. Assign markets based on each broker's prioritized list of insurers[6]
2. Provide identical specifications, risk and underwriting data to all brokers
3. Communicate to brokers and insurers the OCIP objectives, coverage needs and service requirements
4. Prepare in advance a format for evaluating the broker/insurer service proposals and quotations

7. Assist Brokers With The Project Risk Assessment

Every broker will want to conduct a thorough project risk assessment prior to marketing the OCIP. Owners should cooperate by opening up the project to the broker teams conducting the assessment and providing information on the project design, contractors, construction methods and costs. Although the feasibility study will have identified the major risks, the broker's risk assessment team examines the project at a later stage and in far greater detail.

Brokers should pay particular attention to exposures that may create the need for special coverages within the OCIP. These include such risks as environmental, railroad, marine, transportation, design and testing of machinery, and lost revenue from delay-in-opening. Once the project has begun, establish through the broker an ongoing system to identify and measure the project's risks of accidental loss, such as off-site material or damage to adjoining property.

8. Conduct An Underwriters' Orientation Meeting

The purpose of an orientation meeting is to convey vital information to all interested underwriters and vendors about the OCIP objectives, coverage needs, service requirements and broker/insurer selection process. Underwriters also appreciate the opportunity to meet the owner's project management team in person. The owner's broker (if already selected) can organize this pre-bidding meeting; otherwise the qualified competing brokers can accompany their assigned markets. Many owners include a visit to the project site as part of the orientation.

Underwriters are more likely to submit their most competitive proposals only when they have a complete understanding of the owner's priorities. For example, some owners hire their own safety consultants and need little assistance from the insurer or broker. Other owners have specific requirements for a maximum cost limitation, cash-flow features, claims handling, use of attorneys, alternative dispute resolution, information systems or community relations. The underwriters' orientation meeting is an excellent opportunity for the owner to make these needs clear to the underwriting community.

9. Establish Criteria For Selecting The Insurer

Selecting a highly qualified insurer is critical to the OCIP's success. While pricing is always a significant factor, do not rely exclusively on "the bottom line" to the exclusion of all other factors. The owner's broker or independent consultant can help design a scoring system with both objective and subjective factors for selecting the OCIP insurer. These could include:

- Experience with prior OCIPs
- Financial rating and stability
- Compliance with owner's specifications
- Quality of claims and loss control services
- Cost containment approaches
- Risk Management Information System (RMIS) capabilities
- Competitive pricing and maximum cost limitation
- Investment income from workers' compensation premiums[7]

10. Negotiate A Broker-Service Contract

At a minimum, the OCIP broker will probably perform the following: design and market the insurance program; administer the OCIP and enroll contractors; assist in claims handling and reviews; assist in safety consulting and provide a computerized contractor and risk management information system.

To avoid disappointment, define in writing the scope of the broker's services and performance standards. Provide room for additional services as needed. Many owners compensate the broker on a fixed-fee or commission-cap basis. Consider negotiating broker-performance incentives linked to the OCIP's outcome.

Regardless of the arrangement, communicate the broker's compensation to insurers so they recognize it in their pricing, i.e. quote premiums net of commissions. Require full disclosure of the broker's income (e.g., commissions from intermediaries) to avoid paying additional compensation in the form of higher premiums.

Conclusion

This ends Part I of OCIP Best Practices. In future issues of *The Risk Management Letter*, look for discussions of OCIP best practices in the areas of contractor bidding, safety management and administration.

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NOTES

[1] Alternatively, the general contractor can arrange a Contractor Controlled Insurance Program (CCIP) to achieve similar results.
[2] Cost savings are a key benefit and usually the reason owners select an OCIP, but they are secondary to the advantage of improved coverage.
[3] Some states restrict or prohibit OCIPs, particularly for public entities. OCIPs in foreign countries concentrate on builder's and lender's risks and often require local insurer participation. The feasibility study should carefully research these areas.
[4] Some owners have also implemented "rolling wrap-ups" for several medium-sized construction projects over a period of years. By consolidating the coverages with a single underwriter, the owner can achieve the same economies of scale as on a single large project.
[5] The OCIP insurer generally provides the workers' compensation and primary liability coverages. Other insurers may provide the builder's risk, excess liability and E&O coverages. Few direct writers or state funds place OCIPs without broker participation, because OCIPs require extensive services on the broker's part.
[6] Owners should try to assign markets equitably, but also match brokers with carriers who have insured successful OCIPs in the recent past.
[7] Workers' compensation premiums are usually the largest cost of an OCIP. Owners should require insurers to recognize the investment income in their pricing plans, for example, by quoting lower expenses or guaranteeing the return of invested funds to the project owner.

FURTHER READING

To review previous discussions in The Risk Management Letter on OCIPs, please refer to the following "issue:

- "OCIP: Is It For Me?" "(Volume 15, "Issue 2)