



Risk Transfer: A Strategy to Help Protect Your Business

Risk Control



CNA



Businesses rely on crucial relationships with contractors, subcontractors, vendors and consumers. In these relationships, agreements are made and written contracts are negotiated. A growing trend involves contracts in which one party agrees to assume the liabilities of another party. Savvy business owners recognize the benefit of transferring potential liability to others and negotiating contracts to their advantage. However, what does this mean to a business' bottom line?

Agreeing to take on someone else's liability can be costly. By signing such an agreement, you may be forced to pay for claims that normally would not be your responsibility. Alternatively, as a condition of doing business, you may be asking one of your vendors to sign an agreement, holding you harmless. In either case, it is important to understand what you are agreeing to and limit surprises. For example, the agreement should clearly define which party covers the other party's liabilities.

What Is Risk Transfer?

Risk transfer is a risk management and control strategy that involves the contractual shifting of a pure risk from one party to another. One example is the purchase of an insurance policy, by which a specified risk of loss is passed from the policyholder to the insurer. Other examples include hold-harmless clauses, contractual requirements to provide insurance coverage for another party's benefit and reinsurance.

When done effectively, risk transfer allocates risk equitably, placing responsibility for risk on designated parties consistent with their ability to control and insure against that risk. Liability should ideally rest with whichever party has the most control over the sources of potential liability.

Consider the following prior to making an agreement:

- Because your business may be part of several contractual relationships at one time, it is important to control the type and magnitude of the liabilities you assume.
- Where legally possible, identify opportunities to manage risk by having others contractually assume their share of liability.
- The effective management of liabilities can save you money by lowering your overall costs, thus helping to keep you competitive in the marketplace.



How Is Risk Transfer Accomplished?

Insurance

Risk transfer is most often accomplished through an insurance policy. This is a voluntary arrangement between two parties, the insurance company and the policyholder, where the insurance company assumes strictly defined financial risks from the policyholder. In very simple terms, if a worker is injured, the insurance company pays the cost. If a building burns down, the insurance company pays to replace it. Insurance companies charge a fee, or an insurance premium, for accepting this risk. In addition, there are deductibles, reserves, reinsurance and other financial agreements that modify the financial risk the insurance company assumes.

Contracts

Risk transfer can also be accomplished through non-insurance agreements such as contracts. These contracts often include indemnification provisions.

An indemnity clause is a contractual provision in which one party agrees to answer for any specified and unspecified liability or harm that the other party might incur. An indemnity clause also can be termed a hold-harmless or save-harmless clause.

Indemnification agreements are completely independent of insurance coverages and transfer the financial consequences of legal liability from one party, the indemnitee, to another, the indemnitor. In addition to direct financial losses, some contracts may also transfer legal defense or product recall costs.

Layers of Protection

There are several ways to provide layers of protection for your assets, including:

- Certificates of insurance.
- Additional insured status.
- Indemnification provisions in contracts and leases.

Certificates of Insurance

A certificate of insurance is a form issued by an insurer or agent that lists the coverage(s), expiration date(s) and limits of the insured's coverage(s). It includes important information about such coverage, including policy number, policy limits, insurer, agent, coverage period and name of the insured. The certificate may also describe special endorsements that have been added to the policy, e.g., additional insured endorsements, waiver of subrogation endorsements or special notice of cancellation endorsements. Additional notes of interest include:

- A certificate of insurance is evidence of the insurance coverage in effect the day the certificate is issued. It's a snapshot of the coverages in place on the day it is issued, like a balance sheet.
- Certificates of insurance do not alter the terms or conditions of the policies described. The policies' actual terms are the ones that will apply.
- Requesting a certificate of insurance does not, in itself, transfer any risk but does provide evidence of the other party's types and limits of coverage.

Consult your insurance professional and legal counsel to determine what insurance requirements are appropriate for the parties with which you contract.

Why Require Certificates of Insurance?

- You may discover that subcontractors do not have adequate insurance coverage or limits. How much is enough? It depends on the risk. Therefore, it's best to consult your insurance professional and legal counsel.
- You may have to pay for bodily injury or property damage losses arising from the actions of subcontractors if they don't have coverage. State law may require that you pay for injuries suffered by tenants and subcontractors or their employees on your property.
- In some jurisdictions, subcontractors who don't carry their own insurance can be treated as your employees, which could increase the cost of your workers' compensation coverage.
- You may discover that the subcontractor, tenant or service provider has no insurance at all.
- You may discover that the subcontractor, tenant or service provider does not have a type of insurance coverage or appropriate limits for your particular circumstances.
- You may discover that you were not added as an additional insured despite your request or the other party's contractual obligation to do so.



Additional Insured Status

The main advantage of being an additional insured on an insurance policy as opposed to being a certificate of insurance holder for that same policy is that the additional insured has certain rights under the policy. A certificate holder has only a document that provides information as to the insurance coverage in effect.

Insurance policies can be endorsed to add companies that do business with a named insured or policyholder. A company that is added to a policyholder's insurance policy is considered an additional insured. The endorsement that adds the company is known as an additional insured endorsement. This endorsement can complement an existing contract and can help protect a party from liability arising out of another party's negligence. Additional insured endorsements can cover the additional insured for accidents that arise out of the named insured's involvement with a job.

Additional insureds are only covered for operations that involve the named insured in some way. In this respect, additional insureds receive narrower coverage than named insureds, since named insureds are automatically covered for any business activity that isn't specifically excluded by the policy. Policy exclusions apply equally to named insureds and additional insureds unless specifically noted otherwise in a commercial general liability (CGL) policy or on the additional insured endorsement.

It is recommended that you consult your insurance professional and legal counsel regarding the impact of any additional insured endorsements that apply to you.

Why Additional Insured Status?

- Provides coverage even if a court invalidates your hold-harmless agreement.
- Gives you certain rights under your lessee's or subcontractor's insurance policy, particularly with defense coverage.
- Discourages your lessee's or subcontractor's insurance company from subrogating against you when a loss is caused by your acts or omissions.
- Offers more protection than just receiving certificates of insurance.

Indemnification Provisions in Contracts and Leases

Contracts, if properly worded, offer the most comprehensive protection because they can include provisions for insurance requirements, additional insured status, certificates of insurance, and hold-harmless language that can further transfer risk and provide for reimbursement of your damages and costs.

Indemnification agreements, sometimes referred to as hold-harmless agreements, are used to transfer risk of loss, damage or liability from one party to another. They are often incorporated into construction contracts, service job contracts, purchase order agreements, lease agreements and consulting agreements.

Requiring your lessees, service providers and subcontractors to enter into hold-harmless agreements helps ensure that, if you are held liable for their conduct, they will hold you harmless and reimburse you for any monetary losses. As a result, you are not harmed by such liability.

Depending on the way they are drafted, interpreted and enforced, there can be great variety in the extent to which indemnity agreements transfer risk. This includes:

- Wholly, proportionally, or not at all, in the actions or inactions that will trigger a transfer.
- Your own or another party's negligent or intentional acts or omissions, or both.
- Risks that are transferred, i.e., bodily injury, property damage, defense of claims or damages.

Some states have laws that require specific wording to make risk transfers effective, while other states prohibit certain wording or attempted risk transfers. Since individual state laws and circumstances vary, it is important that you contact your legal counsel to discuss how the terms of a hold-harmless or indemnity agreement will apply to you in specific situations.

How to Employ Risk Transfer as a Strategy for Protection

There are five areas to focus on for establishing an effective risk transfer strategy.

- **Certificates of Insurance**

Require certificates of insurance from subcontractors, tenants, service providers and other parties. Before starting any work or lease, you can require that subcontractors, tenants and service providers provide you with certificates of insurance for any insurance coverage appropriate to your circumstances. Four common types include workers' compensation, commercial automobile liability, property and general liability. This can be done annually for multi-year relationships. Use of uninsured contractors, tenants and service providers should be avoided.

Accepting certificates of insurance only from the insurance company or agent, rather than the subcontractor, tenant or service provider, can help protect against receipt of false certificates.

Determine appropriate insurance coverages and limits. When establishing insurance requirements from subcontractors, service providers and tenants, it's important that you first determine an adequate level of protection. You should consult your own insurance professional and legal counsel when determining adequacy of insurance requirements for your specific situation.

Factors to consider include the type of work involved, the value of your property and building(s), and the potential for the other party to cause losses.

Prior to the work starting, develop a system that enables an annual review of certificates of insurance for multi-year relationships. The purpose of the review is to verify the existence of coverage and to determine whether existing coverage limits are adequate and meet the requirements of your agreement.

The review process should be a routine function performed by administrative personnel. A checklist can be developed for this purpose to establish and document procedures to follow when certificates are not received or the information is not in accordance with requirements established in your agreement. A letter seeking the needed changes should be sent to the other party and should be followed up on until a current certificate meeting all requirements is received. For future reference, certificates should be maintained in a file for subcontractors, tenants or service providers.

Enforce certificates of insurance requirements.

Consider using specific measures to encourage adherence to certificate of insurance requirements. These measures may include actions that, with the advice and assistance of legal counsel, can be contracted for:

- Not allowing services to begin until satisfactory evidence of compliance is received.
- Withholding payment for services until satisfactory evidence of compliance is received.
- Terminating the contract unless satisfactory evidence of compliance is provided within a specified time period.

Create a certificate of insurance filing system that enables annual review. Establish a reminder system that alerts the employee responsible for reviewing the certificates of upcoming policy expiration dates, target dates for compliance and any deficient items. Once a contract, lease or purchase order containing insurance requirements and enforcement provisions is executed, a system is needed to monitor the other party's continued compliance with the requirements.

An example of a reminder system is a follow-up file or log that can be sorted based upon insurance policy expiration dates or target compliance dates. This will allow for easier retrieval and follow-up each month. This reminder system should include a procedure for reordering certificates of insurance prior to policy expiration dates. A form letter can be created and sent to all appropriate recipients at least 60 days prior to the expiration date. This procedure will help ensure that the coverages and limits you contracted at the beginning of the relationship to protect your business are maintained throughout the course of the project, lease or other relationship.

Keep and maintain copies of certificates received in the following structure.

- **Project file** — Each project file should contain a current certificate of insurance certifying the coverages, limits and endorsements for subcontractors.
- **Alphabetical file** — Maintain records for your subcontractors and service providers. You can also include any selection or prequalification documentation.
- **Expiration file** — Maintain records for your subcontractors and service providers based upon insurance policy expiration dates. This will allow for easier retrieval and follow-up each month.

- **Additional Insured Status**

Ask for additional insured status from subcontractors, tenants, service providers and other parties. If you name someone or request someone to name you as an additional insured on a liability policy, determine which coverage is primary or excess. Remember that asking to be an additional named insured can act as a backstop if indemnity provisions turn out to be unenforceable.



- **Contracts You Ask Others to Sign**

Secure signed written contracts with subcontractors, tenants and service providers.

Securing signed written contracts from your subcontractors, tenants and service providers before they begin work or their lease starts can prove very beneficial to enforcing the terms of your agreements. Oral contracts, handshake deals or "gentlemen's agreements" can be difficult and costly to enforce. In many cases, participants in unwritten agreements may have different recollections of the terms.

Have your attorney draft a contract or purchase order that:

- Includes a hold-harmless clause that protects you from the acts or omissions of the other party.
- Requires that you be named as an additional insured under their general liability policy.

A written contract can, among other things, define the parties' responsibilities in regard to insurance, indemnity, tools and materials to be used, safety requirements and other aspects of the business relationship.

It is important that your legal counsel review all written contracts to ensure they adequately protect your interests and are tailored to your specific situation. Use of form contracts without consulting a competent legal professional and without consideration of your particular circumstances can lead to unexpected and undesirable results.

Review all documentation submitted for accuracy and adequate requirements before work proceeds or commencement of the lease.

Designate trained personnel within your organization who will be responsible for reviewing certificates of insurance and signed contracts, leases or purchase orders. Your legal counsel can help provide guidelines for such personnel.

It is important that assigned personnel review and approve all certificates of insurance and signed contracts, leases and purchase orders before any work begins or any lease commences. All too often, certificates of insurance, contracts, leases and purchase orders are received but not reviewed until after an incident occurs.





- **Contracts That Others Ask You to Sign**

Carefully review contracts before signing. Review all of your business contracts and look closely at the contract language. Provisions pertaining to indemnity may not be labeled as an indemnity clause. A clause requiring indemnification may be concealed within the terms of a sales invoice or purchase agreement.

Review contract language with legal counsel to determine the extent of hold-harmless protection requested. It is important that your legal counsel review all written contracts you are asked to sign to avoid any unintentional transfer of liability. Signing form contracts without consulting a competent legal professional and without consideration of your particular circumstances can lead to unexpected and undesirable results.

Develop a contract review checklist. Legal counsel may be able to provide more detailed guidance in the form of a checklist for things to look for in the contract.

Check the insurance section of the job contracts for hold-harmless provisions and for mandated coverages that aren't provided by your own policies.

Check for additional insured status. Check with legal counsel and your insurance professional to ensure you understand the consequences of adding the other party as an additional insured.

- **Record Keeping**

Retain purchase orders, leases, other contracts and certificates of insurance in accordance with all applicable laws and regulations in the jurisdictions and industries in which you operate. Consult your legal counsel for information and advice concerning any laws and regulations applicable to you.

Please see our attached CD for more detailed information.



Let us help you manage risk exposures today.

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