First Quarter 2009

The Professional CONTRACTOR

A publication of the Associated Subcontractors of Massachusetts, Inc.

STRATEGIES

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Controlling Insurance Costs in a Challenging Economy

How Does This Apply to Construction Contractors ?

By Bernard K. Quinlan, CIC, CRM, CPCU

Construction contracts require subcontractors to satisfy very specific insurance coverage and limit requirements. Nevertheless, subcontractors retain a significant degree of control over their insurance costs and their total cost of risk. Cost of risk includes insurance premiums, retained losses, administration cost, and services purchased from outside the organization. In the long term, a contractor's loss experience will be the most significant factor influencing total cost of risk.

The most successful contractors carefully manage their loss exposures and insurance program. An effective risk management program utilizes several risk management tools including risk avoidance (not bidding on a particular job), risk retention (utilizing deductibles or self insuring), risk control (loss prevention and claims management), and risk transfer (purchasing insurance or contractually transferring risk to other parties). This article will focus on minimizing insurance cost in the short term.

All contractors and their agents should carefully monitor the financial ratings of their insurance companies. Typically, contracts require coverage to be underwritten by a company with an A.M. Best rating of at least A- (Excellent). If Best downgrades your insurer's rating, you may be in violation of contract requirements. Changing insurance companies mid-term, not at expiration, generally involves penalties, and should be avoided.

Smaller contractors will usually realize savings by consolidating all coverage with one or two companies, while larger contractors may benefit by utilizing several underwriters. Payment terms are typically available and are negotiable. Most companies offer interest-free payment plans. Admitted carriers are preferable to non-admitted, or excess and surplus lines carriers. Non-admitted companies do not participate in the state insolvency fund, typically do not offer payment terms, and identify premium tax as a separate charge. These carriers most often underwrite General Liability and Umbrella Liability coverage.

Workers' Compensation & Employers' Liability

Carefully review Experience Modification and ARAP surcharge calculations to ensure that your company is not being unjustly penalized. A contractor's payroll and loss history developed over a three year experience period, not including the most recent year, determine its Experience Modification and ARAP surcharge. Contractors operating only in Massachusetts are rated by the WC Rating and Inspection Bureau of MA (WCRIBMA). The National Council on Compensation Insurance (NCCI) calculates modifications for contractors with multi-state operations. There is a significant incidence of errors in experience rating calculations. It is critical that this important cost component and benchmark for GC's and owners be verified for accuracy by an insurance professional.

Workers' Compensation rates are set by WCRIBMA and NCCI. While there are standard manual rates by state and classification, individual insurers may offer rate deviations or schedule credits. Discuss the availability of these pricing tools with your agent.

The Massachusetts Construction Classification Premium Adjustment Program (MCCPAP) may reduce an employer's premium if the employer's average hourly wage is $18.00 or greater. The MA Benefits Deductible Program and MA Benefits Claim and Aggregate Deductible Program provide premium credits of 2.5% to 9.4% for employers that are able to self fund losses ranging from $500 to $5,000. Employers willing to retain more substantial deductibles, and realize potentially larger savings, may qualify for a Large Deductible Program. A Large Deductible rating option generally requires security in the form of a letter of credit. A Retrospective Rating Plan written on an incurred loss basis can offer savings similar to a Large Deductible without the letter of credit requirement. Deductible and Retro plans involve more assumption of risk, so these options must be carefully reviewed. Consider historical loss experience and the current labor market environment before electing any of these rating plans.

All contractors should endeavor to have their Workers' Compensation coverage underwritten voluntarily by an insurance company, and not through the residual market or assigned risk pool. Policies placed through the assigned risk pool do not receive premium discount based on volume, and are not afforded the most attractive payment options. Employers that are placed in the assigned risk pool should consider a Qualified Loss Management Program (QLMP). A QLMP credit will reduce premium immediately, and implementation of the program should help prevent and mitigate losses in the long term.

Work with your agent and insurance company auditor to make sure that your employees are properly classified. Rates vary considerably based on the type of work that you perform, and misclassifications can be costly. Prior to your premium adjustment audit, make sure that you have valid insurance certificates from all subcontractors.

Pre-planning will make the audit easy for the auditor, and efficient for your company.

General Liability

As with Workers' Compensation, make sure that your operations are properly classified, and get certificates from all

of your subcontractors. The estimated annual GL premium is typically based on estimated payroll, receipts and subcontract cost. The premium is adjusted at audit based on the actual premium bases. Most policies contain a Minimum Premium provision. The Minimum Premium provision may be 60-100% of the estimated premium. In a slowing economy, contractors should negotiate lower Minimum Premium provisions to avoid paying final premiums on greater than actual exposures.

Deductibles may also be utilized to reduce premiums. Deductibles can apply to both Bodily Injury (BI) and Property Damage (PD), or to BI or PD only. A deductible applying on a Per Occurrence basis is preferable to a Per Claim deductible, because one occurrence (accident) can result in multiple claims. The contractor's exposure to losses retained via deductible during the policy period can be limited by an Aggregate Deductible provision. Depending on the size of the deductible and the contractor's loss history, security may be required. Retrospective rating plans, as discussed in the Workers' Compensation section above, may also be available.

Auto Liability and Physical Damage

Review the policy rating pages with your agent to make sure that garaging, Gross Vehicle Weight (GVW), and classifications are correct. Premiums are lower for vehicles garaged outside urban areas. Premiums vary directly with the GVW. Contractor vehicles are typically classified as service vehicles, the lowest rated commercial classification. Consider increasing deductibles for Collision and Comprehensive coverage, especially if your loss history is good. Discuss with your agent the cost/benefit of Medical Payments, Substitute Transporstation, Towing, and Underinsured Motorists coverages. Consider statutory limits for Uninsured Motorists coverage.

Property, Contractors Equipment, Installation Floater, and Builders Risk

Consider increasing deductibles for all of these coverages. Be aware that documenting a relatively small claim can be time consuming and costly. If you rent equipment on a regular basis, make sure that your Equipment Floater includes coverage for rented equipment. Contractors can generally purchase this coverage much more cost efficiently from their own insurer as opposed to including insurance cost in the rental agreement.

Umbrella Liability

Is the premium subject to audit, or is it on a "flat charge" basis? If subject to audit, does a minimum premium provision apply?

Contractors have a number of options available to reduce insurance costs without reducing the limits or scope of their coverage. Consult with an insurance professional to evaluate the potential cost savings and implications of utilizing the premium modification tools proposed in this article. ▲

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