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COUNTY COMMISSIONERS
Association of Pennsylvania

Risk Transfer

Financing of Your Risks and Best Practices to Consider

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Risk Transfer

Definitions:

- Insurance is a contractual relationship between one party (the insurer) which receives consideration (the premium) and agrees to reimburse another party (the insured) for a loss to a specific subject (the exposure) caused by specific perils.
- Insurance is not a transfer of risk; it is a contractual responsibility to assume the financial consequences of a risk. If the transferee (the insurer) cannot or will not pay the financial consequences, the obligation falls back upon the transferor (the insured).

Risk Transfer

- Non-insurance contractual transfer of control or responsibility for an exposure
- Non-insurance contractual indemnification or financial responsibility
- Risk transfer shifts the physical responsibility or non-insurance contractual responsibility for financial responsibility of certain liabilities from one party to another

Risk Transfer - Considerations

- In considering risk financing, risk managers and insurance professionals face the same challenge – how to determine the right mix of internal funds (retention) and external funds (insurance)
- Level of Risk tolerance
- Budget implications
- Law of large numbers

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Risk Transfer – Risk Management Processes

- Risk Identification
- Risk Analysis
- Risk Control techniques
- Selection of Risk Control technique
- Implementation of Risk Control technique
- Monitor results and revise technique as needed

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Risk Transfer – Risk Control Techniques

- Risk retention
- Risk financing
- Risk transfer

Most common techniques to manage defined loss exposures

Risk Transfer - Risk Financing

- Risk retention – conscious decision to insure and not insure retained losses
- Risk financing – decide how to pay for losses that are retained (Insurance)
- Risk transfer – accomplished through the terms of contracts entered into

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Risk Transfer - Contracts

Definition – “agreement between two or more competent parties which creates an obligation to do or not do certain things directly or indirectly related to the subject of the agreement”

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Risk Transfer - Contracts

- Will create risk for your entity
- Little or no control over other entity's operation or how it conducts its business/activity
- Your entity needs to ensure it is not liable for improper acts of others

Risk Transfer - Contracts

- What you can control to various degrees are the terms of the contract you enter into for a product or service
- Goal of contract negotiations – ensure the duty to perform a certain specific task is nondelegable

Risk Transfer – Contractual Transfer of Risk

- Advantages:
 - Some risks may not be insurable, or coverage may be difficult to obtain or expensive to purchase. **Transfer those risks if possible.**
 - A potential loss may be shifted to another party that is in a better position to exercise risk control.
 - It may be more economical to transfer the risk than to purchase the needed insurance coverage.

Risk Transfer – Contractual Transfer of Risk

- Disadvantages:
 - If the party you transferred the risk to is unable to pay for the loss, your entity may be held responsible for payment
 - If contractual language is ambiguous or violates accepted public policy, the transfer may not be upheld in a court of law
 - Transfers the obligation to pay for a loss; it does not transfer the underlying loss exposure to the other party

Risk Transfer – Contractual Transfer of Risk

- Insurance
- Indemnification language
- Hold harmless provisions
- Basic steps:
 - Develop risk transfer clauses
 - Develop review process for certificates of insurance to verify coverages
 - Additional insured – stipulate coverage from the contractor/firm is primary

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Risk Transfer – Contractual Transfer of Risk

- Properly written insurance and risk transfer clauses – essential elements of any contract
- May not fit all situations
- Always involve your legal counsel to secure proper legal and risk management advice

Risk Transfer – Contractual Transfer of Risk

- Insurance considerations
 - Dollar size of the contract
 - Length or timeframe of the contract
 - Type and hazard level of the work to be performed (low, medium, high and special hazard)

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Risk Transfer – Contractual Transfer of Risk

- Types of Insurance
 - Commercial General Liability
 - Automobile Liability
 - Workers' Compensation
 - Professional Liability
 - Builder's Risk – Course of Construction
 - Umbrella or Excess Coverage

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Risk Transfer – Contractual Transfer of Risk

- **CERTIFICATES OF INSURANCE (COI)**

- Represents existence of insurance coverage
- Not a binding legal document
- Cannot alter, amend or extend the terms of the coverage documents it represents
- Does not guarantee the coverage will remain in existence throughout the coverage period

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Risk Transfer – Contractual Transfer of Risk

- **CERTIFICATES OF INSURANCE AND
ADDITIONAL INSURED**
 - Complicated topic
 - Be very careful about giving your coverage
away (usually for free)
 - If another entity asks you to add it
for all lines of coverage, DON'T

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Risk Transfer – Contractual Transfer of Risk

- **INDEMNIFICATION AND HOLD HARMLESS**

- Assists in avoiding legal costs for proving your entity was not involved in an inappropriate activity
- Also, consider the following:
 - Limitation of Liability
 - Waiver of Subrogation

Risk Transfer – Contractual Transfer of Risk

- **RISK TRANSFER BASICS**

- Transfer risk to an insurer (pool or commercial insurance company) by securing insurance coverage
- Transfer risk “by means of an indemnification provision also known as an agreement to hold a party harmless”
- “Obligation of one party to reimburse the other party for the losses it incurs for damages for which it might be liable”

Risk Transfer – Contractual Transfer of Risk

- Three types of hold harmless and indemnification provisions:
 - **Broad Form** – transfer the entire risk of loss regardless of degree of negligence
 - **Intermediate Form** – transfer the entire risk of loss except that caused by sole negligence
 - **Limited Form** – limits parties to their own negligence

Risk Transfer – Contractual Transfer of Risk

- Drafting hold harmless and indemnification clauses
 - Can be tailored for each contract
 - Clearly define the scope of the work being addressed by the contract
 - State the duration of the clause if the duty to hold harmless and indemnify continues after completion of the work
 - A properly drafted hold harmless or indemnification agreement will be enforced as written

Risk Transfer – Contractual Transfer of Risk

- Waiver of subrogation guidelines:
 - Shifts the risk of loss to one contracting party who, in turn, shifts the risk to an insurance company
 - Exists independently in a contract along with a hold harmless/indemnification clause
 - “Typical language” – “the owner and contractor waive all rights of recovery against each other”
 - Again, don’t accept a loss exposure you can avoid

Conclusion

- Risk management is practiced by each of us to a degree daily
- Contractual risk transfer – cost effective risk management tools available
- Review all contracts and agreements to ensure accuracy when stating your risk transfer position
- Not all contracts are alike – be specific
- Be careful not to get too “boilerplate” with your contracts – don’t cut and paste
- Use consistent and acceptable language
- Always seek advice of legal counsel prior to signing any document

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Thanks for Your Attention

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