

# Risk transfer

How to manage risk through insurance and legal documentation **Interviewed by Elizabeth Grace Saunders**

**G**ood risk management includes identifying and addressing factors that a business can control, usually inexpensively. One way of hedging risk is by financing it through the purchase of insurance. Another method is by transferring risk.

"In the business world, risk transfer often involves contractors' relationship with subcontractors," says Tim Wilson, risk control consultant at Westfield Insurance.

*Smart Business* learned from Wilson about transferring risk to subcontractors through formal agreements and documentation.

## How can risk transfer dramatically affect your liability?

Consider the following scenario: Suppose you are ABC Masonry working on a new office building. You have subcontracted the installation of metal door frames to DEC Doors, which is part of your responsibilities in your contract with the builder. You have always done business with people you know, and don't use a formal subcontractor agreement. An employee of DEC Doors accidentally drops a piece of steel and damages an expensive piece of electronic equipment that FGH Electrical is installing. FGH Electrical comes to you for the cost of the equipment. You are liable since the accident happened as part of your contracted work, and you are responsible for your subcontractors, including DEC Doors. Also, even if DEC Doors' insurance carrier pays the cost, the carrier can legally make a claim against you to recover all or part of what it paid. Even if no claim is ever paid, the time and paperwork carries a significant cost that you cannot recover.

With good risk transfer policies in place, you and your insurance carrier never have to become involved. Your subcontractors would be liable for their employees' negligence, and they would be contractually obligated to defend you.

## What can you do to ensure legally binding risk transfer?

The idea behind risk transfer is that everyone is liable for his or her own negligence and not financially responsible for someone else's negligence. In order to make risk transfer legally binding, it needs to be formalized in a



**Tim Wilson, CPCU, ARM, ALCM**  
Risk control consultant  
Westfield Insurance

written contract that all parties accept.

Typically, contractors use a subcontractor agreement with their subcontractors. This is a legally binding document that spells out terms and conditions and covers matters related to work performance. The language relating to risk transfer should be spelled out explicitly. As risk control consultants, we look for the following:

- Hold harmless and indemnification agreements
- Additional insured provision (asking to be named as an additional insured on the subcontractor's policy)
- Requirement to provide certificates of insurance
- Requirement for minimum limits (ideally matching the contractor's)
- Waiver of subrogation provision
- Review by an attorney or knowledgeable authority

## How does a waiver of subrogation differ from a hold harmless agreement?

In short, this is an endorsement to the subcontractor's insurance policy that says: My

insurance company can't sue you. The endorsement is a standard form known as a CG2404 or CG 2404a.

The hold harmless agreement, simply put, says: I can't sue you. For example, if I am a subcontractor and I trip and fall while I am working for you at your project site, the hold harmless agreement means that I cannot sue you for the cost of my doctor visit. We sign hold harmless agreements all the time when we rent a car or participate in a 10k run.

## What records need to be kept on file, and for how long?

Proper recordkeeping is crucial for many reasons. Having a good system for keeping track of certificates of insurance will save time and effort when your carrier audits your workers' compensation and general liability policies. When and if a claim occurs, having copies of the contracts with all the associated paperwork will simplify the process. These claims often come up many months after you complete work on a project.

## What are some other areas where risk transfer can be important?

If you sell a product manufactured by others, you should consider asking the manufacturer for what is commonly referred to as a vendor's endorsement ['Additional Insured-Vendors' (CG2015)]. Manufacturers and distributors typically purchase their own products liability insurance coverage under which they are the 'named insured.'

The purpose of the vendor's endorsement is to provide products liability coverage to vendors that sell or distribute their products. This endorsement gives primary products liability coverage over and above any coverage that the vendor may carry and lists the vendor as an 'additional named insured.' In short, it saves you the time and expense of being involved in a lawsuit about a product you sold and simplifies claim handling. <<

**TIM WILSON**, CPCU, ARM, ALCM, is a risk control consultant at Westfield Insurance. Reach him at [timwilson@westfieldgrp.com](mailto:timwilson@westfieldgrp.com) or (904) 642-2144 x210. Westfield Insurance provides commercial and personal insurance services to customers in 17 states. Represented by leading independent insurance agencies, the product we offer is peace of mind and our promise of protection is supported by a commitment to service excellence. For more information, visit [www.westfieldinsurance.com](http://www.westfieldinsurance.com).

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