

CENG 6101 Project Management

# **Insurance in Construction Industry**

Abraham Assefa Tsehayae, PhD

January, 2017

# What is Risk Management and Insurance?

- Construction industry is subject to more risk and uncertainty than many other industries.
- Technical Component: Identify, Analyze, Address Risk
- Practical:
  - Prevention & Response
  - Contractual Transfer
  - Purchase Insurance
- Insurance/ Surety is cash for:
  - Replacing / repairing your property and others property
  - Medical Costs / Lost wages
  - Defending you from others

# What is Risk Management and Insurance?

- Risk transfer is not risk management



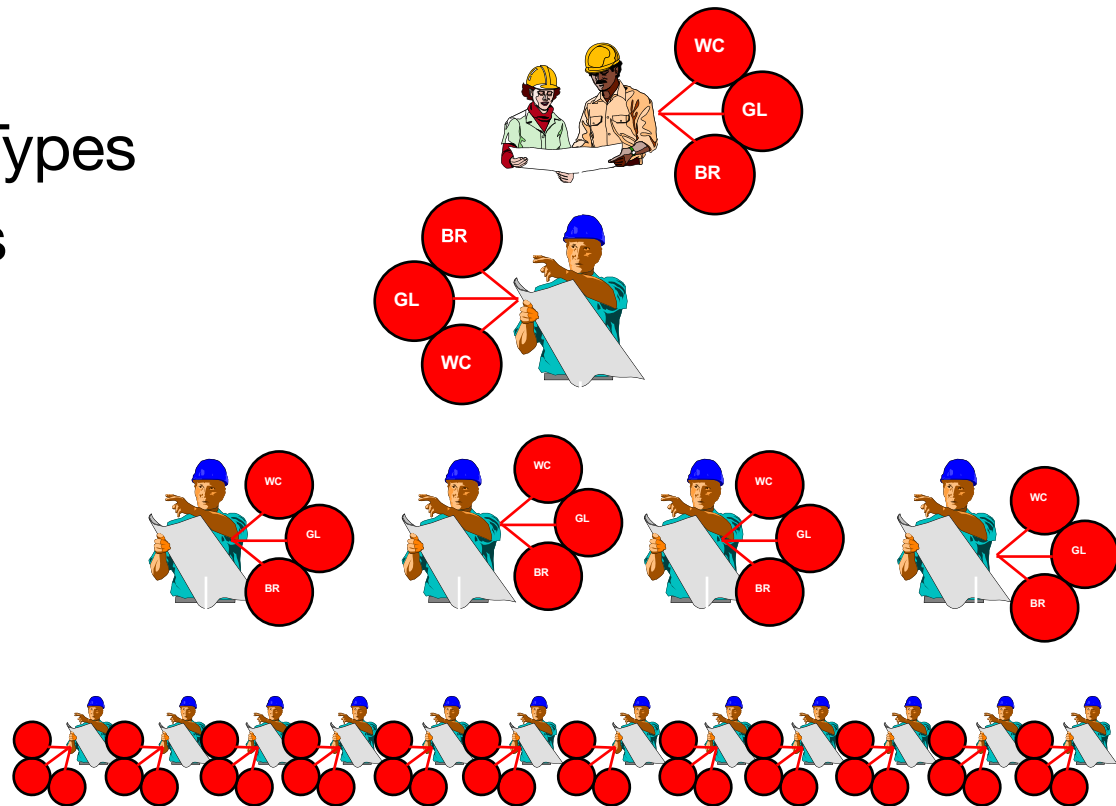
Charles De Gaulle International Airport, Terminal 2E  
May 23, 2004, 05:00 GMT

# What is Risk Management and Insurance?

- What insurance can and can't do?
  - Not all risk is insurable
  - There is an interplay between insurable and uninsurable risk
  - Regardless of insurance in place, loss avoidance and mitigation are preferable to an insurance settlement
  - Insurance can remove barriers to collaboration
  - Insurers provide their best terms and conditions to projects where risk is managed

# Traditional Project Structure

- Multiple Parties
- Multiple Contract Types
- Various Skill Levels
- Gaps
- Hope



# Delivery System and Insurance Choices

- Design Build and EPC:
  - May provide single source and turnkey responsibility, but owners will still want to be sure downstream coverages are adequate.
- Integrated Project Delivery:
  - Together with BIM, may minimize errors, but they also blur project roles making insurability of certain risks problematic. Use of highly capitalized design builders tends to decrease the need for project-specific policies.
- Public Private Partnerships
  - May entail substantial and sometimes unrealistic insurance program demands by sponsors and lenders.
- Construction Management
  - Involves provision of professional services that requires professional liability coverage.

# Key Components

- Pre-Construction
  - Project Evaluation
  - The Contract
  - Insurance
  - Project Safety Requirements
  - Project Claim Procedures
- Construction Duration
- Post Construction
- The Contract: Most Important Construction Document
  - Scope and Timeline
  - Responsibilities
  - Indemnification Language
  - Insurance Requirements
  - Project Safety Requirements
  - Administration Requirements

# Benefits of Insurance

- Business Risk and Providing Security
  - The success of any business is based on mitigation and controlling risk it encounters.
  - Insurance allows businesses to take necessary risks without fear of huge financial loss or hardship in case of a disaster.
- Safety by Awareness
  - Insurers are better educated and aware of the causes of various losses, and they can offer professional assistance for avoiding the most common causes of losses.
  - Insurance companies generally require assessments as part of the process for getting coverage, this helps to bring awareness of the risks you have and help you plan ahead to mitigate those risks.
  - Insurance companies also organize information for policy holders and prospective clients.



# Benefits of Insurance

- Economic Stimulation
  - Premium, received regularly in instalments, creates large funds.
  - The funds (cash reserve equal to or greater than a certain percentage of liabilities) can be gainfully employed in industrial development of a country through investments.
- Spreading Risk
  - The basic principal of insurance is to spread risk among a large number of peoples.
  - A large number of companies and persons get the insurance policies and pay premium to the insurer.
  - Whenever a loss occurs, it is compensated out of fund to the insurer, who will usually also have its own insurance with other financial institutes.

# Types of Construction Insurance

- **Contractor's All Risk Policy (CAR)**
  - This policy is specially designed to give financial protection to the Civil Engineering Contractors in the event of an accident to the civil engineering works under construction.
  - In case the policy period exceeds 12 months, the premium can be paid in quarterly instalments .
- **Professional Indemnity Policy**
  - This policy is meant for professionals to cover liability falling on them as a result of errors and omissions committed by them whilst rendering professional service.
  - The policy offers a benefit of Retroactive period on continuous renewal of policy whereby claims reported in subsequent renewal but pertaining to earlier period after first inception of the policy, also become payable.
  - Group policies can also be issued covering members of one profession.

# Types of Construction Insurance

- **Contractor Plant and Machinery Policy**
  - The sum insured of each item of machinery should represent the current purchase cost of a similar new machine including all incidental expenses like freight, duty, taxes, cost of erection etc.
- **Public and Product Liability**
  - It is also known as combined liability or general liability. Public liability is a legal ability to pay compensation to third parties arising in connection with the business activities of the insured. Product liability is the legal ability to pay compensation to third parties arising in connection with the insured's products.
- **Worker's Compensation policy**
  - This insurance effectively covers all liabilities whether arising under statute or at common law, in relation to death or injury of employees or persons demand to be employees.

# Bonds



- Not Insurance but standing on their own
- Bid Bond
- Advance Payment Bond
- Performance Bonds
  - Guarantee the specific performance of the contract or completion of the contract
- Payment Bonds
  - Guarantees the payment of subcontractors on the project.

# Performance Bonds

- For use when the project is not completed as contracted.
- Bonds are not insurance and Bond holders will go after contractor for non-performance
- Goals of the Bond Holder may be Different than Yours
  - Step in and defend
- Do not release bond too early



# Payment Bonds and Stop Notices



- No mechanics liens on public projects
- Stop notices
  - Must hold payments to cover stop notice until dispute is resolved
- Use “Stop Notice” Bonds to release payments

# Insurance Policy

- Insurer Requirements
- Coverage Requirements
- Limit Requirements
- Premium / Deductible Responsibilities
- Documentation Requirements

## References:

- *Babu, A. and Kanchana. (2014). Role of Insurance in Construction and Infrastructure Projects, IJCIET, 5 (12), pp. 206-210.*