

→ Don't Retain Your Subcontractor's Risks by Not Requiring Adequate General Liability Insurance - **Page 1**

→ Protect Your Officers with Drive Other Car Coverage - **Page 2**

→ Benefits Of Requiring Additional Insured Coverage Of Subcontractors - **Page 2**

→ Workers' Compensation Experience Rating - **Page 3**

→ Top Tips to Streamline the Premium Audit Process - **Page 4**

# Risk Monitor

APRIL 2012

A NEWSLETTER FOR CLIENTS AND FRIENDS OF FIRST INSURANCE AGENCY INC.

## Don't Retain Your Subcontractor's Risks by Not Requiring Adequate General Liability Insurance

Risk management is one of the most important tools available to keep your business's financial bottom line looking good. But, for risk management to be successful, you must be able to identify all cases of risk retention whereby you'd be responsible for any portion of a loss.

If you can't transfer a risk to another party, then you retain the risk by default. There are both known and unidentified risk retentions. An example of a known risk retention would be your insurance policy deductible. This type is considered known since you already know the predetermined deductible amount that you'd be responsible to pay before the policy provides its preset amount of coverage. On the other hand, any amount of loss over what your insurance policy's limits are would also be considered a retained risk, but categorized as unidentified since you wouldn't know the amount of loss beforehand.

General contractors need to be able to identify all their known and unidentified risk retentions in order to adequately protect their business. If you're like most, then the most likely area for problems will be identifying unidentified retentions. Subcontractor negligence is of particular concern. Of course, you can always buy additional insurance coverage to cover subcontractors. However, it's usually more financially feasible to require that your subcontractors carry their own liability insurance with a coverage amount that could potentially replace the entire project if a problem were to occur.

Make sure that you've taken the following five key actions to proactively handle potential subcontractor

negligence:

1. A professional should review your contracts to ensure that your insurance policy continues to adequately meet your needs.
2. Either purchase additional insurance coverage yourself -or- require all subcontractors to purchase a sufficient amount of insurance on their own. Gauge the minimum acceptable policy limit for a subcontractor according to the scope and size of the project. Do be sure to specifically specify the minimum acceptable policy limit in the subcontractor's contract.
3. You should also take precautions to ensure continued compliance with minimum acceptable policy limits by periodically asking your subcontractors for their certificates of insurance and checking that the coverage hasn't elapsed.
4. Your subcontractor contracts should specify that the primary coverage for the project will be the subcontractor's general liability coverage, not yours. Stated as such, your insurance coverage will be excess coverage and only be relevant if the subcontractor's insurance coverage isn't enough to cover the damages.
5. Check whether or not a subcontractor indemnity agreement is allowable by law in your area. This agreement would make a negligent subcontractor reimburse you any money that you were made to pay the owner of the project due to the negligence of the subcontractor.



# 1ST INSURANCE

**First Insurance Agency Inc.**

25 West State St. Upper Level

Mason City, IA 50401

[www.1stinsurance.com](http://www.1stinsurance.com)

Phone: (641) 423-8184

(641) 421-8000

Toll Free (Iowa)

(800) 247-0713

Toll Free (out of Iowa)

(800) 367-6907

Fax: (641) 421-1940

# 1ST INSURANCE

Protection and Security Since 1921

1ST INSURANCE

# Protect Your Officers with Drive Other Car Coverage



Mary is a junior partner in a law firm and drives a car that the firm owns and insures. She is unmarried and her children are not old enough to drive, so she does not carry a personal auto insurance policy. The firm's auto insurance covers her as a partner and she doesn't own another car, so she sees no need to have her own policy. Most of the time, this is not a problem. However, spring break comes and she takes her kids to DisneyWorld. She rents a car at the Orlando airport and never gives a thought to whether her firm's insurance will cover her if she has an accident with the rental. In this case, a phone conversation with the firm's insurance agent would have been a good idea.

While driving back from the Magic Kingdom one night, Mary accidentally rear-ends a new Lexus. The damage to the other car is extensive. Mary looks to her firm's auto liability coverage

for the cost of repairing it. The ISO Business Auto Policy covers the person or organization shown in the policy declarations (the information page at the beginning.) In this case, the name shown in the policy Declarations is the name of Mary's firm. The policy goes on to say that, for liability insurance, the firm is an insured and so is anyone else using, with the firm's permission, a covered auto the firm owns, hires or borrows, with some exceptions. Unfortunately for Mary, the firm didn't rent the car she did. She rented the car in her name. Consequently, the firm's insurance will not cover her liability for this accident. She will be forced to pay for it out of her own funds.

However, there are a couple of policy changes that the firm can buy that would solve Mary's problem. The first is an endorsement called Drive Other Car Coverage-Broadened Coverage for Named Individuals. The insurance company will require the insured to list the names of one or more individuals on the endorsement. The change extends several of the policy's coverages so that they apply to the listed individuals and their resident spouses. This endorsement comes with some significant limitations:

- It extends to the listed individuals coverages that the policy already provides it does not add coverages not provided. If the firm's policy does not provide collision coverage on any its vehicles, Mary will not have collision coverage on a car she rents.

- It covers the named individual's spouse only while a resident of the same household. If Mary is married to Jim, Jim automatically has coverage for a car he rents in his name. If they separate, however, Jim loses that automatic coverage because he no longer resides in the same household as Mary.
- The only family member it automatically covers is the resident spouse. It will not cover any other family members in the household unless the endorsement specifically lists their names.
- An alternative to this endorsement is to list individuals' names in the policy declarations along with the firm's name and attach an endorsement called Individual Named Insured. It covers the individual listed in the declarations and automatically covers the person's resident spouse and family members. It also covers these individuals should they injure another of the firm's employees.

These policy changes affect several coverages, including liability, uninsured motorist, medical payments, and physical damage. An organization should consult with a professional insurance agent to discuss the endorsements' details and identify the one that will best insure the concerned individuals. With the right coverage in place, Mary can enjoy her vacation without having to worry about who will pay for the fender-bender.

## Benefits Of Requiring Additional Insured Coverage Of Subcontractors

There are several ways for contractors and subcontractors to allocate the risks of damage on job sites to subcontractors. Constructing a contract that requires subcontractors obtain insurance is one of the best risk management strategies. The subcontractor's coverage should also include the contractor or higher subcontractor as an insured party. With this option, contractors have the same rights as policy holders under commercial general liability policies. Both the hiring contractor and the party purchasing the policy have the same rights and coverage provisions. By requiring this coverage for

subcontractors, general contractors are able to prevent paying for the expensive legal fees arising from damages on a job site.

When a subcontractor's employee is injured on the job, the subcontractor usually tries to sue the higher tier subcontractor or general contractor to cover damages. The hiring party then faces the expenses of court costs, legal fees, damages and lost salary for the injured worker. However, a hiring party that requires all subcontracted parties to have CGL insurance naming them as additional insured parties has protection from such financial burdens. In some

cases, the CGL policy is primary to any others. This means that CGL policies naming the hiring contractor as an additional insured party must be the first to pay legal fees and damages.



*continued on page 3*



# Workers' Compensation Experience Rating



How does safety pay dividends to the business owner? Time and resources spent on developing a culture of safety repays the business in the long run. Safety cultures rely on reducing the number of workers compensation claims, in return, the odds of a disastrous claim are reduced.

Business owners with workers' compensation experience modifications above 1.25 need to review their safety policies with professionals. It is possible one year or even one claim causes this situation but it should not be ignored. Discover and repair the root cause.

A 1.01 to 1.25 modification indicates worse than average experience. State rates can be less than adequate for a short period of time. The actuarial or mathematical calculations just incorrectly reflect the average expected claims. Slightly elevated modifications may be caused by these issues however, review your losses by department in these cases and see if a problem area exists.

For slightly elevated modifications, review the safety program and types of losses. Seek out a professional risk manager for help if needed. Look for patterns in the losses, and consider changes in safety equipment or procedures to reduce problem issues.

Proactively nurturing a safety culture will pay long-term dividends. Experience modifications will decrease with positive results. How?

Each state calculates workers' compensation experience modifications

**Safety cultures rely on reducing the number of workers compensation claims, in return, the odds of a disastrous claim are reduced.**

independently. Many states do utilize the services of the National Council on Compensation Insurance (NCCI) to gather data and promulgate base rates and experience modifications but each state regulates its own workers' compensation system.

Workers' compensation experience rating predicts future behavior by analyzing past performance. It is a consequence of loss control performance, neither a reward for no losses nor a punishment for too many claims.

The generic formula for experience modifications follows some rules:

Just as payrolls are the basis for the standard premium, they form the basis for expected claims. Payroll is multiplied by an average claim factor to produce total expected claims. A discount factor is then applied to predict the potential severity of the claims. The product of this equation is expected losses. Actual medical only (MO) claims combine and report as a number of claims/total amount. Some states designate the MO claims as primary (maximum average) and excess, and then apply a discount rate to one or both of these amounts.

*continued from page 2 ... Benefits Of Requiring Additional Insured Coverage Of Subcontractors*

With these policies, there are no requirements for subcontractors to ask for indemnification for loss claims as a condition for the hiring party's coverage. There is also no need for determining the faults of each party involved. Having a subcontract that requires subcontractors to provide adequate insurance is enough. The simple requirement of the policy to pay for legal fees is one of the most advantageous aspects of this coverage. Another advantage is that the scope of coverage is broad. Insurance companies must pay for attorneys' fees whenever there are allegations of a complaint. Although the insurance company may not be required to pay all damages claimed by an injured worker, they have a strong duty of defense.

Most states set a limit on the value of any one claim, and then discount large claims on a sliding scale. This historical claim experience is divided by expected losses. That quotient is the experience modification.

The insurance industry spends millions of dollars to find ways to predict the future. Loss analysts discovered one important fact: the best predictor of future claims is the frequency with which companies suffer losses in the past.

Frequency reflects the number of claims per employee, usually expressed as claims per payroll unit (\$100), claims per year, or claims per time unit. Frequency, however, more importantly, reflects the safety culture of the business.

If the frequency of claims is predictable, how about the severity of an individual loss? No, severity, the magnitude of the loss, is not predictable. With greater frequency, however, comes greater odds that a severe claim will occur.

Experience modifications indicate the status of the safety culture within a business. Good management listens to risk management and loss control experts who ultimately reduce workers' compensation costs.

# Top Tips to Streamline the Premium Audit Process

Are you due for a workers' compensation premium audit? Audits are how insurance rates are determined, and it's possible that an audit will uncover information that can actually save you money. In any case, it pays to be prepared. These five tips can help you get ready.

**1. Let your broker know when there are changes in your staffing, payroll or areas of operation.**

This is important not just at audit time but all the time. Your rates are based on variable rating information, including the number of employees, job classifications, the states in which you operate, etc. Updated information results in more accurate premium assessments.

**2. Get your records ready.** Your auditor will need to see records such as federal and state tax returns, ledgers, checkbooks, contracts and employee or contractor tax documents. If you prepare your records in advance, you'll speed up the audit process.

**3. Make sure you break out various types of compensation in your records.** For example, to set your premium, your broker considers pay but not contributions to employee benefits packages and other perks, so it's important to make sure your records are clear on the various types of compensation. Also make sure overtime pay is clearly defined since it's classified as regular pay for workers' compensation insurance purposes.

**4. Ensure that contractors have their own insurance.** This is important not only from an audit standpoint but from a liability prospective as well. If an uninsured contractor has an accident while performing work on your behalf, you can be held liable. If an audit identifies contractors for whom you don't have certificates of coverage, you can be charged for their premiums.

**5. Remain on hand to answer questions.** As your auditor



reviews your material, he or she may have questions or need additional data. If you are available to provide answers, your audit will be completed more quickly.

By following these tips, you'll be more prepared for your workers' compensation premium audit. A fast, efficient audit process can save time for both you and your auditor, so it pays to be prepared.

Information contained in this newsletter about product offerings, services, or benefits is illustrative and general in description, and is not intended to be relied on as complete information. While every attempt is made to ensure the accuracy of the information provided, we do not warrant the accuracy of the information. Therefore, information should be relied upon only when coordinated with professional tax and legal advice.



**First Insurance Agency Inc.**  
25 West State St. Upper Level • Mason City, IA 50401  
[www.1stinsurance.com](http://www.1stinsurance.com)

Phone: (641) 423-8184  
(641) 421-8000  
Fax: (641) 421-1940

Toll Free (out of Iowa)  
(800) 367-6907

Toll Free (Iowa)  
(800) 247-0713

# Risk Monitor