

# Enhancing risk management through risk transfer



Common business practices and relationships carry risk. There is risk in all of your business relationships, for example, relationships with contractors, vendors and tenants. Unexpected or uncontrolled risks can cause significant harm. Risk management using risk transfer helps protect your business, clarify responsibility when accidents happen, minimize legal disputes, and control costs.

Smart businesses will try to transfer potential liability to others and negotiate contracts in their favor. As a condition of doing business, you may require another party to carry insurance or sign an agreement that indemnifies you or holds you harmless. On the other hand, in order to get business, you may have to agree to take on someone else's liability. It is critical to understand how your agreements treat potential liability, which will in turn limit surprises if an unexpected event arises. With the help of your broker and legal advisors, you can implement a risk transfer program that drives risk-conscious behavior and provides your business with greater protection.

## **Risk transfer**

Implementing a risk transfer strategy will allow you to manage risk in your business relationships and gain certainty as to who will be liable in the event that a loss occurs. Risk transfer involves shifting the risk of loss to the responsible party. Consider commercial landlord-tenant relationships. If a tenant spills water that causes a customer to fall and suffer injury, both the landlord and the tenant could face liability. Without any risk transfer in place, the customer may seek and collect damages from the landlord. However, in this situation, the tenant created the risk and had the best opportunity to manage the risk. The landlord had the ability to ensure that the tenant shielded the landlord from such liability.



One way to do that is by contractually shifting risk from one party to another, a business practice known as “risk transfer.” Risk transfers can be used to place responsibility for risk on specific parties consistent with their ability to control and insure against potential risks. Businesses may transfer risk through insurance policies and written agreements.

### **I. Through Insurance**

Insurance is at the forefront of your risk transfer strategy. Insurance companies assume strictly defined financial risks from policyholders. It is also important to understand whether the parties you work with have insurance. You should work with your broker, and perhaps legal advisors, to determine appropriate coverages for yourself and third parties.

#### ***A. The Importance of Certificates of Insurance.***

A Certificate of Insurance, commonly referred to as a COI, allows you to confirm that someone is insured. The certificate typically lists the basic coverage type along with its terms, limits, and dates of issuance and expiration. COIs serve an informational purpose.

These best practices regarding COIs may help your business effectively and efficiently transfer risk:

1. Work with businesses that carry insurance and provide timely certificates.
2. Collect COIs directly from the insurance company or insurance broker/agent. Do not accept COIs directly from policyholders.
3. Review COIs annually or semi-annually to verify the terms and existence of sufficient coverage. Develop written procedures to use when reordering certificates, when certificates are not received, or when they reveal insufficient coverage. Maintain certificates and related records in your files.
4. Require COIs before third parties begin work or submitting payment to another party. Terminate contracts where the other party refuses to comply.
5. Monitor your files to ensure timely receipt of COIs.

You should work with your legal counsel to determine whether any of these best practices are appropriate for your business.

### ***B. Additional Insured Status***

Some business relationships or contracts may require: (1) adding an additional insured to your policies; or (2) adding your business as an additional insured to another party's insurance policies. Additional insured status may entitle the additional insured to certain rights under another's policy.

Additional insured status does not replace primary insurance coverage. Additional insured coverage is typically limited to losses involving the named insured. Also, the named insured may erode policy limits with other losses. Additional insured endorsements may refer to the contract between the parties. Parties should consider obtaining both ongoing operations coverage and completed operations coverage. Consult your insurance professional and legal counsel to verify that the contractual language and the Additional Insured Endorsement work as intended and provide sufficient coverage to protect your business.



### **C. Waiver of Subrogation Endorsements**

A waiver of subrogation is an endorsement that you can seek to avoid the risk of someone's insurer coming after you to recover what it paid on behalf of its named insured. Legally, subrogation means that one party (usually an insurance carrier) has the right to "step into the shoes" of another party (its insured) for the purposes of bringing a claim for damages. For example, in the event of a loss, an insurer might pay a claim on behalf of its insured but believe your company caused or is otherwise responsible for some or all of the loss. A waiver of subrogation endorsement may prevent that insurer from seeking recovery of the claim from you. If you intend to transfer risk, work with your insurance professional and/or legal counsel to determine and put in place waiver of subrogation endorsements as necessary.

## **II. With Contracts**

Contracts provide the foundation of a strong risk transfer program. A contract typically defines each party's rights and responsibilities concerning the scope of work, the insurance requirements and responsibility for potential liabilities. Best practices include obtaining written and executed contracts before work begins and involving your legal advisors with drafts prior to execution. Relying on oral agreements can cause problems later; each party may remember the terms and the circumstances differently, leading to potentially costly disputes.

Also, it is important to understand the distinction between written contracts and other written documents like purchase orders ("POs") or requests for proposal ("RFPs") that you might exchange as part of your working relationship with other parties. POs and RFPs typically do not contain risk transfer provisions that negotiated written contracts might include. A typical

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business relationship should be governed by a formal written agreement, with POs and RFPs governing individual transactions within the overall framework of that relationship. To the extent written agreements are not possible, you should work with your legal advisor to ensure that key risk transfer terms are incorporated into any POs or RFPs that you exchange.

### **A. Including Insurance Risk Transfer Tools in Contracts**

Insurance requirements can be implemented into contracts. For instance, contracts may require the timely provision of COIs with negotiated coverage terms and limits. The contract may specify which insurers are acceptable, such as carriers with "A" ratings or better. Parties can also require additional insured status and waiver of subrogation endorsements in contracts.

### ***B. Indemnification Provisions***

Parties can also negotiate indemnification and hold harmless provisions. A properly drafted indemnification and hold harmless provision requires one party to protect another against damages or loss caused by the indemnifying party. Such losses may include compensation to an injured person as well as legal fees incurred while defending against claims.

Whether such indemnification provisions are enforceable varies among states—some states have stricter limits on transferring liability. Certain states forbid transferring liability for your own negligence while others allow the parties’ contracts to fully dictate the extent of protection. Because of these varying state requirements, legal counsel is essential when drafting and agreeing to indemnification provisions.

### **III. Implementing Risk Transfer Strategies**

Risk transfer requires consistent attention. With the right strategy, risk transfer can be accomplished effectively and efficiently. With input from your insurance professional and legal counsel, you should consider implementing risk transfer strategies including:



1. Ensuring that your contracts with third party entities reflect your intent with respect to risk transfer. Using contracts of others such as contractors and service providers may impose their risk transfer intent.
2. Reviewing all existing contracts to identify risk transfer exposures and opportunities.
3. Considering indemnification/hold harmless provisions when renewing existing contracts or executing new contracts.
4. Requiring COIs before work starts or payment is made and setting periodic reminders to ensure that COIs are updated.
5. Requiring additional insured endorsements and/or waiver of subrogation endorsements where appropriate.
6. Maintaining all pertinent records, including written contracts, COIs, and relevant insurance policy endorsements.

Unexpected events arise from time to time. Implementing a risk transfer strategy helps your business understand risk and helps ensure that the risk from these unexpected events is transferred in the way that you intend. Put simply, it ensures that if something goes wrong, you have a clear view of which party is financially responsible for any resulting loss or damages. Risk transfer tools offer protection, so you can focus on running your business.

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