A Changing Landscape

CONSTRUCTION RISK MANAGEMENT

by David Nichols

Managing construction risk has always been viewed as a dynamic challenge, but a number of significant changes in traditional industry practices are presenting issues that today's construction risk manager must address. Fortunately, favorable insurance market conditions and the increasing availability of new products are making it easier for risk managers to navigate through this new landscape successfully.

Almost every risk manager of a large construction company will say that external factors are helping to reduce their organization's risk management costs. Insurance company consolidation, the arrival of additional carriers and the introduction of new products are creating a level of competition among insurance companies not previously witnessed by the construc-

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tion industry. Frances Oliver, director of risk management at Centex Corporation in Dallas, says, "Not only have we seen significant competitiveness in pricing on our program, but also on coverage conditions and terms." While this premium competitiveness is not limited to large contractors, it seems to be strongest among carriers vying for this segment of the marketplace.

An increased focus on loss control and claims management is also allowing major construction firms to reduce their cost of risk. In addition, improved experience in workers' compensation programs has resulted from benefit level changes, managed care, fraud management and a labor market sensitive to the value of maintaining a safe environment. Mike Markman, president of Zurich American Construction in Schaumburg, Illinois, indicates that "many contractors are seeing cost reductions as a result of insurer competition, but an equal number are achieving significant reductions as a result of favorable loss trends."

reductions as a result of the carriers' increased efficiencies."

The market share fight has been accentuated by the emergence of new or more focused insurers including Liberty Mutual, Hartford, Zurich and USF&G. These companies, while historically active in construction, have either modified their distribution systems or created special units to focus exclusively on this market segment. Ray Beane, vice president of national accounts, construction and wrap-up at Liberty Mutual in Boston, states, "There is an increasing number of carriers focused on expanding their market share, and the end result is driving down costs for contractors and construction projects."

Although the major brokers have not experienced this type of consolidation, there has been significant movement of teams and a rededication to the industry among firms. Mr. Davis of Willis Corroon comments, "While these changes have little direct impact on risk management costs, we are seeing a long-overdue increase in the number of creative ideas being put in front of today's risk manager." The risk management community seems to share this view, according to Ms. Oliver of Centex. "Our brokers seem very focused on bringing us creative concepts that will reduce our current and long-term costs," she says.

The risk management community also seems to be approaching its relationships with brokers

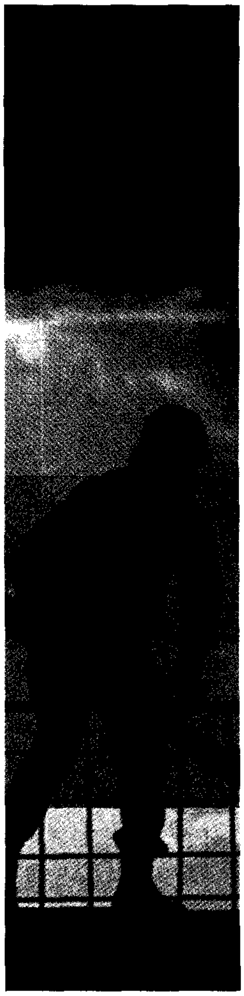
The fight among the consolidated companies to maintain and expand their share of the construction insurance market is driving competition and reducing risk management costs.

Concerns among some industry participants that consolidation among insurance companies specializing in construction risk management would lead to large premium increases appear, thus far, to be unwarranted. The last few years have seen merger or acquisition activity among the Travelers and Aetna, Zurich and Home, and CNA and Continental, all of which play substantial roles in construction insurance. However, the experience of risk managers indicates that consolidation has not adversely affected market competition, services or policy terms. In fact, the fight by the consolidated companies to maintain and expand their market share is driving competition and reducing risk management costs. Steven Davis, executive vice president of Willis Corroon Construction in Nashville, says that "if the benefits of insurer consolidations are real, then construction companies should see further cost

and other service providers differently, looking for firms to be able to serve as strategic partners. This contrasts with the opinion that insurers and brokers can be treated like interchangeable commodities. "We view our brokers as partners helping us achieve our goals and offering us new ideas," says Pam Rainey, senior director of risk management at Fluor Corporation in Irvine, California. This also holds true on the insurer side, where risk managers are equally concerned about a carrier's ability to form a long-term relationship with them.

Industry Shifts

Along with external developments, there are significant changes within the construction industry itself that are altering the costs and risk management programs of major contractors. For instance, the rapid growth of the design-build segment of the industry, in which



contractors provide integrated design and construction services, is creating new design-related exposures that must be addressed. "We are responding to these new exposures by providing flexible products that integrate contractors' professional liability coverage as well as standard general liability into a single contract," states Bill Rohde, construction underwriting officer at St. Paul Fire & Marine in St. Paul, Minnesota.

Some contractors are witnessing this trend, which is expected by many industry observers to continue at an even greater pace, in the international segments of their business as well. Ms. Rainey of Fluor states, "We see a trend in international business toward design-build concepts, and our program must respond to these exposures." In addition, the growth in privatization and projects that incorporate operational and management responsibilities is creating new issues for risk managers.

instead of the traditional annual practice policies in which contractors insure all of their projects under a single policy. Others recommend a combination of using project-oriented insurance when the circumstances offer favorable risk financing opportunities while continuing to use an annual practice policy for the remainder of their business.

As new risk financing approaches reach the marketplace, many risk managers are aggressively reviewing their current retention and deductible levels. Significant increases in retention levels are occurring among risk managers confident that effective loss control and claims management programs improve their ability to predict losses and manage costs. In addition, insurers are offering significant credits to companies that assume higher amounts of risk. Mr. Davis of Willis Corroon says that more large contractors believe that higher retentions, especially in workers' compensation programs, provide the best long-term cost management strategy. In contrast, smaller contractors are turning to guaranteed cost programs.

In addition, a growing number of companies are exploring the use of nontraditional policies to manage their financial and operational risks in integrated programs that effectively address a range of coverage issues, perhaps over multiple years. While not yet a common feature of construction risk management programs, many companies are evaluating new options. "We are

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Significant risk management changes are also occurring as a result of current trends such as the growing popularity of owner-controlled insurance programs (OCIPs), changes in retention or deductible levels and the use of financial insurance products.

"We see OCIPs as an effective way for owners and contractors to manage risks and anticipate continued growth in their use," says Mr. Markman of Zurich. Some view the growth of OCIPs to be "the result of owners seeking to improve the risk management aspects of major projects and the efficiency of a project's timely completion," according to Ron Goldberg, vice president of construction insurance at USF&G in Baltimore.

Although questions remain about the long-term use of OCIPs, their current popularity has led some to speculate that the industry is moving to a preference for insuring specific projects

actively evaluating products such as credit enhancement, blended programs involving finite risk and other products that provide an opportunity to manage our income statement and balance sheet," says Ms. Rainey of Fluor. Major insurers supporting the large construction market are positioning themselves to address these needs. "We are trying to better understand how contractors work and how we can apply our resources to allow them to manage all risks, not just traditional exposures," adds Mr. Markman of Zurich.

In this changing landscape for the construction industry, risk managers are faced with increasing design-build and operational exposures. The resulting challenges may be numerous, but so are the opportunities to take advantage of favorable market conditions and incorporate new techniques into programs that reduce their organization's cost of risk. RM