

Owner Controlled Insurance Programs Significantly Reduce Construction Costs

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Since 2007, California hospital construction expenditure has increased from \$2 billion to \$9 billion annually (California Healthcare Foundation). This surge in costs is expected to continue for the next 15 years, as hospitals strive to comply with seismic regulations and modernize physical infrastructure. The challenging economic environment and uncertain financial impact of health reform will compel hospital leadership to aggressively identify mechanisms to minimize construction costs during the next two decades. One valuable cost control mechanism

is the Owner Controlled Insurance Program.

What is an Owner Controlled Insurance Program (OCIP)?

An OCIP is a single insurance program, purchased and controlled by the owner of the project(s) under construction. This insurance program insures the owner, general contractor, and all enrolled contractors performing work at the project site. Under the terms of a single project OCIP, the owner typically arranges for Workers' Compensation, General Liability, Excess Liability and Builder's Risk coverages. In return for receiving these coverages from the owner, the contractors remove insurance costs from their bids. The owner realizes a cost savings by being able to pool and negotiate more favorable insurance rates than the individual contractors.

Whereas, on small construction projects, an owner typically requires contractors to provide their own insurance, the cost and complexity of large construction projects requires a more sophisticated approach to controlling insurance costs and ensuring proper coverage. For this reason, OCIPs are

now the norm when an owner is involved in projects that exceed \$100 million in construction costs.

Advantages of an OCIP

Although there are many reasons to consider this approach, the most compelling arguments are described below:

- *Cost Savings* -- An owner can realize a pre-tax cost savings of 1%-2% of total construction cost by sponsoring an OCIP. The cost savings are realized by the owner's ability to secure insurance coverage at a cost less than that which would have been paid by the owner, had each contractor provided their own insurance coverage and passed these costs onto the owner in their bid.
- *Control of Insurance Coverages* – By purchasing the coverage under an OCIP, the hospital is able to be first Named Insured on the policy, to select which carriers will provide the insurance, influence on how claims are adjusted, and agree to terms of coverage and limits provided.
- *Enhanced Coverage* – Due to

leverage gained by aggregating insurance purchasing, the owner gains access to higher insurance limits and broader coverages--dedicated solely to the owner's project. Establishing separate limits also ensures that construction-related claims will not erode the hospital's existing insurance limits. Hospitals find that this benefit is particularly relevant to their existing general liability programs.

How are Cost Savings Realized?

Due to the amount of insurance premium generated by insuring all of the contractors under a single insurance program, the owner is able to significantly reduce its fixed insurance costs for Worker's Compensation, General Liability and Excess policies by:

- Maintaining a self-insured layer of loss and purchasing catastrophe insurance only above this amount. This structure eliminates the risk charge paid to an insurer on the primary

loss layer. The same approach is commonly utilized by hospitals for other lines of insurance coverage (e.g., Professional and General Liability) and is generally well understood.

- Aggregating insurance purchasing, allowing the owner to effectively leverage its volume to negotiate meaningful discounts with insurers.
- Eliminating the 10-15% contractor mark-up on the insurance line. (Contractors typically pay for insurance on a guaranteed cost basis. At bid time, the contractor marks up these insurance costs by 10-15% for profit and overhead and passes the entire amount to the owner as part of the bid amount.)

Who Does the Work?

The vast majority of the work associated with the OCIP is performed by the OCIP administrator. The hospital is usually expected to facilitate the activities of the OCIP

administrator by helping establish and enforce OCIP administration protocols.

Is my Hospital a Candidate for an OCIP?

Any single construction project or series of projects generating in excess of \$100 million in hard construction costs is appropriate for the OCIP approach. OCIPs are successfully used by public, not-for-profit and private for-profit entities. Currently low worker's compensation rates and a soft insurance market create ideal conditions for initiating an OCIP.

Gisele Norris is a Managing Director of Aon Healthcare. As the world's largest insurance broker, Aon hosts the world's largest construction and healthcare practice groups. Norris works with experts from both of these groups to provide specialized OCIP expertise to California hospitals implementing large construction projects. She can be reached at 415-458-2973 or gisele.norris@aon.com.

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