A tip for contractors: The importance of contracts and risk transfer.



When there's a new project ahead of them, contractors can forget the importance of the words in front of them. Contracts are where every construction project starts. They're essential in establishing project scopes, timelines, and teams. And perhaps most importantly, they're important when establishing liability for risk.

Before you sign on the dotted line or negotiate work, it's important to understand the ins and outs of the contract and who is responsible for liabilities. Wondering, "What is risk transfer in construction?" We're breaking it down so you can break ground with less stress … and risk.

What is risk transfer in construction?

Simply put, risk transfer is the shifting of responsibility from one party to another in a construction contract. Let's say you've signed on for a project and have additional subcontractors, service providers, suppliers, and architects. If a mistake is made on another party's watch or behalf, risk transfer predetermines who is responsible for that risk (and can help ensure it's not you).

Risk transfer is legally binding. It helps distribute risk equitably and move risk to the party that is most equipped to stop it. When established clearly at the start, it can save parties time, money, and even legal trouble when they're not responsible.

What should contractors know?

- **Mind the gaps.** Sometimes, risk transfer policies are drafted by professionals who aren't well versed in the subject. In this case, there can be gaps in contractually assumed liabilities … and you may be left covering the difference. Always have a trusted entity draft and review your risk transfer policy so you aren't the default party left insuring the gaps.

- **Know the options.** Risk transfer is often executed through two common outlets: picking up insurance or drafting a contract. For the first, a contracting party can add specific insurance coverages to cover certain financial and legal risks ahead. With contracts, indemnity clauses and other language can effectively lay out and transfer risk to the receiving party. Both are effective and should be considered when transferring risk.

- **Follow best practices.** Effective contracts should contain things like general acceptance provisions, hold harmless/indemnification agreements, additional insured coverage, minimum insurance requirements and limits for contractors, a certificate of insurance requirement, a safety program requirement, and more. Review effective contracts and check to see if yours follows/includes these best practices.

- **Remember, not all contracts are created equal.** If you've transferred risk in the past, don't assume the details will look the same now. Use a critical eye when reviewing contractual language to ensure nothing was copied and pasted from the last agreement. Just like this project will look different, its risk assumption should, too.

- **Turn to the professionals.** Because your money, risk, and reputation are on the line, don't treat risk transfer as an afterthought. Always use a trained professional who is well versed in the specifics of risk transfer and who can help you and your subcontractors effectively divide risk. Only then will your project be set up for success.

Now that we've answered, "What is risk transfer in construction," you're more prepared to start work with peace of mind. But to add even more protection to the project, we offer construction insurance for your changing needs. Explore our policies, then contact your local, independent agent.