



## Owner-Controlled Insurance Programme in Construction Contracts



### 1. Purpose

This fact sheet provides information on Owner-Controlled Insurance Programme (OCIP) in Construction Contracts for industry stakeholders' reference.

### 2. What is Owner-Controlled Insurance Programme in Construction Contracts?

OCIP is a centrally procured and managed insurance programme arranged for a specific construction project or for multiple contracts. OCIP is procured by the owner to cover all project interests of the contractors and sub-contractors in the project.

The owner maintains risk control and takes up management and administration of the insurance policy.

This arrangement differs from a Contractor-Arranged Insurance Programme where each individual contractor takes out its own insurance policy on different terms, conditions, limits and insurance coverage.

### 3. Coverage of Owner-Controlled Insurance Programme in Construction Contracts

The following are types of insurance coverage commonly included in an OCIP:

- **Contractors All Risks (CAR)** covers physical damage to the permanent and temporary contract works and materials;
- **Third Party Legal Liability (TPL)**, usually Section 2 of a combined CAR/TPL policy, covers third party property damage and personal injuries for which the contractors are liable;
- **Excess Third Party Legal Liability (XSTPL)** provides higher limits of indemnity where required; and
- **Project Wrap-up Employees' Compensation (PWEC)** provides coverage as required by the Employees' Compensation Ordinance for all workers on site irrespective of by whom they are employed and including self-employed workers with waivers of subrogation rights between all parties.

Where required, an Owner-Controlled Insurance Programme may also include the following categories of insurance:

- **Delay in Start-Up Insurance (DSU)** covers delayed commencement of the revenue stream or debt service costs which may be a requirement of a project finance agreement relating to the project;
- **Project Professional Indemnity Insurance (PI)** covers all construction parties engaged in the provision of professional services including the principal, design professionals, and contractors;
- **Environmental Impairment Insurance (EII)** covers pollution clean-up costs and liabilities arising from the undertaking of the project; and
- **Terrorism Insurance** covers damage to the project and other costs associated with the impact of a terrorist act or acts on persons and property.

### 4. Benefits / Limitations of Owner-Controlled Insurance Programme

#### Benefits of OCIP:

- Gives the owner reliable first hand knowledge of the project insurance cover;
- Ensures continuity and uniformity of coverage;
- Avoids coverage gaps between multiple contracts and sub-contracts, giving increased peace of mind to owners;
- Allows the broker to leverage wider coverage at improved policy premiums through larger policies and better knowledge of the project scope and risks;
- Allows improved control of the quality of the insurance underwriters;
- Enables improved control and risk management at the interface between construction and operations cover;
- Enables better and more consistent claims management with simplified insurance administration;
- Enables tendering contractors to take the cost of insurance out of the tender price as insurance risks are separately covered;



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Address: 15/F, Allied Kajima Building  
138 Gloucester Road, Wanchai, Hong Kong  
Tel: (852) 2100 9000  
Fax: (852) 2100 9090  
Email: enquiry@hkcic.org



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- May result in a slight reduction in overall project costs; and
- Minimises the impact of a change of contractor in insurance terms.

### Possible limitations of OCIP:

- Owner may need to pay increased administration costs to establish and manage the programme. This should however be offset by the saving of time and cost which would otherwise be spent on checking multiple policies under a contractor provided programme;
- The OCIP cover may duplicate or overlap with a contractor's annual cover, although carve outs can generally be made by the contractor. (If a contractor has an annual cover, he can declare to his insurer that a particular contract is covered by Owner-Controlled Insurance and requires a carve-out from his annual coverage and with the relevant premium deducted); and
- It is perceived that there might be less safety / risk management incentive for contractors as insurance claims will not impact on the contractor's annual premiums. This is unlikely to happen with reputable contractors particularly if the principal imposes strong risk and safety management obligations in the contract and enforces them on site.

OCIP is widely considered to be of particular benefit for large, complex and/or high risk projects with many contracting parties and interfaces. In such circumstances the benefits of an OCIP will likely outweigh the limitations.

### 5. Considerations when Deciding Whether to Adopt Owner Controlled Insurance Programme in Construction Contracts

The following key issues should be considered when deciding on whether to adopt OCIP in construction contracts:

- For projects undertaken by the private sector or public corporations, the following needs to be taken into account:

corporate governance, risk management, balance sheet protection, interests of financiers and revenue implications for delayed commencement of operations.

- The decision on whether to adopt OCIP should be made after going through a systematic risk management process. Consideration can be given as to which party is best able to manage, identify and assess risks and to determine which risks specifically require insurance.
- Specialist brokers working with specialist construction insurers with a larger volume of insurance placement activities, will generally be able to obtain a broader scope of coverage more cost effectively than individual contracts insured by contractors.
- For large and complex projects with multiple contracts, OCIP is often preferred. Nevertheless smaller projects can also share the benefits of OCIP, especially for smaller specialist installation or fit-out contracts involving extensive interface and overworking. Also, where an owner (such as a retail chain fitting out its stores) requires cover for repeat projects, OCIP may achieve economies.
- Under OCIP the contractors will be responsible for negotiating their own claims with the loss adjusters and insurers and liability for claims exceeding policy limits remains with the defaulting party. For the project principal, OCIP provides the added advantage of transparency, allowing him to be involved in the claims process.
- At the time when an OCIP is negotiated and placed, most of the contracts have not yet been awarded and the contractors' identities have not yet been known. The insurers will therefore take into consideration the reputation and past loss records, and the extent to which the tender documentation demonstrates on-site management controls on safety, risk control and loss prevention.



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### 6. Factors to be considered in the Implementation of Owner-Controlled Insurance Programme in Construction Contracts

- The drafting of insurance and indemnity clauses in contract documents needs to be specific and clear;
- The quality of insurers in terms of financial standing, responsiveness and claim handling needs to be of a high standard;
- A reputable specialist insurance broker should be appointed to advise on risk and insurance programme issues and to negotiate cost-effective policy placement in the insurance market;
- There should be adequate coverage in terms of policy wording, limit, excesses and period of insurance for all insured parties;
- The principal will need to provide information such as the following to the insurance underwriters via their brokers in order to maximise the benefits of the policies (and in due course possibly to comply with policy requirements):
  - value breakdown of the works
  - construction methodology
  - programme
  - geotechnical report
  - relevant information regarding surrounding properties and other construction constraints
  - contractual risk and safety management obligations and procedures
  - details of piling and substructures
  - contract procurement process
- Systemised contractor selection including detailed pre-qualification to procure capable contractors with strong reputation and track records will positively influence insurers' pricing and risk appetite; and
- Implementation and adherence to effective risk management processes.

### 7. Application of Owner-Controlled Insurance Programme Overseas

- OCIP is commonly procured for infrastructure projects, particularly in Europe, North America, the Middle East and Asia. In Latin America and Africa it is still more common for the contractors involved to arrange full project coverage along the lines of the OCIP;
- A significant proportion of major world projects are insured on an Owner-Controlled basis. This can also apply to Private Sector Participation (PPP) projects and other non-government projects where project finance is involved;
- Examples of high profile overseas Owner-Controlled Projects include :
  - The Channel Tunnel
  - The Storebaelt Link
  - Cross Rail, London
  - The Panama Canal Expansion
  - 2012 London Olympics Venues
  - Freedom Tower, New York
- Major retrofit programmes for power stations (whether nuclear, thermal or hydro), oil and gas fields on and offshore, oil refineries and petrochemical plants also work under Owner-Control policies;
- In Macau, the major casino complex projects have been developed mainly by international corporations and the majority of these projects have been undertaken using Owner-Controlled Insurance Programmes, following experience on large multi-use developments in Hong Kong and worldwide; and
- With regard to government agencies and corporations globally, there is no predominant preference for a particular type of insurance programmes as different organisations may take a different view on what is appropriate. Some government agencies do not insure their projects at all while others take out OCIP or impose strict contractual insurance obligations on their contractors.



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## Owner-Controlled Insurance Programme in Construction Contracts



### 8. Application of Owner-Controlled Insurance Programme in Hong Kong

- Owner Controlled procurement of project insurance coverage in Hong Kong was introduced by MTRC who has developed infrastructure projects since the late 1970s using specialised forms of contract and project management techniques including OCIP for contractors all risks and third party liability. MTRC has adopted OCIP for all of their railway construction projects;
- By the mid-1980's OCIP was used by both power companies for their new power station construction. OCIP was also adopted for the residential redevelopment of the Caltex Oil Terminal and for the City Polytechnic New Campus;
- The next milestone was the New Airport Core Programme (ACP) which commenced in 1991. The size and scope of the ACP introduced new project management and contracting practices and it was realised that OCIP would be necessary to control the integrated insurance for such varied construction works throughout Hong Kong. A specialist construction insurance broker was appointed by the Provisional Airport Authority for the construction of the new airport at Chek Lap Kok and by the NAPCO of Works Branch for the government transportation infrastructure from Central through West Kowloon and North Lantau including the Lantau Link bridges to the new airport. The MTRC arranged their third OCIP for the Airport Rail Link Construction;
- Following the experience with employees' compensation claims relating to the ACP contracts which were individually insured with many insurance companies via contractors which resulted in extensive litigation and subrogation lasting up to 10 years, the concept of PWEC was developed to overcome these problems. This covers all workers on the project irrespective of by whom they were employed, including self-employed workers, and provides waivers of subrogation rights between all parties to the project;
- After the ACP from 1989 through 2010 a series of major infrastructure projects were undertaken adopting OCIP and PWEC. These projects include:
  - Highways Department – Route 8 (Stonecutters Bridge, extensive viaducts and three tunnels) the Deep Bay Link (extensive viaducts) and the Shenzhen Western Corridor (bridges constructed over water)
  - MTR Corporation – Tseung Kwan O Line, Quarry Bay Relief and Disney Resort Line
  - Kowloon Canton Railway Corporation – West Rail, East Rail Extensions (Ma On Shan Railway, Tsim Sha Tsui Extension and Lok Ma Chau Spur Line) and the Kowloon Southern Link
- During this period the Cyberport Development, Ocean Park and Disneyland projects were all undertaken by OCIP and PWEC. Subsequently a number of major high-rise multi-use structures and the CX Cargo Terminal have adopted OCIP;
- MTRC has adopted OCIP for 5 railway projects (West Island Line, South Island Line (East), Kwun Tong Line Extension, Express Rail Link and Shatin to Central Link) currently under construction; and
- West Kowloon Cultural District Authority has also implemented the OCIP for its venue construction projects.



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