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# Is “The Sky Is Falling” in the Current Strata Insurance Marketplace?

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**T**oday’s hyper-attention on “strata insurance” has likely caught the attention of 30% of BC’s 5,071,000 residents who live in 32,218 filed strata plans comprised of 671,351 active strata lots. (Land Titles Office, September 1, 2019)

Many strata corporations are caught in a “Hard Market” with premiums going up and coverage going down. A key question is: Are insurers price-gouging or transferring some of the risk back to each strata plan?

In the past, insurers found strata insurance a profitable class of business. Currently, to a number of insurers that found it unprofitable, it has become a very unpopular risk class.

To avoid the catastrophic paralysis we saw in Chicken Little’s “The Sky Is Falling Down” scenario, it is important

- to understand the contributing factors external to each strata’s insurable risk profile, and
- to explore internally controllable remedies.

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## Legislative Insurance Parameters

Unlike aging or the wear-and-tear of common assets or property that are the strata’s responsibility to repair under section 72 of the *Strata Property Act*, the principle underpinning strata insurance is that coverage is provided for damage or loss associated with a specifically unpredictable event. While probability factors into premium-setting, deductibles, and scope of coverage, insurable damage or loss hinges on unpredictability.

The *Strata Property Act* (the “Act”) prescribes that each BC strata corporation must, not should, obtain and maintain full replacement value insurance against major perils to cover its common assets, common property, buildings as shown on the strata plan, and, other than for bare-land stratas, those fixtures built or installed as part of the original construction. See section 149 and Reg 9.1.

While aircraft impacts, civil commotion, explosion, fire, hail,

lightning, malicious acts, riots, smoke, strikes, vandalism, vehicle impacts, water escape, and windstorm are the Act’s prescribed 14 major perils, even though 60% of BC’s population is near the tectonic edge, earthquake insurance is, if available, optional. See sections 149(1) and (4)(b) and Reg 9.1(1) and (2) of the Act.

Strata “insurers” are not a single entity. It is not uncommon for a strata’s insurance to have 20 or more participating insurers, each insuring different parts of the risk such as: Directors and Officers Liability; Employee Dishonesty; Environmental/ Pollution Liability; Equipment Breakdown; General Liability; Glass Breakage; Money and Securities; Privacy Breaches; Property Damage; Robbery; Terrorism; Volunteer Accident; or even Earthquakes.

## Price-setting Variables Beyond Strata Control

Perhaps the most tangible factor in setting a strata’s insurance coverage is its claims experience. While some strata minutes obfuscate or understate its claims experience to its owners, others incorrectly conceal disclosure by misapplying privacy legislation. Even if a claim were unreported either to the strata’s insurer or to

an owner's insurer, when the data surfaces, actuaries strategize how best to recapture some, or all, of those losses having occurred during the most recent insurance period.

Perception also factors into rate-setting. With risk assessment analytics, there is a significant correlation between a strata's prior claims and the perceived likelihood of future claims. Additionally, there can be a perceived cloning relating the risk profile experience of other similar strata plans, often geographically proximate. The percentage of rentals is one such risk profile variable. In spite of their modernization and prestige, the skyward-seeking high-rises present compounding unique risks, particularly concerning water loss damages.

More intuitively and less strata-plan specific, projecting how local, global, behavioural, environmental, or geological risks might impact claims are factored in by actuaries. Actuaries can also factor in recapturing losses from external geographic areas into the BC marketplace.

A less known underwriting factor is each strata's position on the "Fire Underwriters Survey" [FUS], integrated by actuaries and underwriters in almost all Canadian property insurers. Using proprietary software, based on standardized measures across Canada, this FUS survey graphically and visually presents each community's ability to prevent and control expected fires.

A key in FUS's underwriting assessment is that the evaluation is not strata-complex specific, but analyzes the community in which it is situated, covering such variables as Emergency communications; Fire equipment; Fire halls; Hydrant locations; Risk distribution; Road networks; Water deliver reliability; and even public education.

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With the Act requiring full replacement value insurance, the sum insured is directly correlated to each strata's annual insurance appraisal

by 3rd-party firms. Such compounding figures are a compendium of increasing property values, labour and material repair costs, as well as the time, given possible labour shortages, projected to repair the strata along with the offsite accommodation of its residents during the rehabilitation. In some major losses, it might take over 6 months even to get the required building permit to commence repairs.

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Beside the drain of claims expenses, certain economic principles factor into the current Hard Insurance Market. Each insurer's shareholders have return on investment expectations. With low interest rates, claims expenses more directly undermine shareholder profitability. Given low rates of return, or even worse, perceived lowering returns, many investors elect to cut their losses and invest in alternate industries, or even the same industry but in completely different geographic arenas. To stem the loss of investors, insurers may raise premiums to provide a more attractive shareholder rate of return.

With an exodus of insurance investors, supply and demand economics becomes significant. With a reducing supply of insurers and a demand for strata insurance—the Act requires that stratas must have insurance; following the theory of supply and demand, prices rise. Additionally, with a contraction of supply, the remaining insurers may simply not have the capacity to provide insurance. Those insurers may calculate their overexposure to loss or are restricted by the statutory reserves required to issue insurance.

Additional contractions are also driven by Canadian Insurers moving toward the International Accounting Rules impacting their Actuarial Reserves. For those insurers electing to continue in the strata marketplace,

to remain compliant with the required statutory reserves, they may need to raise the level of deductibles, thus transferring part of the risk back to each strata corporation.

While most stratas are only aware of the upfront or name of any participating insurer, almost all participating insurers share a portion of their risk with another insurer(s). Those insurers sharing the risk with the participating insurers are termed "reinsurers."

For a premium charged to each participating insurer, the risk-sharing reinsurers consider all the same price-setting variables as do the participating insurers. While many reinsurers may work in a symbiotic relationship with the participating insurer, reinsurers also have the capacity to further influence pricing and/or restrict coverages.

Compounding the potential anonymity between the participating insurers and their reinsurers is the strata's insurance brokerage firm. Known as "White Labelling," each of BC's 3 major strata insurance brokerage firms assemble a number of participating insurers under each of their respective insurance brokerage firm's brand label.

While it may or may not be disclosed to owners, for property insurance every taxable insurer must pay the government 4.4% of its net taxable premiums under the *BC Insurance Premium Tax Act*, section 3(a.1).

Concerning the particulars provided to most owners, usually all they receive is a 1 or 2 page certificate of "Insuring Agreements" listing the "Limits" for the various types of risk and each of their respective "Deductibles." While the strata corporation should receive all the policy particulars including the listing of participating insurers, some strata councils or strata managers may not pass on that information to owners.

While there is currently no data as to the number of stratas being adversely impacted in this Hard Market, even by excluding the impact of a strata's specific claims experience,

the net impact is the likelihood that many stratas are susceptible to the external price-setting variables resulting in any combination of increases in premiums, deductibles, and/or restrictions in coverages.

While reportedly some stratas have had their coverages cancelled or not renewed, those situations are most likely precipitated by excessive prior claims or a perception that somehow those stratas are on the precipice of a pending disaster from either internal or external claim causes. Regardless, under BC's *Insurance Act*, the insurer must not cancel or alter the insuring contract without giving notice to the person, which for stratas would be the strata corporation or its authorized representative. See section 28.

### **Taking a Proactive Leadership Role**

With approximately 2/3rds of each strata's insurance premiums more determined by external factors, it is important to focus on the 1/3rd over which each strata has some control.

While the Act requires each strata corporation to have full replacement value insurance, there is no such requirement for owners or residents on their strata lots. While some stratas have passed bylaws requiring that owners "must" have insurance, such is likely a breach of the Act in that any bylaw is unenforceable to the extent that it contravenes the Act, which in the case of a strata lot owner's insurance is optional. See sections 121(1)(a) and 161(1).

A conundrum in multioccupant units such as strata corporations whereby all owners have shared ownership is that while the majority may be risk conscious and strive to avoid precipitating claims, a minority who may be less so can skew the claims experience for the entire strata corporation.

While in some cases recovering claims-related expenses may be like trying to get blood from a stone, well before any future claims issues arise, stratas should retain knowledgeable legal counsel to draft an encompassing chargeback bylaw to recapture the cost of a claim, thus lessening the strata

corporation's burden. Even though such may reduce the premium impact, however, stratas will still be adversely affected by such a claim, although potentially on a reduced scale that may not be factored in for several years.

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Subject to a strata's structural nature, another bylaw strategy may be the creation of strata lot Types or Sections. In addition to allowing for a differential sharing of operating expenses, and in some cases contingency reserve fund expenditures, this may compartmentalize the full replacement value limits and deductibles, particularly those expressed as a percentage. See sections 92, 96, 97, 191(1) and (2), and Reg 6.4, 11.1, 11.2 and 11.3.

One of the most proactive strata-driven strategies is the development of a multifaceted risk reduction plan. Such a plan details how to reduce and/or prevent losses attributable to such major causes as water escapes and fire. For the most frequent type of loss, water claims, how is your strata addressing such things as absences from strata lots; appliance hoses; drainage systems; shut-off valves; sprinkler heads; or washer drains?

While fire ranks as the 2nd most frequent class of strata losses, it is usually the most costly. Does your plan cover BBQs; evacuation plans; fire extinguishers; grow ops; immobile occupants; smoke and CO2 detectors; smoking; and even prevention and intervention education?

While volunteers within a strata may work toward drafting such plans, hiring an external objective expert who routinely sees multiple situations will likely return exponential dividends

on the prevention side as well as implementing a plan to mitigate loss if any such occurrence were to occur. With their significance being skewed by local geography, such a plan should also include the traditionally lesser severe claims due to equipment breakdown, floods, freezing, and sewage back-ups.

In addition to such physical claims, consideration needs to be given to those human-based claims ranging from theft and vandalism to suits against the strata corporation and/or its strata council. See section 163.

When written by appropriately designated professionals rather than well-intended volunteers, risk management plans have authoritative credibility when being considered during the underwriting process. An important administrative component to such risk prevention will also include the protocols and documentation required for strata lot alterations that will expand on the Act's Information Certificate disclosures. See section 59(3)(c).

In addition to bylaws and risk-reduction plans, marketing your strata to the insurers, that may include more than the strata's current list of insurers, is paramount. Such a goal is to differentiate the various ways your strata stands out from all other stratas with your strategies to prevent or manage claims.

How does your strata stand out from the crowd?

In the insurance renewal process, there are seemingly only two key dates, with the more obvious being the policy period that may or may not have any relationship to the strata's fiscal year-end. A lesser known date for most insurances is that the 3rd party "Insurance Appraisal" needs to be completed within 3 months of the strata's renewal date or there may be a coinsurance factored into the coverage.

While there is a tendency for some property management firms to renew the majority of their stratas on a common renewal date, sometimes these bulk renewals overwhelm the underwriters who are then less able positively to assess those stratas that

are not just “one of the crowd.” There is absolutely no restriction on a strata initiating discussions well before its policy renewal date.

When completing an insurance renewal application, that is not the time to be fuzzy or omissive. Full disclosure will gain trust with the underwriter by lessening their professional inquisitiveness as to “What is this strata not telling me?” In addition to the insurer’s renewal questionnaire, the strata would be well advised to add supplemental materials covering their risk management plans as well as even particulars that may be less than favourable.

The Courts do not look favourably on those situations whereby elements that are material to the assumption of risk were not disclosed in advance. A poor alternative to nondisclosure is to pay insurance premiums and then have a claim denied based on material nondisclosure or misrepresentation.

Part of the strata corporation’s insurance premiums are to cover the operational costs of its insurance agent or broker. As currently permitted by the Insurance Council of BC, their share of the premium may include the payment of referral fees to an unlicensed third party.

### **Who Takes Leadership?**

Given the Act’s requirement that each strata corporation must have property insurance, those powers and duties are to be performed by the strata council as long as each council member acts honestly in exercising the care, diligence, and skill of a reasonably prudent person in comparable circumstances and that there is no direct or indirect conflict of interest. See sections 4, 26, 31, 32, 149.

In situations whereby an owner senses any degree of nondisclosure concerning either insurance claims and/or the renewal process, and such owners are dissuaded from accessing such information, the Act prescribes two readily available remedies.

Under the Act’s section 36, an owner has access to strata corporation records, of which section 35 lists the records the strata corporation must

maintain, and Regulation 4.1(2) to (7) prescribes the time frame such records must be maintained ranging from a minimum of 2 years to permanent.

While no fee may be charged to an owner or authorized person inspecting the documents under section 36, the strata corporation may charge that person up to \$0.25 per copied page. See sections 35, 36, and Reg 4.1, 4.2.

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The other internal option is that persons holding at least 20% of the strata corporation’s votes may demand in writing that the strata corporation hold a special general meeting to consider a specified matter and that such a meeting must be held within 4 weeks and that the specified matter is to be the first item on the agenda. See section 43.

As an alternative to an owner applying to BC’s Supreme Court to prevent or remedy unfair acts, a second external option is to file a Dispute Notice with the Civil Resolution Tribunal for its consideration. See sections 124, 164, and 189.1.

While the Act requires strata corporations to have full replacement value insurance, this can protect what is likely each owner’s most valuable asset, his or her strata lot.

In the event the strata corporation was responsible for a misrepresentation (innocent or intentional) in the insurance-renewal process, each owner is exposed to his or her proportional share of a judgment against the strata corporation. See section 166. ▲

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