STRATA COMMUNITY INSURANCE

Insurance and Strata Managers

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The Strength of Experience.

Recent debate concerning the receipt of insurance commissions by Strata Managers has highlighted the need for managers to ensure that the insurance policy is chosen for the right reasons, all of which are unrelated to the commission it attracts.

The industry needs to ensure that the choice of a particular insurer by a Strata Manager is always the result of a very careful analysis of what is being offered and their suitability taking into account certain key criteria. Strata Managers often influence the choice of policy and where this occurs it is important that the outcome is the best one for the scheme.

Key criteria

The range of considerations when choosing a cover include (in order of importance) the following:

1. The strength and performance of the insurer.
2. Whether their policy satisfies the specific insurance requirements of the governing legislation.
3. The extent of the cover.
4. The amount of cover.
5. The cost.

The commission paid to the manager (if any) is not a factor to be taken into account.

The insurer

The fact is that some insurers are more financially sound than others and some have a better record than others when it comes to paying claims promptly. There are independent sources Strata Managers can access such as Standard & Poors[1] that provide guidance on financial strength. Brokers with strata experience can provide guidance on the financial standing of insurers, but generally won't do so unless instructed to provide such advice in writing. Importantly, Strata Managers who have traded with a variety of insurers over the years are often able to assess the insurer's record in paying claims promptly. The timeliness of payments can have a significant financial impact on cash flow and investment income on funds held at bank. The importance of a rigorous financial assessment will not be lost on those who lost heavily when HIH Insurance Ltd collapsed back in 2001.

In NSW for example the insurer must be an "approved insurer", although the mere fact that an insurer is "approved" does not remove the need for that rigorous financial assessment.

The policy

To some extent all strata legislation specifies the type of policy required for schemes and their buildings.

While the specific legal requirements and terminology used differs between each jurisdiction, there are some common elements. For example:

- All States and Territories require insurance for "replacement" or "reinstatement" value.
- Most legislation explicitly requires cover for costs incidental to replacement or reinstatement. Terminology used varies, and may refer to preliminary demolition work, removal of debris, fees of architects and other professional advisers, and surveying, architectural or engineering work.

[1] http://www.standardandpoors.com/ratings/property-casualty/ratings-list/en/us/?sectorId=1221186658105&subSectorCode=37&subSectorId=1221187347856&countryVal=AUS

- Public liability insurance – in respect of damage to property, death or bodily injury – is a requirement in each jurisdiction, although prescribed minimum amounts vary. In one jurisdiction this is expressed in terms of a requirement to insure against "liability in tort", while some, but not all, legislation explicitly extends the requirement to also cover "illness".
- Most legislation also refers to "other types" of insurances, which are expressed as being mandatory (such as fidelity guarantee insurance in South Australia and voluntary workers in NSW) or optional. Further, where "other" insurances are expressed as optional, they are in same cases – but not all – limited to particular types of insurance.

Someone has to undertake an assessment to ensure that the policy complies with the technical requirements of the particular jurisdiction. The Strata Manager needs to ensure that this is done thoroughly.

The cover

Not all insurance policies provide the same cover. Some may cover some events or items but not others. Some limit or remove the cover by exclusions, either totally or in certain circumstances. Sometimes the nature of the building (e.g. mixed use or holiday apartments) or the nature of uses within the building (e.g. a fish and chips shop) may affect the cover.

Each policy needs to be assessed and compared with their competitors to determine the suitability of the cover for the building and its comprehensiveness.

Some policies provide cover on things which are not required by the governing legislation, such as cover for the cost of alternative accommodation in the event the building has to be evacuated. These 'nice to have' additions need to be included in any assessment of the competing covers. It is important that owners are made aware that insurance is a risk transfer mechanism, one that forms an integral part of financial management of owner's liabilities. The broader the insurance cover, the less owners need to fund from the reserves of the Body Corporate or from call ups. The cost of insurance needs to be assessed within this risk/reward trade off.

Amount of cover

Again, the amount of cover required must be determined with reference to the governing legislation. It must be sufficient to achieve the outcomes required by the legislation (e.g. replacement or rebuilding of the building).

Generally speaking, the required sum insured should be calculated by adding together:

(a) estimated rebuilding costs (on a replacement and reinstatement basis);

(b) estimated cost of removing debris; and

(c) incidental costs including fees of architects, consultants and other professionals.

In addition, provision for escalation of costs should be factored in to the calculation – in terms of the amount by which (a), (b) and (c) above may increase over the approval and rebuilding process. NSW stands alone in prescribing this as a legal obligation, requiring calculation of cost escalation within 18 months of commencement of the policy. Experience suggests, however, that this requirement is inadequate. Best practice would entail that such calculations should be taken into account in each jurisdiction – and allow for a period of 18 months to 2 years from the expiry of the policy (depending on the size and complexity of the rebuilding process).

The most effective way to determine an appropriate figure in accordance with the above is to undertake regular valuations. Here again we see jurisdictional differences in approach, with some States requiring valuations at least every five years, and others remaining silent on the subject. Irrespective of the legal requirement, regular valuations are essential in helping to prevent underinsurance – which is illegal under all governing legislation – and which can result in substantial loss to owners in the event of a major incident. Further, indexing limits each year to take into account building cost inflation between valuations is essential.

The cost

This is the least important of all the criteria to be considered by Bodies Corporate. But sadly, it is often the first and only factor that is considered. This is where the Strata Manager can add real value for a Body Corporate – by ensuring that the owners focus on the other more important criteria.

In particular, cost needs to be assessed against each of the other 4 criteria, but particularly the extent of the cover, to determine which combination is the best value for money. Experience suggests that the cheapest premium often does not equate with the best value for money, particularly when it is compared to the breadth of risk transfer (less liabilities for owners to self-fund). It is not unreasonable for owners to select higher cost insurance policies having performed such an assessment.

Conclusions

The process for a Body Corporate to choose an insurer is not an easy one. It is a process in which the Strata Manager should be involved in a supporting role. The most important thing is to approach the process in the right way. This involves putting the question of cost aside and focusing on the other more important criteria. Once those criteria have been assessed, then the question of cost can be meaningfully considered – the test being the determination of the 'value for money' proposition having regard to all relevant criteria.

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Strata Community Insurance would like to both acknowledge and thank Gary for his independent contribution on this topic. More detail on Gary can be found at www.bugdenlegal.com.au