

DECEMBER 2020

Strengthening Foundations

A Report on the State of Strata Property
Insurance in British Columbia

BCFSA 

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The Honourable Selina Robinson
Minister of Finance
PO BOX 9048
STN PROV GOVT
Victoria, B.C.
V8W 9E2

AND TO

The Honourable David Eby, QC
Attorney General and
Minister responsible for Housing
PO BOX 9044
STN PROV GOVT
Victoria, B.C.
V8W 9E2

December 18, 2020

Dear Ministers:

I am pleased to deliver this report, *Strengthening Foundations: A Report on the State of Strata Insurance in British Columbia*, prepared by BC Financial Services Authority (BCFSA).

This report follows on the release of BCFSA's Interim Report on June 16, 2020. It is the culmination of our findings from our investigation, inquiries and stakeholder engagement sessions. The report outlines the key factors affecting the health of the strata insurance market in B.C. It is intended to inform B.C. government and the public of the issues needing to be addressed in order to make this very important market more stable and sustainable.

BCFSA recognises how the current unhealthy market is impacting affordable housing and quality of living for British Columbians. BCFSA welcomes an opportunity to discuss this report with the Provincial Government and other stakeholders.

Yours truly,

A handwritten signature in black ink that reads "Blair Morrison". The signature is fluid and cursive, written in a professional style.

Blair Morrison

Chief Executive Officer
BC Financial Services Authority

1. Executive Summary

INTRODUCTION – AN UNHEALTHY MARKET

BC Financial Services Authority (BCFSA) is pleased to release its final report on strata corporation property insurance (strata insurance) in British Columbia (B.C.). BCFSA released an interim report on June 16, 2020¹ which concluded the current state of the market in the province was “unhealthy”. From a consumer perspective, the net effect of this unhealthy market has been rapid increases in costs associated with obtaining strata insurance coverage. For the insurance industry, a lack of profitability combined with a variety of other factors has prompted many insurers to leave the market, further driving up premiums for consumers and creating significant capacity challenges.

Following the interim report release, BCFSA committed to continue its analysis of the issues. It conducted an engagement program with stakeholders in order to provide government with a comprehensive report on the issues facing strata insurance along with possible ways to help improve the state of B.C.’s strata insurance market (the market) for consumers. This final report provides insight into how and why strata insurance premiums continue to rise across the province.

THE PERFECT STORM

Over the course of the past year, the market has faced near unprecedented increases in premium rates and deductibles. What has been occurring in this province is not typical. A convergence of factors has contributed to this situation, some specific to the local market, while others are global in scope. These factors have created what could be considered a perfect storm, which has led to dramatic year-over-year strata insurance premium and deductible increases for consumers and an unsustainable market for insurance providers.

Although BCFSA’s findings provide an in-depth analysis of the factors that culminated to put B.C.’s strata insurance market in its current position, the reality is there are no simple solutions. Although the rate of increase can be mitigated with the right actions, complex local and global issues as well as significant natural risk factors such as earthquakes and the impacts of climate change provide little prospect of short or medium-term relief from further pricing increases.

¹ <https://www.bcfsa.ca/pdf/publications/StrataInsuranceFindingsReport.pdf>

CONTRIBUTING FACTORS AND POSSIBLE SOLUTIONS OUTSIDE BCFSA'S REGULATORY CAPACITY

The factors influencing strata insurance premium increases are varied and complicated. They need to be addressed by all parties to return stability to the market and assist in its return to a healthier state.

- **Loss Reduction** – Claims costs and claims experience have the single biggest influence on premiums and deductibles. The higher the overall loss experience is in the market, the higher the premiums will be. Insurers will start to readjust their prices when they see sustained reductions in their overall loss experience. Until that point, premiums and deductibles will remain under pressure and are likely to continue to increase for some properties.

In B.C., the market has also been underpriced for more than a decade and as claims costs have continued to increase, it has caused significant losses for insurers. Historically, insurers have been able to subsidise some of these losses through investment returns but with a prolonged market of low investment yields, insurers have become more reliant on the need for outright underwriting profit.

- **Catastrophe Exposure** – Insurers have been facing increasing losses from catastrophic events, both here in Canada and globally. This has put additional pressure on insurers profitability and capital. Additionally, as densification occurs, it increases concentration risk exposure for insurers, especially for earthquake risk.

Federal and provincial governments need to address the excessive exposure insurers have to earthquake risk in some parts of B.C. and to other types of catastrophic losses like flooding. Exposure to catastrophic risk, especially earthquake, is a key factor, along with profitability, influencing insurers' participation in the market and impacting premiums and deductibles.

- **Education** – Insurers, brokers, strata councils, strata property managers, municipalities, builders, and developers need to collaborate on improving information sharing between stakeholders and improving consumer education. Consumers who live in or own a strata unit would benefit from enhanced knowledge of their property's risk profile and a better understanding of how it could impact their premiums and deductibles prior to entering into a purchase agreement. Insurers, municipalities, builders and developers could also benefit from sharing information that may lead to more proactive risk mitigation in future strata property developments.
- **Risk Model Changes** – Changes to risk models have required insurers to set aside more capital to cover potential losses. Reinsurance costs have risen. These factors are not unique to the B.C. strata insurance market, they are impacting commercial insurance markets everywhere and have created significant price increases in Canada and globally. It is causing insurers to rethink what markets they wish to participate in and results in them raising prices.
- **Lack of Premium Increases** – The amount of recent increases in B.C. could have been less dramatic if premiums over the past number of years had been gradually rising with claims costs. Also, if prices had shown more gradual increases it may have encouraged some strata councils to address potential repair or maintenance issues.
- **Building Construction** – Increases in density and value of properties, rising construction costs, and an overall increase in the cost and quality of the fixtures found in strata properties have also impacted premiums. Insurer representatives expressed interest to being involved in discussions regarding new or amendments to building codes so they could provide information related to the impact the changes could have on insurance costs.

- **Increasing Insured Value** – As overall total insured value (TIV) in the market increases, more supply of insurance is required. TIV can increase due to demand from population growth, larger buildings, and construction costs. Buildings with very high TIV often require more insurers to participate in the coverage and magnifies exposure concentration for insurers reducing the number of properties an insurer can underwrite.
- **Innovation** – Insurers and insurance brokers need to be more innovative and look for alternative ways to offer insurance to enhance the supply of insurance. The market has significant supply challenges. Supply is defined as the amount of insurance (or reinsurance) companies are willing to commit to an insurance market. BCFSAs believes industry and other key stakeholders need to offer different types of products that could support existing and future expected demand.
 - **B.C. Private Sector Insurance Company** – BCFSAs believes that market participants (global insurers, strata owners, investors) should explore the option of a B.C. incorporated private sector insurance company or reinsurer to provide additional supply. The supply can be targeted towards a specific part of the market, such as strata properties up to certain TIV, or toward the excess loss portion, the hard to fill portions, and/or the broader market. Additional supply is needed and BCFSAs sees the creation of B.C. incorporated private sector insurers as a way to help address this issue.
- **Private-Public Partnerships** – BCFSAs is aware that there has been discussion in the media about the use of a public insurance model to provide strata property insurance. While there is no factual basis to show this option would provide dramatic improvements to the situation, particularly without other factors also being addressed, the merits of a public-private partnership model should be explored to achieve long-term supply stability by addressing more extreme catastrophic risk exposure and reducing concentration risk of private insurers.
- **Captive Insurance** – B.C. is the only jurisdiction in Canada with captive legislation. Since the creation of the captive legislation, substantial innovation has occurred in captive structures internationally, some of these newer structures could provide even greater flexibility for strata corporations. Further exploration on legal captive structures could be pursued for the B.C. market.

WHAT BCFSAs CAN DO

As the regulator, BCFSAs has identified that it can work to address the following areas:

- **Data Gaps** – Strata insurance data is not part of information that insurance regulators across Canada regularly collect. As such, BCFSAs had to make special requests using its regulatory powers to obtain the data informing this report. Moving forward, BCFSAs will be working with its regulatory colleagues in the Canadian Council of Insurance Regulators (CCIR)² to seek the regular collection of strata insurance data.

- **Home Warranty Insurance** – BCFSA intends to continue to work with B.C. Housing and B.C. government on issues regarding claims under home warranty insurance³. During the engagement sessions, many stakeholders noted that it was not always clear if a claim should be pursued through a home warranty program or as a strata insurance claim. Another matter raised was the need for clarity whether consequential damage is covered under home warranty insurance. All of this indicates a potential lack of working knowledge or awareness around the appropriate and inappropriate use of claims under home warranty insurance versus claims made under strata insurance policies.

ELIMINATION OF BEST TERMS PRICING

One of the factors BCFSA identified in the interim report that was contributing to some of the increase in premiums was the industry practice known as Best Terms Pricing (BTP) that was used to construct many policies in B.C. When insuring strata properties with multiple insurers involved, each insurer submits its own bid on price and terms. This can also be known as insuring under a subscription policy. Under BTP, strata owners were paying a premium based on the highest of those bids, even if the majority of quotes were lower.

BCFSA is pleased that thanks to its efforts, BTP will be effectively removed from the market in B.C. by the end of 2020. Since the release of the interim report, BCFSA has been engaging with industry to ensure that this practice ceases. Insurers and insurance brokers have been cooperative. Each has played a role in implementing measures to stop the practice. BCFSA recognised a small adjustment period was necessary to allow industry to make operational changes to remove the practice by year end without causing withdrawals from the market.

While the removal of BTP will help alleviate some of the upward pressure on premiums, it was not the sole reason for those premium increases and as such, its elimination will not result in premium reductions.

NO SIMPLE SOLUTIONS

It will take time, effort, and cooperation by all stakeholders in the strata insurance market to address the foundational issues at play in B.C. This includes strata councils, owners, insurers, insurance agents and brokers, strata property managers, property developers and builders, as well as federal, provincial, and local governments. There are no simple solutions.

Overall, strata insurance claim costs need to be reduced and show signs of sustained reduction. In discussions with industry, BCFSA heard that a three to five-year horizon of demonstrated and sustained improvement in losses may be required before premiums will significantly adjust. This means addressing the root causes of what claims are being made and why. As such, stakeholders need to consider the type of supports that can be provided to strata councils, owners, and property managers as well as builders and developers to better prevent the issues that lead to claims from happening in the first place.

Together with stakeholders, BCFSA will continue to work towards finding strata insurance solutions, including advice and support to B.C. government.

² The Canadian Council of Insurance Regulators (CCIR) is an association of insurance company regulators from each jurisdiction in Canada. CCIR members work collaboratively to develop solutions to common regulatory issues.

³ In 1999 the B.C. government implemented a new program mandating that any new home built for sale in the province be covered by a mandatory warranty providing two years on labour and materials, five years on the building envelope, including water penetration, and 10 years on the structure of the home.

2. Background

BCFSA'S INVOLVEMENT

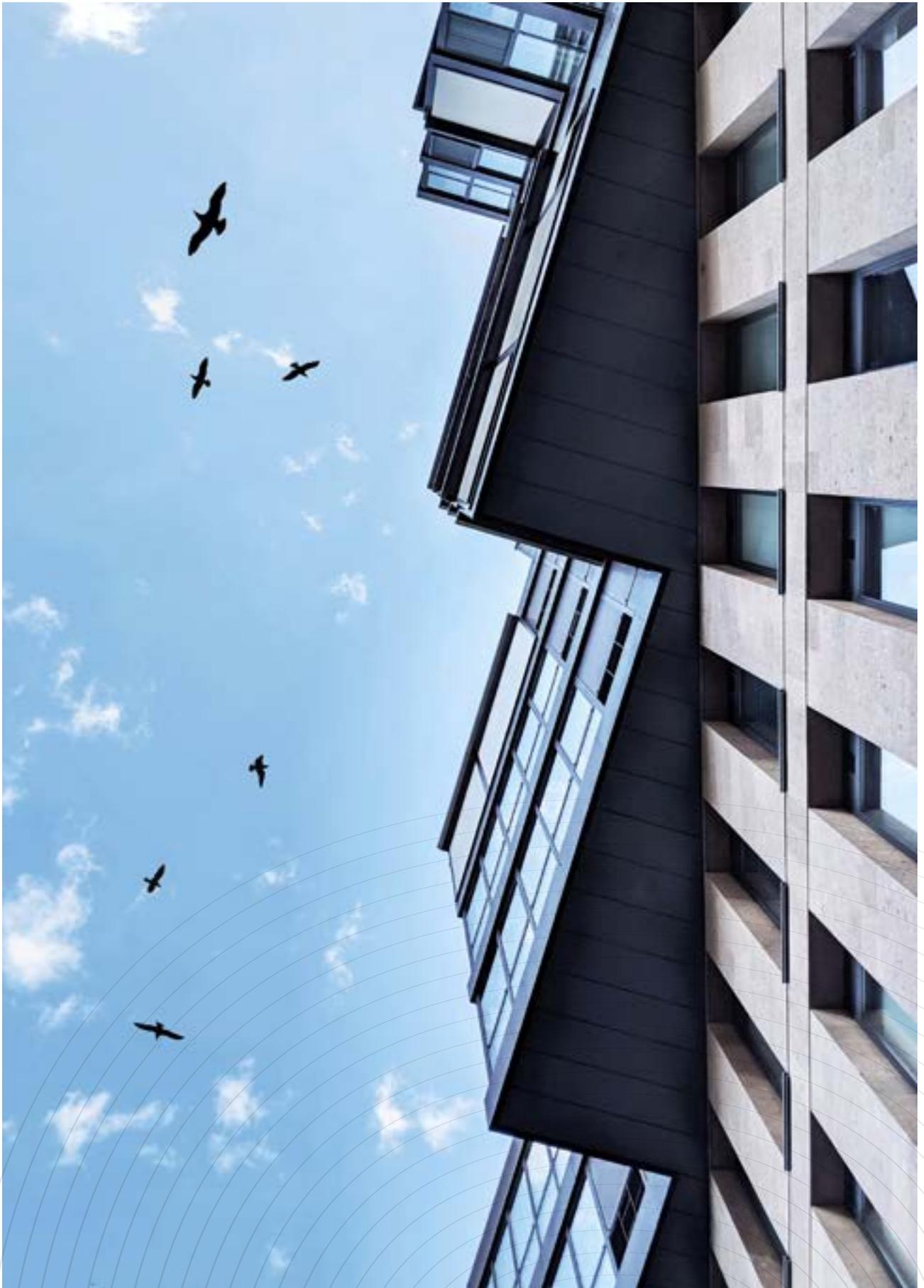
BCFSA is a crown corporation established by the B.C. government to regulate certain sectors of the financial industry, including private sector insurance companies operating in the province⁴. BCFSA is also mandated to ensure that the private sector insurers are solvent, engage in appropriate business practices, and act against unsuitable parties and inappropriate practices if required. Rates in the private sector insurance market are determined by competitive market forces and are not regulated by the B.C. government. BCFSA does monitor the market and acts when it identifies inappropriate business practices. BCFSA also collaborates with other regulators involved in B.C. and across Canada's insurance market to deal with broader national issues.

In early 2020, BCFSA began a fact-finding task to better understand the premium and deductible increases consumers were facing in the strata insurance market (the market) see Appendix 2. Subsequently, BCFSA was asked by the B.C. government to formalise its research efforts to confirm changes in premiums and to gain further understanding of the underlying factors causing the increases. As a financial service sector regulator, BCFSA is provided legislative authority by the provincial government to inquire and collect data, additionally it has the expertise to investigate this matter for the public. As an integrated regulator, BCFSA is also well equipped to identify cross-sector impacts through coordination with other regulators when regulatory oversight overlaps.

BCFSA's initial strata insurance research and data collection were structured to obtain a representative sample of information that would provide a data-driven picture of annual premium changes, the scope of change, and the underlying factors. In June of 2020, BCFSA issued its findings in an interim report to the B.C. government, which provided the first in-depth analysis of the issue throughout B.C. The interim report illustrated that B.C.'s strata insurance market is challenged by long-term price stability and sustainability issues and is not currently fulfilling B.C. strata residents' needs. The report also acknowledged that all participants involved in the market have a role to play to return it to a healthy state.

Subsequent to the interim report release, BCFSA continued to engage stakeholders to discuss the analysis to date, obtain additional insights, and validate assumptions of factors impacting the market. This report presents BCFSA's conclusions on the underlying factors contributing to instability in the market, provides recommendations on items related to BCFSA's regulatory oversight, and identifies potential next steps for additional action.

⁴ BCFSA was established as an independent crown agency in 2019, replacing the Financial Institutions Commission (FICOM) as the regulator responsible for provincially regulated financial institutions.



SUMMARY OF ISSUES

Interim Report Key Findings

In February 2020, BCFSA initiated inquiries under Section 213 of the *Financial Institutions Act* (FIA). Working with three of the major strata insurance brokers (brokers) and insurers with the largest market share of strata insurance in B.C. BCFSA obtained data and other information regarding price increases and availability of insurance. Detailed information on this specific market had not been part of the data that Canadian regulators had previously collected from insurers. The data calls were specifically limited to obtaining a sufficient representative sample, designed to draw broad market observations of the strata insurance industry in B.C.

The interim findings indicated the following:

- **Premiums have risen** – Data collected in January and February 2020 indicated that premiums on average were up by approximately 40 per cent across the province (higher in some areas) while deductibles had increased up to triple-digits over the previous year.
- **Price pressures will continue for high risk strata properties** – Data indicated buildings considered to be high risk were facing the most significant increases. On top of that, media was reporting some properties were struggling to obtain full replacement value insurance coverage as required by strata legislation⁵. A building's risk profile depends on multiple factors, including claims history, age, type of construction, maintenance, proximity to fire hydrants, and potential catastrophic loss exposure.
- **High volume of minor claims impacting premiums** – BCFSA determined premiums and deductibles were increasing because of a lack of profitability. BCFSA heard from insurers that they have been incurring losses mostly from frequently occurring lower-cost claims (particularly those resulting from

water damage). Sustained losses incurred by insurers puts upward cost pressures on premiums and deductibles.

- **Strata policy structure impacting premiums** – BCFSA identified the need to research further business practices used to construct strata insurance policies, Best Terms Pricing was resulting in higher premiums being charged for some properties, especially for those that are considered to be higher risk.
- **Construction industry economics impacting premiums** – Insurance costs were also rising because of the increases in insured values from larger new buildings, the use of more costly building materials, and overall increases in construction costs (new and replacement). This further strained insurer profitability and, therefore, increased insurance premiums.
- **Earthquake risk exposure reducing insurer supply** – BCFSA found excessive exposure to earthquake risk in B.C.'s largest strata markets was prompting some insurers to reduce the amount of strata insurance offered in the province. Less insurer supply was resulting in higher premiums and availability issues.
- **Supply constraints may continue to drive premiums up** – There were also concerns raised that there may be insufficient supply in the strata insurance market to support future expected demand. A lack of insurance supply coupled with increasing demand, would result in further upward pressure on premiums.

Overall, BCFSA is of the opinion that the state of the strata insurance market in B.C. needs improvement. Subsequent work focused on engaging stakeholders to validate the findings from the interim report and better understand what needs to be done to return stability and long-term sustainability to the unhealthy market.

⁵ Under section 149 of the Strata Property Act a strata corporation must obtain and maintain property insurance for prescribed risks that covers the full cost to replace the common property and common assets of the strata corporation the buildings shown on the strata plan and the original fixtures built or installed on the strata lot by the owner developer during original construction. The prescribed risks are fire, lightning, smoke, windstorm, hail, explosion, water escape, strikes, riots or civil commotion, impact by aircraft and vehicles, vandalism and malicious acts and any other risks set out in the strata corporation's bylaws.

SUMMARY OF LEGISLATIVE CHANGES

Since the interim report release, the B.C. government passed Bill 14 - *Municipal Affairs and Housing Statutes Amendment Act (No. 2)*, 2020. Various changes were enacted to the FIA and the *Strata Property Act (SPA)* to mitigate the impact of insurance challenges on strata corporations and strata owners. The changes included:

- A requirement for strata corporations to inform owners of material changes to the strata corporation's insurance coverage, including increased deductibles, as soon as possible (came into effect August 14, 2020);
- Allowing strata corporations to use their operating fund or contingency reserve fund to pay for sudden increases to insurance premiums required by legislation or strata corporation's bylaws (came into effect August 14, 2020);
- Banning the practice of insurers or insurance brokers paying referral fees to strata property managers that complete an insurance deal with them (came into effect September 10, 2020);
- Amending the Financial Products Disclosure Regulation to require insurance companies and insurance agents to give strata corporations more notice of any changes to their strata property insurance, including an increase or plans to deny coverage (effective November 1, 2020); and
- Amending the Financial Products Disclosure Regulation to require insurance agents selling strata insurance to disclose the amount of their commission (effective November 1, 2020).

There were also several changes announced that will be brought into force at a later date through regulation after further stakeholder consultation, including:

- Creating guidelines clarifying what strata corporations are required to insure and identifying circumstances when strata properties are not required to get full replacement value insurance coverage;
- Limiting and/or capping liability for individual strata owners held responsible for damage or loss; and
- Strengthening depreciation reporting requirements and changing minimum required contributions to a strata corporation's contingency reserve funds.



SUMMARY OF SUBSEQUENT WORK

BCFSA Engagement Sessions

BCFSA engaged industry, the public, and other stakeholders to engage in dialogue and understand the market's root issues and causes. Specifically, BCFSA undertook stakeholder engagement to identify and validate the interim report findings and discuss the long-term sustainability of the B.C. strata insurance market. Engagement sessions included meetings with individual insurers, insurance brokers, insurance and reinsurance associations, financial institution associations, strata homeowner associations and representatives, and peer regulators. BCFSA also heard from members of the public, including a grassroots group concerned with strata property insurance increases.

The engagements were primarily focused on regulatory matters within the purview of BCFSA's mandate, root causes of actions being taken by insurers, a discussion of influences in participation in the market, and identifying what is needed to build stability and long-term sustainability. Where BCFSA heard issues raised relating to broader issues of housing and building policies (i.e. affordability impacts, building codes, zoning, incorporation of loss prevention devices, etc.) the B.C. government was informed of those matters and concerns.

The engagement sessions consisted of one-on-one discussions with key stakeholders and virtual focus groups with select organisations participating in moderated discussions. Throughout the process, stakeholders not only validated BCFSA's interim findings but provided valuable insights and raised additional matters to explore, demonstrating a shared commitment to help stabilise the market and make it more sustainable in the long term. BCFSA also observed a greater commitment to raising awareness of the market issues and a desire to contribute to education efforts for all participants.

BCFSA conducted an additional data call in July 2020 to obtain a sufficient sample of data to better understand the impacts of BTP. BCFSA did not gather additional market data such as premium and deductible rates beyond the data initially gathered as part of the interim report.

In addition to our stakeholder engagement sessions, BCFSA welcomed written submissions from interested parties and responded to individuals who made contact either with a complaint or with suggestions and comments about the market. Following the release of BCFSA's interim report and throughout the engagement period, a contact centre was maintained to gather input from the public and direct those with specific recommendations or inquiries outside of BCFSA's regulatory scope to the appropriate government contacts.

3. Findings and Observations

ECONOMIC DRIVERS

Several forces are impacting strata insurance premiums and insurer participation. While insurers ultimately decide on the premium they charge, external market forces besides profit can influence premiums and market supply. Evolving changes in some of these external forces are having a greater impact on the market than they did in the past. For example, new modelling for catastrophic risk puts upward pressure on reinsurance costs, which ultimately affects premiums and participation rates. The following are some of the key forces or drivers impacting pricing and participation decisions.

PRICING EXPECTATION AND PRICE DRIVERS

Supply constraints and upward pressure on prices will continue until there is a return to consistent market profitability.

The pricing correction occurring in the market is often referred to as a hardening of the market. Like all property and casualty (P&C) insurance markets in Canada, the strata insurance market is subject to a recurring market phenomenon known as the insurance cycle. The insurance cycle is characterised by recurring hard and soft cycles where competitive forces create periods of higher prices and profitability (hard market) followed by periods where prices are reduced and profitability is strained (soft market).

The hard market phase is where prices (premiums and deductibles) increase to address losses incurred during the soft market phase. The pricing increases eventually improve overall market profitability, which then attracts new competitors (supply). As supply, and thus competition increases, prices are driven down, creating the soft market phase. During that phase, prices fail to keep up with costs and over time profitability deteriorates. This leads to reduced competition and creates upward pressure on prices as the market hardens again. Insurance prices, insurer profitability, and insurer participation in certain market segments are largely driven by this market phenomenon. Turning points in the cycle are often influenced by structural changes in society and business.

Insurers need to see evidence of a commitment to a reduction in the volume and value of claims for premiums to be reduced.

In Canada and globally the commercial insurance market, including B.C.'s strata insurance market, has been in a prolonged soft market, by most accounts, for over a decade. Commercial markets started to harden in late 2018, and more hardening took place near the end of 2019. The B.C. strata insurance market truly began to feel the impacts of the hardening in late 2019 and into 2020. A recent report by Deloitte^{6.1} on the state of the Canadian commercial property and casualty markets suggests that for the first six months of 2020 this sector had an underwriting loss of \$564 million and the claims ratio⁷ increased by 11.5 per cent. The report also suggests that the hard market is expected to continue until the Canadian economy fully recovers and interest rates rise prompting more competition and some softening of insurance premiums.

Market Cycle Characteristics		Figure 1
Hard Market	Soft Market	
<ul style="list-style-type: none"> • Insurers struggle with profitability/losses 	<ul style="list-style-type: none"> • The market has been sustaining ongoing profits 	
<ul style="list-style-type: none"> • Competition declines as supply withdraws 	<ul style="list-style-type: none"> • Insurers enter the market and/or increase supply 	
<ul style="list-style-type: none"> • Some buyers have difficulty finding coverage 	<ul style="list-style-type: none"> • Competition increases and coverage is widely available 	
<ul style="list-style-type: none"> • Insurers remaining in the market increase prices sharply 	<ul style="list-style-type: none"> • Premium (and deductibles) decrease or flatten 	
<ul style="list-style-type: none"> • A period of pricing increases may ensue until profitability stabilises 	<ul style="list-style-type: none"> • Insurer's profitability decreases 	

A market begins to soften at the end of the hard market cycle when insurers add more supply, which creates downward pressure on prices. Premium (and deductible) rates begin to soften, and contracts and terms become more flexible. This continues until insurers begin to incur losses or unfavourable market conditions and start to reduce supply starting the cycle's hard market.

⁶ The Claims Ratio measures the costs of claims versus the premium earned. It tells an insurer what percentage of its premium is going out to pay for a loss and the costs of adjusting the loss. It is one of the two components of the Combined Ratio (Claims Ratio + Expense Ratio) which ratio measures underwriting profitability. The Expense Ratio is the underwriting costs and overhead expenses incurred to write the business such as commissions paid to insurance agents and other marketing expenses.

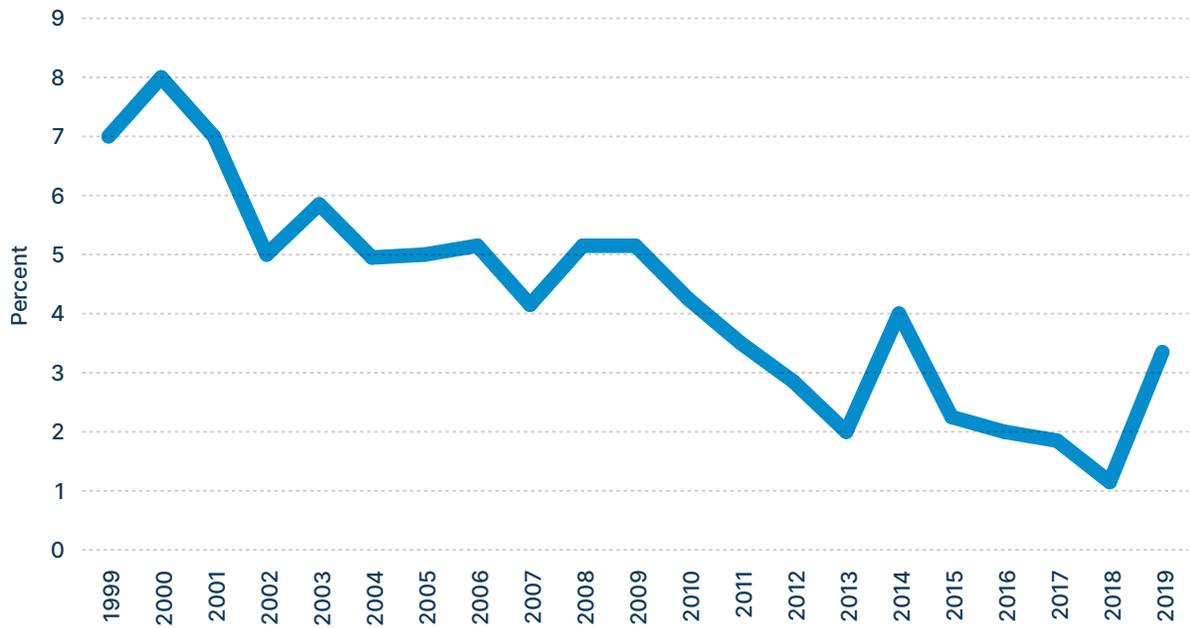
^{6.1} Deloitte, November 2020. "State of the Canadian Commercial Property & Casualty Insurance Market: Pressures Facing the Canadian Commercial Insurance Market in 2020."

During the engagement sessions, BCFSA heard that this is not the usual hardening of the market cycle and that in fact, other financial factors are influencing the current insurance cycle and may cause it to be prolonged. The major factors noted include:

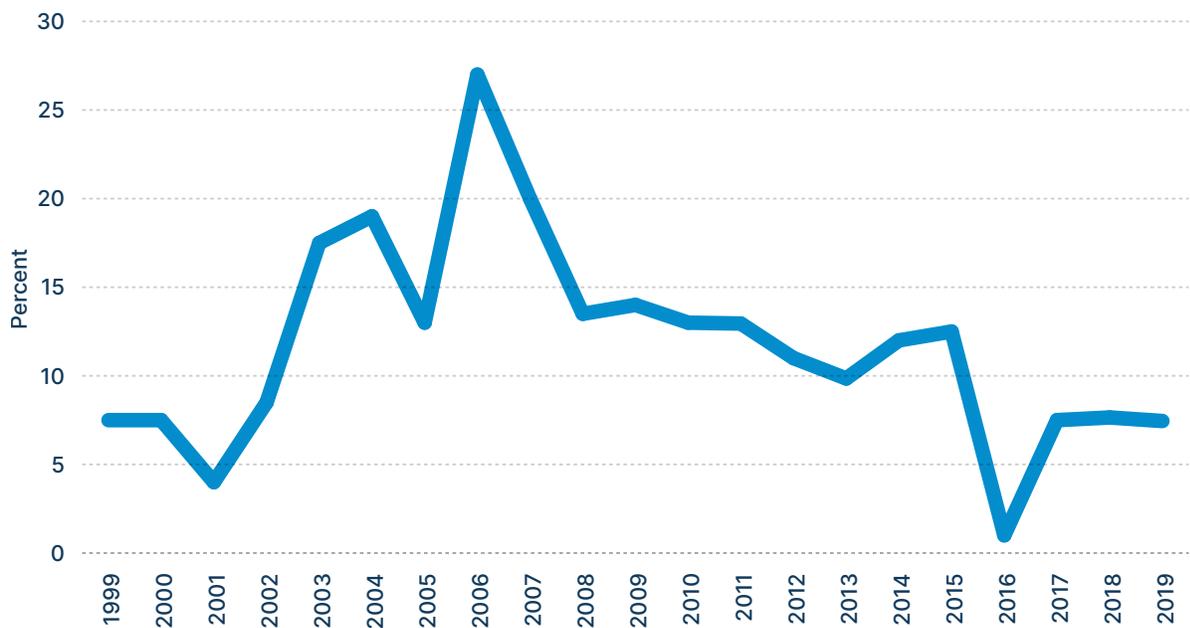
- **Consistent profitability** – Hard market cycles continue until the market demonstrates consistent profitability, attracting new supply and more competition. Until there is a proven track record of strata properties demonstrating that they are managing their risks and there is a significant reduction in the number and value of claims, overall premiums and deductibles are not expected to reduce.
- **Persistent low interest rate environment** – low interest rates result in decreased investment yield for insurers. When investment income decreases, this puts more pressure on insurers to obtain better underwriting results to remain profitable. Underwriting profitability is influenced by premiums charged and loss experience. Insurers become more selective about risks insured to reduce loss.
- **Significant increase in Property and Casualty (P&C) catastrophic losses** – Over the past decade, Canada has experienced a significant increase in catastrophic losses, as well as increased severity and frequency of claims. According to data from the Insurance Bureau of Canada⁷, the P&C industry which writes personal and commercial property and liability risks has incurred over \$1 billion in catastrophic related losses in eight of the last ten years (2010-2019) and expects losses over \$2 billion this year. This is affecting reinsurance costs, allocation of supply and puts significant pressure on the industry's profitability.
- **Significant decline in Return on Equity** – Insurers, like all private market enterprises, expect a reasonable return for their equity use. A standard measure of return is the Return on Equity (ROE) ratio. Commercial property insurers have seen a significant decline in ROE. If an insurer's ROE falls to low levels, insurers typically react by increasing rates, restricting the amount of business written, or both. With investment yields down and the risk of catastrophic losses, insurers need to find ways to improve profitability to improve ROE. This can mean looking for more profitable markets.

⁷ Severe Weather Caused \$1.3 Billion in Insured Damage in 2019 (<http://www.abc.ca/on/resources/media-centre/media-releases/severe-weather-caused-1-3-billion-in-insured-damage-in-2019>)

Investment Yield⁸ **Figure 2**



Return on Equity⁹ **Figure 3**



⁸ Source: MSA Data
⁹ Source: MSA Data

DEDUCTIBLES

Strata councils need to understand the impact that deductibles can have on strata owners.

Deductibles are often used to reduce premiums. The deductible is the amount of the money a policyholder must pay toward a claim before the insurance policy covers the remainder of the claim. Generally, the higher the deductible, the lower the premium, as higher deductibles reduce the amount insurers pay. Deductibles form a part of the policy's overall cost and act as key influencers on the premium price.

Depending on the insurance policy, it may also contain several deductibles that apply to specific causes of losses. Some common additional types of deductible include earthquake, flood, sewer backup, and water damage. Each deductible can have a significant impact on a claim, and the portion the strata corporation must cover.

During the prolonged soft market, not only were premiums being suppressed, so were deductibles. During its stakeholder engagements, BCFSA heard of instances where the deductibles were so low that strata councils and strata owners became reluctant to address maintenance and repair issues. BCFSA heard from various stakeholders that the strata insurance policy was being used by some properties as its maintenance strategy. It was less costly to file a claim because of the low deductibles and low premiums than finance repairs and maintenance directly.

While higher deductibles can help reduce premiums, there is a need for a balance between the deductible and premiums.

With increased densification of strata buildings, insurers have advised that losses, especially water-related losses, are not being contained and are spreading to more units, increasing the overall claim payout. One of the steps they have taken to reduce the losses is to increase water damage and sewer backup deductibles. Insurers and insurance agents are very aware that deductibles have consequences for policyholders. As such, they cannot be increased to a level that negates the value of the insurance. This creates additional pressure on premiums as deductibles have limited ability to be further increased to reduce premium costs. During the stakeholder engagements, BCFSA heard of instances where strata owners could not cover their portion of the deductible from a claim resulting in delays in the claim being paid and repairs effected. While the strata insurance legislation requires strata corporations to obtain strata insurance, there is no requirement for strata owners to obtain insurance to cover their share of the deductible¹⁰.

¹⁰ The B.C. Government website has a page on insurance for both strata corporations and strata owners and renters. <https://www2.gov.bc.ca/gov/content/housing-tenancy/strata-housing/operating-a-strata/finances-and-insurance/insurance>.

COMMERCIAL AND STRATA PROPERTY CAPITAL EXPECTATIONS & SUPPLY DRIVERS

For the market to return to a healthy state and sustainable over the long term, there needs to be a consistent amount of supply of insurance. The amount insurers are willing to supply is affected by several factors, including:

- **Profitability Expectations** – Insurers need to feel they can obtain a profit to stay in a market. Even if a market may be generating some profitability currently, if insurers expect the market will cease to be profitable, they may decide to withdraw from a market and move to a different one with higher profit expectations.
- **Capital Requirements** – Insurers are required by regulators to hold capital and reserves to cover their losses. As risk increases, more capital is required. Each country's regulator determines its capital requirements. Those requirements influence decisions of where insurers operate and in which market segments.
- **Catastrophe Risk Modelling** – In Canada, insurers must hold special reserves for their earthquake exposure. New earthquake research has indicated that previous loss estimates are likely understated. This is causing updates to the risk models insurers use to estimate their probable losses along with their reinsurance and reserve needs. Ultimately, it impacts some insurers' decisions about whether to participate in the B.C. strata insurance market.
- **Reinsurance** – Insurers cannot provide earthquake supply without reinsurance support. Reinsurance is when an insurance company shares its risk by purchasing insurance policies from other insurers to limit its losses. Capital alone cannot cover an insurer's overall potential risk exposure. The increase in the frequency of catastrophic losses globally and in Canada, along with the recent hardening of the catastrophic reinsurance market has been contributing to increases in reinsurance costs impacting strata insurance market participation decisions.
- **Risk Concentration** – Insurers need to manage risk concentration. The more concentrated the risk is the greater the exposure an insurer has to a large loss (fire, flood, catastrophic event). High-risk concentration negatively impacts insurers' catastrophe models, reinsurance costs and credit rating assessments. As strata properties get more concentrated in both the number of units and physical proximity, especially in geographic areas with high catastrophic loss exposure, insurers will charge more for that exposure or reduce supply or both.
- **Increasing Insured Value** – As overall TIV in the market increases, more supply is required. TIV can increase due to demand from population growth, larger buildings, and construction costs. Buildings with very high TIV often require more insurers to participate in the coverage and magnifies exposure concentration for insurers reducing the number of properties an insurer can underwrite.

The figure below demonstrates how these factors contribute to the current state of the strata insurance market.

Factors contributing to the current state of the strata insurance market¹¹ *Figure 4*



Note: Demand drivers in red and supply drivers in blue.

¹¹ Source: Oliver Wyman

CAPITAL REQUIREMENTS

The amount of capital that insurers must hold to cover their existing and probable losses influences what markets they participate in. The higher the risk in the market, the more capital they must hold. More capital is required when the frequency and severity of loss is increased. In Canada, regulators use standard tests to determine capital adequacy of insurers. The test helps regulators evaluate insurers' ability to meet their policy obligations now and in the future. Two specific elements of the test that directly impact the market are:

- The requirement for insurers to maintain acceptable margins to cover risk related to who they reinsure with and,
- The requirement to hold catastrophe reserves.



REINSURANCE REQUIREMENTS

When an insurer reinsures its risk with a reinsurer that is not authorised or registered to do business in Canada (unregistered¹² reinsurer), they are required to hold additional capital in case that reinsurer fails or is delayed in paying its share.

Two factors have been increasing the use of unregistered reinsurance by Canadian insurers:

- Many of the P&C insurers operating in Canada are global in scope and rely on reinsurance purchased by head offices outside of Canada from reinsurers also outside Canada to cover their global risks and
- Insurers need to purchase more reinsurance due to the increase in frequency and severity of catastrophic losses in Canada and globally.

In 2019, the federal insurance regulator, the Office of the Superintendent of Financial Institutions (OSFI), increased the collateral requirement¹³ insurers must hold for reinsurance placed with unregistered reinsurers from 115 per cent to 120 per cent of the liability. The unregistered reinsurer provides the collateral (security/assets). This increase in collateral could have the unintended longer-term consequence of reducing the willingness of foreign insurers to write Canadian risks. While unregistered reinsurers may still be willing to write some business in Canada to assist in diversifying their overall risk, they may not be willing to provide as much reinsurance due to the increase in collateral requirements. In the past, Canada has been considered to be a market to assist with global diversification by the reinsurance industry. However, this still increases the overall costs for many of the insurers in the strata insurance market and affects supply allocation decisions.

¹² For the purpose of this paper the terms registered/authorised and unregistered/unauthorised refer to similar concepts, i.e. whether an insurer or reinsurer is permitted by regulators to conduct business in Canada.

¹³ Insurers where able to use collateral provided by unregistered reinsurers to offset the need to hold additional capital.

EARTHQUAKE EXPOSURE

Most of the insurers supplying significant supply to B.C.'s strata insurance market are foreign companies or subsidiaries of foreign insurers. As noted in the interim report, global reinsurers have identified B.C. as a higher-risk market due to earthquake exposure. For many of the insurers in the market, supply allocation decisions are being made by head offices outside Canada. Since the interim report release, one major participant has decided to exit not just the B.C. strata insurance market the overall Canadian mid-sized commercial property market. We understand the exit was due to the amount of capital and reinsurance it needed to allocate to cover its Canadian exposure.

Even with a return to profitability, significant additional supply from new insurers is needed to reduce overall risk concentration and help supply future demand. Reducing insurers' exposure to the higher excess loss limits¹⁴, especially from extreme earthquake risk, will also allow insurers to increase supply to cover claims losses and most of the overall excess losses.

Some parts of B.C. are located near seismic zones that potentially expose them to earthquakes, especially the Greater Vancouver and Greater Victoria regions which are also the two largest strata property insurance markets. While, as noted earlier, earthquake shake damage is not mandatory coverage required by strata legislation, insurers are still exposed to fire following an earthquake which is mandatory coverage.

Since the 1990's, B.C. and OSFI have been requiring insurers to hold additional capital to cover their exposure to earthquake risk, gradually building up the amount of capital held from a 1 in 250-year event to a 1 in 500-year event¹⁵. Further, in 2013, OSFI implemented a change to the treatment of earthquake risk from covering a singular event occurring in either B.C. or elsewhere to multiple events. While this change was implemented seven years ago, insurers were given until 2022 to comply with the requirement. According to an analysis by OSFI, this new rule was expected to have only a modest effect on the capital requirements requiring an increase of just nine per cent in the amount of extra capital required to be held. The following figure shows the estimated impact.

¹⁴ Excess loss is the difference between the expected loss from attritional losses and the total replacement costs.

¹⁵ The probability of a severe earthquake happening in a 500-year time span is higher than one occurring in a 250-year span.

OSFI Estimate of Additional Capital Required by Insurers to Meet 2022 Regulatory Guidelines Circa 2012¹⁶ Figure 5

These changes are considered important prudential matters to better protect policyholders by increasing the likelihood the insurer can pay a claim in the event of an earthquake and reduce a systemic failure in the insurance industry. However, compared to other jurisdictions, such as the United States, the Canadian regime is more capital intensive. This can cause insurers that have global connections to move capital and supply to less capital-intensive regimes.

For example, regulators in the U.S. use a Risk-Based Capital (RBC) formula that requires less capital. A hypothetical example prepared for BCFSa by a recognised expert on reinsurance, consulting firm Oliver Wyman, suggests an insurer would need to carry nearly two times more capital if licensed in Canada than the U.S. Other factors are also influencing why each country's capital requirements differ. The Canadian marketplace is very different from the U.S. (overall size, number of insurers, size of insurers, and a portion of the country exposed to earthquake risk). Earthquake risk in this country presents unique regulatory challenges. It poses systemic risk¹⁷ not just to the insurance industry but also to the overall economy. Due to the overall size of its economy, an earthquake in the U.S. will have less impact on

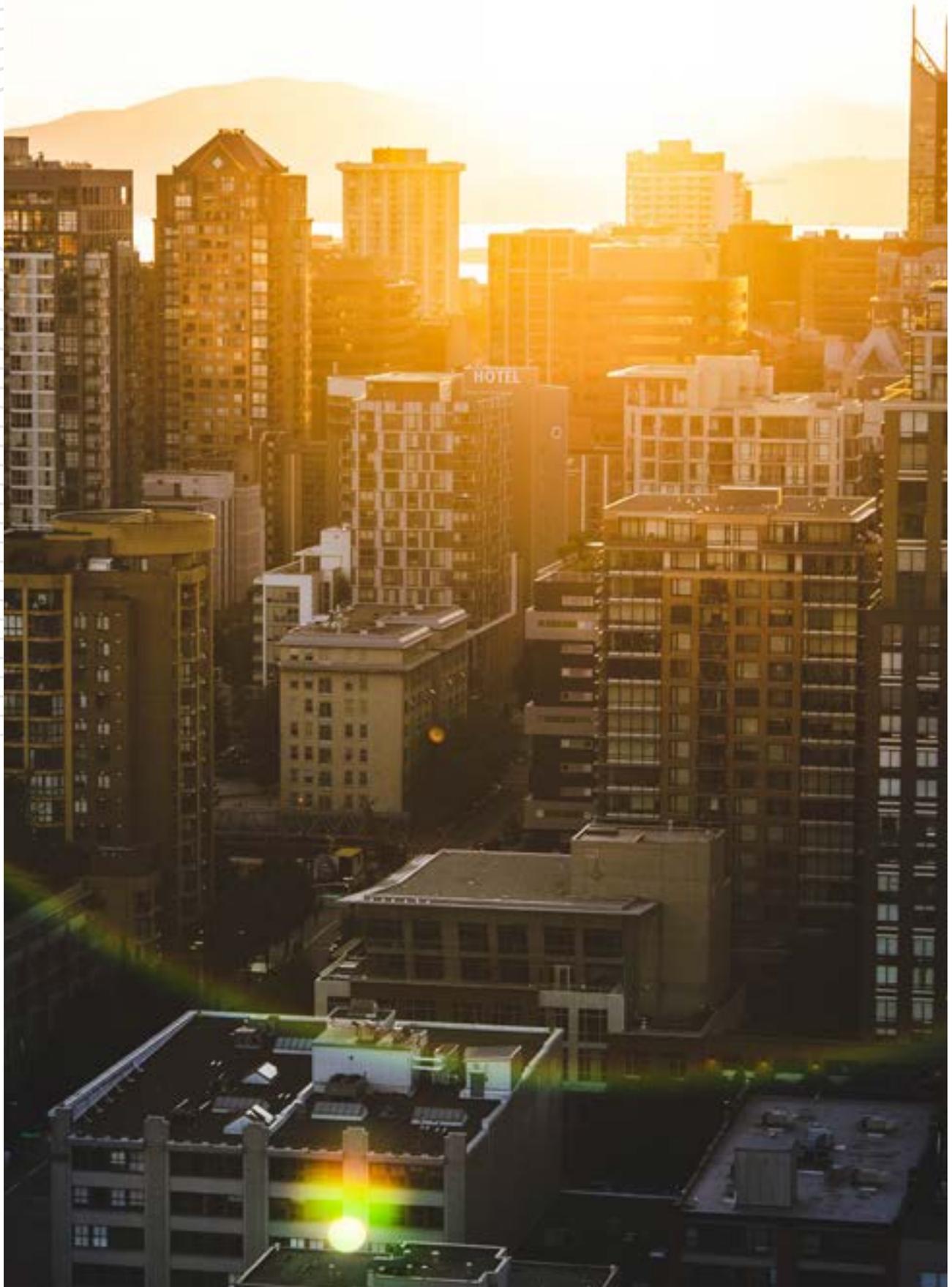
its economy or economic recovery. The purpose of providing this example is to highlight that overall, the OSFI catastrophe capital requirements generally appear to be more conservative than some other international standards. Still, they may impact supply allocation decisions by the globally oriented insurers.

Another factor affecting supply decisions is catastrophe modelling. Insurers use risk modelling to estimate, in a variety of scenarios, the expected Probable Maximum Loss (PML) of a catastrophic event. Since the first catastrophe loss modelling was introduced in the 1980s, the sophistication of the modelling has increased with new iterations. Recent scientific research¹⁸ conducted on Canadian seismic risk has indicated that the loss from a major earthquake event in B.C. is likely significantly underestimated. This new research was to update the seismic design values for the 2020 National Building Code of Canada. Research such as this can have a significant effect on how models represent events. For a history of such updates impacting Canadian earthquake, see the following figure.

¹⁶ Source: OSFI

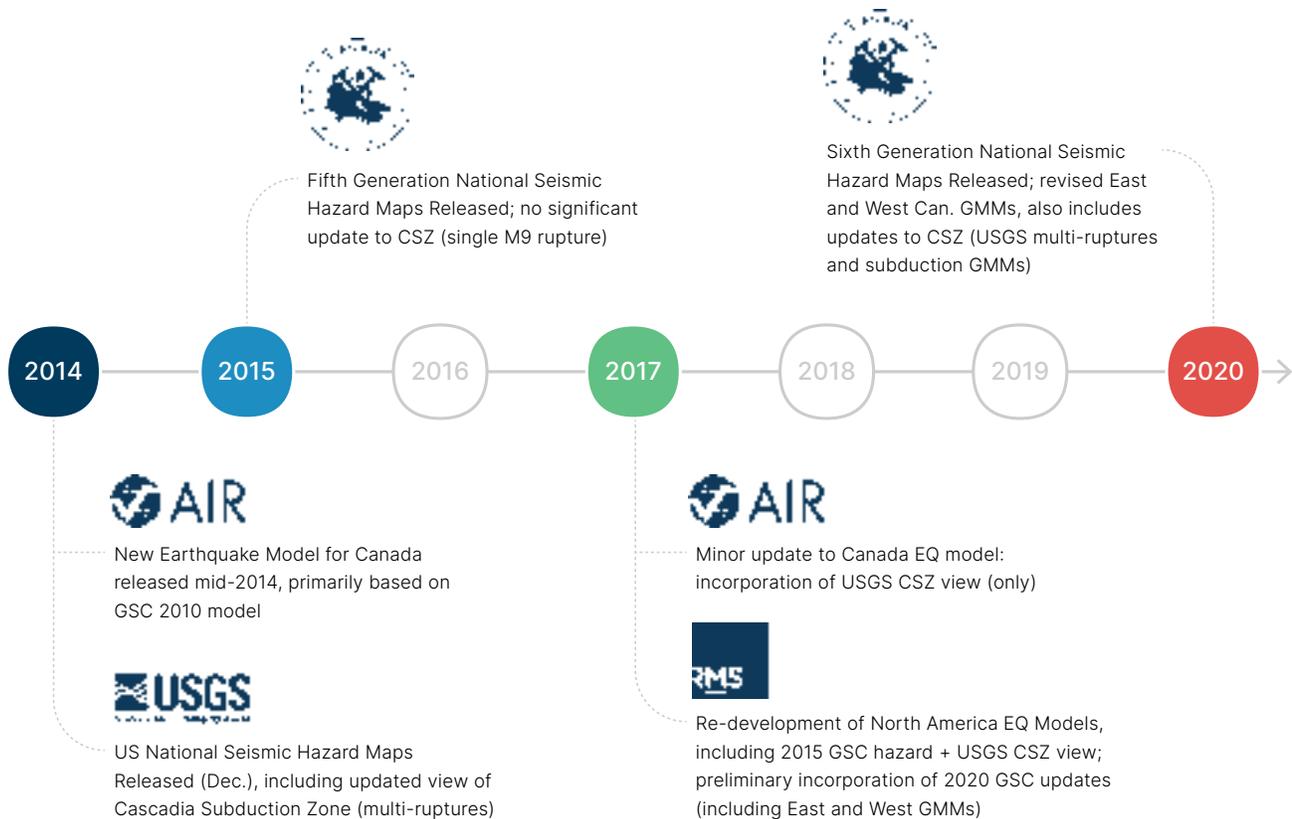
¹⁷ Systemic risk is a failure that cascades through an industry causing the whole or most of the industry to fail. Currently a mega earthquake event in B.C. could trigger the collapse of most of the P&C insurance industry in Canada and cause residual impacts on other sectors of the Canadian economy.

¹⁸ https://www.seismescanada.rncan.gc.ca/hazard-alea/2019_12CCEE/12CCEE_Adams_etal_6thGenerationModel_192-Mkvp-139.pdf



Select History of Scientific and Catastrophe Model Updates Related to Canadian Earthquake¹⁹

Figure 6



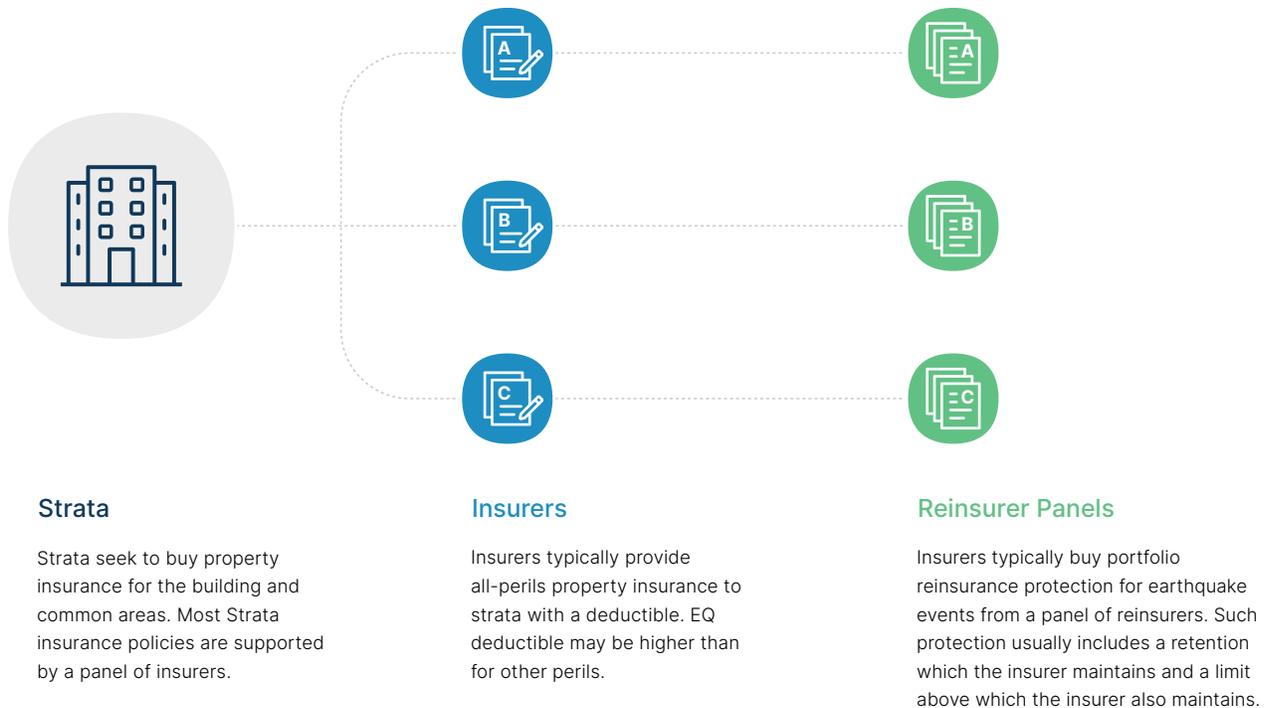
As noted in the figure, two of the major companies supplying catastrophe risk models, AIR and RMS, updated their models in 2017 which started to influence changes in reinsurance needs and costs for insurers. To manage the costs, insurers can pass them on to policyholders and/or reduce their exposure by reducing the amount of insurance it provides in higher risk areas.

The capital requirements and effects of catastrophe risk modelling apply to all insurers and reinsurers operating in Canada. It impacts the price of reinsurance from registered reinsurers and flows through ultimately to the policyholder. This is demonstrated in the following figure. Strata corporations purchase insurance from an insurer(s); the insurers then purchase reinsurance to protect exposure to a catastrophic loss. The costs of reinsurance flow back to the strata owners.

¹⁹ Source: Guy Carpenter. CSZ = Cascadia Subduction Zone; GMM = Ground Motion Model

An Illustration of the Typical Strata Property Insurance Value Chain²⁰

Figure 7



Increasing frequency and severity in catastrophic events has created more volatility in profits, causing a steady increase in global reinsurance costs since 2016. Canada is still considered a desirable country to provide reinsurance supply for diversification purposes. Insuring risks in different countries reduces volatility and increases the likelihood of profit being made. However, reinsurers are not prepared to assume the risk at any price; they require an appropriate price for the risk. Overall, reinsurance costs look to be increasing at least for the near term and will continue to be a factor that insurers consider in making supply decisions for the market.

Of note, BCFSFA has heard that, historically, due to the highly competitive commercial property markets in Canada over the last decade, a substantial share of the premium that was being charged for the actual earthquake exposure was actually being used to subsidise mostly water damage claims. This suggests that going forward, reinsurance costs will have a greater impact on strata property premiums.

TOTAL INSURED VALUE - GROWTH EXPECTATIONS

Demand for strata insurance is expected to increase. As more strata properties are constructed in the province, TIV will continue to grow. TIV is directly impacted by the volume of strata properties and changes in construction costs. Increases in either put added pressure on an already constrained supply market.

Although the full extent of the COVID-19 pandemic's impact on B.C.'s economic activity is yet to be determined, new data on the housing market indicates new construction starts will be lower than anticipated on apartment starts (refer to Figure 8, apartment starts forecast). This will alleviate some of the pressure on TIV growth in the near-term. It is not clear what effect the pandemic will have longer-term. Factors such as employment, population growth, consumer confidence, interest rates, and household savings all influence home buying decisions. The pace of economic recovery will determine the extent of the impact on decisions such as when to buy, where to buy, and what to buy.



Taking a long-term perspective, B.C. Stats²² estimates population in the province is projected to grow by 1.1 per cent on an average compound annual basis from 2020-2041²³. Much of this growth will likely be in and around the two major cities in the province - the Victoria and Vancouver regions - creating more urban density and the demand for strata properties, and strata insurance.

As densification occurs, it increases concentration risk exposure for insurers, especially for earthquake risk. Insurers need to manage that risk. They do so in part through reinsurance but also geographic diversification. This means they will typically limit the amount of supply deployed in any one geographic location. These limitations may be defined by postal code or other predetermined boundaries and can be substantially influenced by the local exposure to catastrophic risk. Higher exposure to catastrophic risk due to risk concentration, as noted earlier, adversely impacts an insurers' reinsurance costs and capital requirements.

²¹ Source: Altus Group Economic Consulting, based on data from CMHC, October 2020. Apartments include strata properties.

²² <https://www2.gov.bc.ca/gov/content/data/statistics/people-population-community/population/population-projections>

²³ Absolute growth of 28 per cent from 2020 to 2041.

Risk concentration is magnified by the increase in TIV. Insurers need to cap the accumulation in TIV to which they are exposed. As TIVs of existing strata properties increases from inflationary (cost of construction) effects, insurers' regional exposure caps are met quicker. This can result in an insurer either insuring fewer buildings or taking less of a percentage of any particular risk, especially on newer buildings that are larger and have very high TIV values. Overall, there will likely be the need to have more insurers participate on a strata subscription policy than in the past to fill the subscription. Without significant supply entering the market from new insurers, this will put additional pressure on existing insurers to more closely evaluate which buildings they wish to underwrite and could conceivably cause more challenges for buildings considered high risk.

Most of the insurers in the strata insurance market are also exposed to the same risks in other markets they insure. Some insurers may not only insure the strata property; they may also insure some of the strata owners or tenants through personal property insurance. Others may insure some of the non-residential commercial buildings in the vicinity. Overall, this increases the insurers' concentration risk and accumulated exposure. This risk concentration has had a negative impact on risk modelling results and will continue to increase the demand for a finite amount of affordable reinsurance.

As existing insurers in the market reach their concentration limits, this raises the question as to who will supply the capacity to meet the growth. New entrants are needed to increase competition and provide risk concentration relief to meet the increasing demand. BCFSA understands from its discussions with industry that attracting new supply is currently challenging. The market needs to demonstrate a consistent level of profitability, and some of the factors discussed above, especially concentration risk and exposure to earthquake, need to be addressed.

New entrants are critical for long-term stability and sustainability of the market.

Some of the supply and demand drivers of the current strata property insurance crisis may be long-lasting. The current market conditions suggest a further hardening of the commercial and reinsurance markets in 2021 in response to the increased wildfire activity along the North American westcoast, the catastrophic losses from Alberta events in 2020, and a very active U.S. hurricane season. There are also still unfolding claims and investment losses from COVID-19, especially in some countries where business interruption claims are likely to have significant impacts on the insurance industry's profitability. These events are very clearly challenging issues and are outside of the insurance industry's and financial regulators' control.

DIFFERENCES BETWEEN B.C. AND THE U.S. WESTCOAST

During the stakeholder engagements, it was suggested that U.S. rates were not as low as those in B.C. when the market started to harden. This would mean the amount of increase in the U.S. would be less because prices were higher to begin with. BCFSAs heard that there are some other factors which may be contributing to the regional differences: the U.S. has much more catastrophe reinsurance available, risk exposure to catastrophic losses does not have the same capital charges in the U.S., and the ability of insurers to create more portfolio diversification because of the overall size of the U.S. insurance market versus Canada's.

B.C. shares many of the same risk exposures with California, Oregon, and Washington. Some of these risks are natural, such as wildfire and earthquake risk, but also urban growth concentration. However, while those markets have not seen the same type of percentage increases as the B.C. market, they are also facing the same issues. The U.S. insurance market is managed very differently than the B.C. market. California, Oregon and Washington require rate filings which has seen rates rise more gradually than in B.C. The insurance coverage is also provided differently. In the U.S., commercial property insurance is generally bifurcated with a mix of what they deem to be admitted carriers (i.e. fully regulated with policies having guaranteed backing) and non-admitted carriers (i.e. not fully regulated and the policies are not guaranteed). The admitted carriers generally do not insure to the full replacement value or cover all the risks. Instead, strata properties use a combination of admitted and non-admitted carriers to fill out the coverage with the non-admitted carriers providing the coverage

not provided by admitted carriers, such as providing excess or surplus insurance or higher-risk policies. This creates more supply, especially for higher risk properties. It does not, however, lower overall costs in those U.S. markets.

Another key difference is the way an earthquake risk is insured in the U.S. Earthquake insurance is optional and is often provided by a different insurer(s) than the one providing the strata property policy. Because of the unique difficulties in underwriting earthquake insurance coverage and a desire to increase rates significantly after events, earthquake coverage is often offered by non-admitted carriers. This keeps the basic property insurance rates down as the insurer(s) involved, usually admitted carriers, are not typically exposed to the damage caused by the building being shaken by an earthquake. In B.C., coverage for damage from building shake from an earthquake is optional, but fire caused by an earthquake is required to be covered. So, while B.C. strata corporations can choose not to purchase earthquake shake coverage, insurers are still exposed to fire following earthquake risk.

A recent study prepared for the Institute for Catastrophic Loss Reduction²⁴ estimates that losses to property, (buildings and personal possessions), from fire following an earthquake in the Vancouver region could range from nil to \$10 billion²⁵ depending on the event. The report also stated that the losses would be almost entirely insured and does not include other losses insurers would incur from an earthquake such as the insured damage from the shaking. The report included a reference that losses of this magnitude may result in failure of some insurers and could conceivably lead to financial contagion.

²⁴ <https://www.iclr.org/wp-content/uploads/2020/11/Vancouver-fire-following-earthquake-E.pdf>

²⁵ The report stated that the estimates are median estimates with significant probabilities of greater or lesser damage from fire depending on the magnitude and location of the earthquake, time of day, weather and other factors.

Of note, the U.S. is not without challenges. In California, due to the high frequency and severity of wildfires, the California Insurance Commissioner took the extreme step of placing a one-year moratorium on insurers cancelling or dropping homeowners who live in or alongside ZIP codes struck by recent wildfires. The moratorium covers approximately 800,000 homes. According to public reports published last year by an actuary and consulting firm, the insurers lost \$20 billion in the 2017 and

2018 wildfires alone, representing twice the amount of total industry profit earned since 1991. The moratorium did not address prices and will not solve the issue in the long term as insurers can still exit the state. It also exposes insurers to heightened risk of bankruptcy, and they are not required to take on new customers.



RATE REGULATION

Rate regulation is one option that some jurisdictions use to control premium costs. BCFSa currently does not rate-regulate but has studied rate regulation and has discussed this in the past with other Canadian regulators. In the long-term, rate regulation can distort the market and reduce insurer participation, thereby adding upward pressure on premiums.

Rate regulation may provide temporary relief but has long-term negative impacts.

The regulation can take two forms, file and use or control prices. In a file and use system, the insurers file the intended rate ranges, and the regulator only intervenes if the rates they charge are outside the range. In a more controlled system, jurisdictions either impose a price ceiling (i.e. prices cannot be higher than a predetermined amount/percentage) or they “cap” the differences between the rates insurers can charge for different risk classifications (i.e. uniform rates – higher risk and lower risk classifications must be priced similarly).

A common argument for rate regulation is that insurance markets may not be competitive, leading to inflated or excessive prices. Consumers may also lack the information or expertise required to determine whether they are being offered a reasonable price. The regulator is often viewed as being better positioned to judge if rates are “fair.” However, rate regulation takes significant regulatory and insurer resources, regardless of the system. File and use systems require a considerable data system and have administrative resource demands for both insurers and regulators increasing costs and ultimately increasing premiums. In a more controlled system, additional resource costs are imposed on the regulator for specialised actuarial expertise. Although rate regulation may initially protect consumers from prices that are perceived as excessive, it can have unintended negative consequences, including adding significant additional costs that increase premiums.

Supply

Impacts on supply are amongst the most persistent challenges in a rate regulation environment. In a competitive insurance market, allowing insurers to determine their prices encourages insurers to supply as much coverage as feasibly possible. This is especially important in areas with high catastrophic risk as insurers will manage their exposure to ensure they have sufficient capital to meet their obligations to policyholders²⁶. In B.C.'s strata insurance market, where supply constraints have been identified, rate regulation could further reduce some insurers' willingness to offer coverage.

Insurers are often reluctant to provide insurance in markets where they are not allowed to charge rates required to cover their risks. Insurers need to accumulate some level of profit to protect their capital and continue to provide insurance. If capital erodes from losses, the insurer must reduce the amount of insurance it writes as it has less capital to back the insurance. In markets where profit opportunities are limited, this may discourage newcomers from entering the market while inadvertently pushing participants out of the market if they have better profit opportunities elsewhere.

More Frequent Losses

Rate regulation may also create incentives that ultimately lead to greater, more frequent losses. Insurance does not lower the costs of losses but instead offers a way to manage the remaining risk after appropriate risk-mitigation measures are implemented²⁷. Policyholders may have fewer incentives to manage their own risks with rate regulation as the incentive to reduce premium costs is mitigated²⁸. One of the findings from BCFSA's interim report, which was affirmed during stakeholder engagement, is that there

are varying degrees of investment in preventive maintenance and risk reduction measures by strata corporations and owners. BCFSA heard that low deductibles might have resulted in some strata corporations in the past to use their strata insurance policy as a "maintenance policy" as it was more cost-effective for the strata and its owners to use insurance to pay for minor claims rather than investing in repairs and maintenance.

If premium rates are controlled, insurers will need to look at other ways²⁹ to control costs. One way is to increase deductibles, which, as discussed earlier, ultimately passes some or all of the costs of a loss to the strata corporation and the owners who must fund or pay the deductible.

Reduction in Coverage

Insurers may also hollow out the terms of policies if rates are regulated. By reducing the amount of coverage and imposing more strict terms and conditions, insurers can reduce the amount they pay for a loss and the circumstances for which they are obligated to pay, effectively reducing the insured's coverage. This is somewhat mitigated by the strata legislation, which mandates certain coverage be obtained by the strata corporation and limiting the ability of insurers to reduce what risks or perils they cover. The strata legislation requirements do not however, prevent insurers from imposing conditions under which they will participate or actually insure a risk²⁹. For example, under the legislation, fire is a peril that must be covered. However, an insurer can decline to insure a property if its not within a certain distance of a fire hydrant.

²⁶ Born and Klimaszewski-Blettner (2013) demonstrate empirically that certain regulatory responses such as rate regulation can negatively affect insurers' willingness to provide coverage against natural disasters

²⁷ <https://pdfs.semanticscholar.org/2933/7616c40be40c982579ef16701014c3fb349b.pdf>

²⁸ Harrington and Danzon, 2001, Harrington, Scott E., and Patricia Danzon, 2001. "Workers' Compensation Rate Regulation: How Price Controls Increase Costs," *Journal of Law & Economics* 44(1): 1–36.

²⁹ Section 9 of the Strata Property Regulation defines what a strata insurance policy must cover and includes as mandatory coverage losses from fire, lightning, smoke, windstorm, hail, explosion, water escape, strikes, riots or civil commotion, impact by aircraft and vehicles, vandalism and malicious acts.

BEST TERMS PRICING IS INFLATING PREMIUMS

BCFSA has addressed Best Terms Pricing

In the interim report, BCFSA identified a pricing practice used in the market that was potentially having an inflationary impact on overall premiums. The pricing practice is known as ‘Best Terms Pricing’ (BTP). Since the interim report was released, BCFSA undertook additional analysis on the practice to better understand its impacts not only on pricing (positive and negative) but also on supply in B.C.

BTP is a practice where each insurer quoting on a strata property subscription policy obtains a rate that is established by the best rate being quoted by any of the insurers. The practice ensured each insurer obtained the same price on the policy and the same overall terms.

In the previous soft market cycle, insurance brokers were often able to negotiate prices down below the bid rates due to the amount of competition in the market. Insurers were willing to accept a lower price in order to retain market share. This caused underpricing in the market and distortion in the actual rates being charged. While it benefited consumers by providing lower rates, it also contributed to insurers leaving the market due to lack of profitability, which caused a significant reduction in supply.

With the recent hardening of the market, BTP has had two impacts. It has contributed to the sharp increase in overall premium rates. Instead of rates increasing gradually, the suppression of rates during the prolonged soft market has resulted in insurers needing to charge significantly higher rates to return to profitability. Further, because the overall price is now being set by the highest bid rate, in situations where an insurer submits a significantly higher bid, all insurers get that same rate inflating the premium.

An example of how BTP works is set out below. The example is a 175-unit strata property with a TIV of \$60 million. There are five insurers involved with bid rates ranging from 16 basis points³⁰ to 23 basis points. If each insurer received their own bid price, the premium paid would have been approximately \$104,700. However, since each insurer received the price set by the highest bid (23 basis points), the actual premium paid was \$138,000, a difference of approximately \$33,280.

³⁰ A basis point is a standard unit of measure used in financial sectors and is equal to one hundredth of one percent. In dollar terms one hundred basis points is equal to 1 cent

Best Terms Pricing (BTP) Table #1³¹

Figure 9

Insurer	Participation Rate (%)	Insurers Share of Risk (\$)	Bid Rate (\$)	Actual Premium (Share of Risk x Highest Rate)	Bid Rate Premium (Share of Risk x Bid Rate)	Difference in Premium (Actual - Bid)
i	10%	\$6,000,000	0.230	\$13,800	\$13,800	\$0
ii	49%	\$29,400,000	0.165	\$67,620	\$48,510	\$19,110
iii	9%	\$5,400,000	0.168	\$12,420	\$9,050	\$3,370
iv	10%	\$6,000,000	0.160	\$13,800	\$9,600	\$4,200
v	22%	\$13,200,000	0.180	\$30,360	\$23,760	\$6,600
Total	100%	\$60,000,000		\$138,000	\$104,720	\$33,280
Extra Impact						32%

To better understand how much BTP was inflating premiums, BCFSFA collected data from a select number of brokers for all strata insurance properties they placed during a period of one month. The sample resulted in information on 527 properties involving 32,150 units. The sample included strata properties ranging from one unit to 344 units and with TIV values ranging from \$445,000 to \$145 million. The properties themselves included bare land strata subdivisions, high rises, townhouses, mid-rise, and a variety of building types (age and construction material).

The findings showed approximately 94 per cent of the properties in the sample had been impacted. The impact ranges from a savings of \$43,600 for one property to a property paying \$261,800 in additional premium over what it would have paid if each insurer received its own bid price. Overall, the findings determined approximately 34 per cent of the properties sampled paid less than 10 per cent more in premium due to BTP. However, the data found that approximately 13 per cent of the properties paid 50 per cent more due to BTP.

³¹ Source: BCFSFA – BTP Illustrative Example

Best Terms Pricing (BTP) Table #2 ³²			Figure 10		
% Increase over Quote Rate Price	# of Strata Properties	% of Properties Sampled	\$ Increase over Quote Rate Price	# of Strata Properties	% of Properties Sampled
< BTP	2	0.4%	<\$5,000	257	48.8%
No Impact	28	5.3%	\$5,000 to \$10,000	83	15.7%
0 to 10%	148	28.1%	\$10,000 to \$20,000	72	13.7%
10 to 20%	121	23.0%	\$20,000 to \$30,000	34	6.5%
20 to 30%	75	14.2%	\$30,000 to \$40,000	26	4.9%
30 to 40%	50	9.5%	\$40,000 to \$50,000	16	3.0%
40 to 50%	36	6.8%	\$50,000 to \$75,000	24	4.6%
50 to 60%	25	4.7%	\$75,000 to \$100,000	6	1.1%
60 to 70%	15	2.8%	> \$100,000	9	1.7%
70 to 80%	14	2.7%			
80 to 90%	3	0.6%			
90 to 100%	2	0.4%			
> 100%	8	1.5%			
Total	527	100%	Total	527	100%

INDUSTRY RATIONALE FOR BTP

In discussions with industry regarding this practice, some of the rationale provided for its use was that it facilitates standardisation of the policy terms and deductibles, so the same terms apply to all participating insurers. This creates consistency in the policy instead of having unique terms applying to each insurer. This makes it easier and more efficient not only to construct the policy but to obtain participation by insurers. It also creates more certainty for the strata property owners regarding terms of coverage and claims settlement. In some cases, it also allowed insurers less familiar with the market to participate as they build up the necessary underwriting expertise, thus enabling additional supply to enter the market.

³² Source: BCFSAs – BTP Data Call; refer to Appendix 5 for additional detail.

BTP has been in the market for decades. As discussed earlier, in the previous soft market the willingness of insurers to accept prices below their bid price may have unduly distorted the market and prevented strata corporations from truly understanding the actual risk profile of their property. BTP may have acted as a disincentive for owners to take actions earlier to address some of the risks as it created a false sense of what the actual premium costs should have been.

BTP TO CEASE

Removal of BTP corrects a market distortion but it is unclear how much impact it will have on many strata properties.

Since the interim report was released, BCFSAs has been working with industry to address the practice. Due to the positive cooperation from industry, BCFSAs has been able to obtain assurances that the practice will be eliminated from B.C.'s strata insurance market. Many insurers have already indicated they have ceased the practice, and the others are targeting to stop it by the end of 2020. Due to the complexity of subscription policies, insurers and insurance agents need time to adjust their information technology systems to adapt to having different prices for each insurer. If insurers are not permitted time to make these adjustments, they will be forced to leave the market causing more disruption for consumers.

Insurers and insurance agents will still be able to negotiate prices, and insurers will not be bound to the original bid. They can follow the price of the lead insurer or use the weighted average price. This will still permit competition over the final price and allow insurers who would otherwise leave the market remain in the market. Going forward, this should enhance underwriting discipline and prevent unintentional pricing distortions.

Even though the practice is being quickly phased out, consumers should not expect prices to return to prior-year levels. BTP caused suppression of prices in a prolonged soft market that was not aligned with the risk of most properties. For most properties, the increases over the past year were primarily caused by the hardening of the market and price adjustments to reflect insurers' lack of profitability. Close to 49 per cent of the properties paid less than \$5,000 more as a result of BTP. Removal of the pricing impact of BTP will reduce the artificial increase it was having on the most affected properties. It will also create more transparency in the actual building risk profile. For many properties, it is less clear how much impact the removal will have. It is anticipated some insurers who relied on BTP to stay in the market will adjust their prices to the new bidding process, which may see more insurers following the weighted average or lead insurers price.

4. Other Regulatory Issues Identified

BCFSA has identified a few areas that require more regulatory action. BCFSA intends to engage with industry and with other regulators to address the following areas.

DATA GAPS

Regulators require better data to monitor the strata property insurance market.

Currently, Canada's insurance regulators collect information on insurance markets and on insurance companies through nationally harmonised reporting forms. CCIR leads the development and revision of many of the reporting forms, which are subsequently adopted, where applicable, by insurance company regulators across Canada. All federal and provincial regulators use these core, functional reports.

The focus of the data currently collected is to allow insurance company regulators to measure the profitability and financial health of an insurance company as it pertains to solvency risk and to understand how companies are complying with market conduct rules.

Strata insurance data is not collected separately. It is aggregated into a broader commercial property class of insurance, where it is grouped with all other types of commercial property, ranging from small one storey office buildings to large industrial manufacturing and refining complexes. Therefore, it requires a special data call and such data calls often have completeness and consistency issues as each insurer may not keep the data the same way.

The lack of granular data by class of insurance results in gaps of information pertaining to the strata property insurance market:

- **Insurer Identification** – There is a need to enhance the regulators' ability to identify which insurers are writing in distinct markets. With data currently being aggregated for most insurance classes, it is impossible to quickly identify which insurers are writing in the sub-level market segments such as strata insurance and the amount they write. Having more granular data in these segments would allow regulators to understand market participation better and facilitate any regulatory work aimed at that market segment.
- **Underwriting Performance** – With underwriting data (premium, claims, expenses) reported on an aggregate basis for most insurance classes, it takes ad-hoc data calls to understand how most sub-level market segments are performing. Consideration should be given to what types of markets, including strata insurance, separate and distinct data should be collected to determine underwriting performance.

- **Reinsurance Costs** - Another gap in reporting requirements is information on reinsurance costs. These costs are typically reported on an aggregated basis and not allocated directly to class of insurance business. This does not give a true picture of the costs an insurance company is incurring for that class of business and distorts the true profit or loss experience. Consideration should be given to improvements in reporting reinsurance costs so regulators can better understand the impacts those costs have on certain business classes.

BCSFA has raised these data gaps with CCIR members and is working with them to explore options to address this issue. As noted earlier, most of the reporting of data to regulators is done through forms and processes developed by CCIR. When developing regulatory reporting forms, regulators must find a healthy balance between data they require and collect from insurers, so it doesn't result in an unnecessary regulatory burden.

DELEGATED AUTHORITY OVERSIGHT

Regulators should work with industry to look at enhancing oversight of delegated authority.

As noted earlier, many strata insurance policies are constructed by insurance brokers with specialised strata insurance programs that encourage insurer participation.

Given brokers' market knowledge, it is common in the insurance industry for insurers to delegate some of their authority to brokers such as underwriting and claims administration. This reduces the costs for insurers, allowing them to offer supply in less familiar markets. The brokers have a clear incentive to manage the programs effectively as poor program performance will result in insurers leaving the program and the strata property insurance market reducing the supply of insurance. Insurers need to ensure proper oversight of the authority it delegates to ensure its customers are being treated fairly.

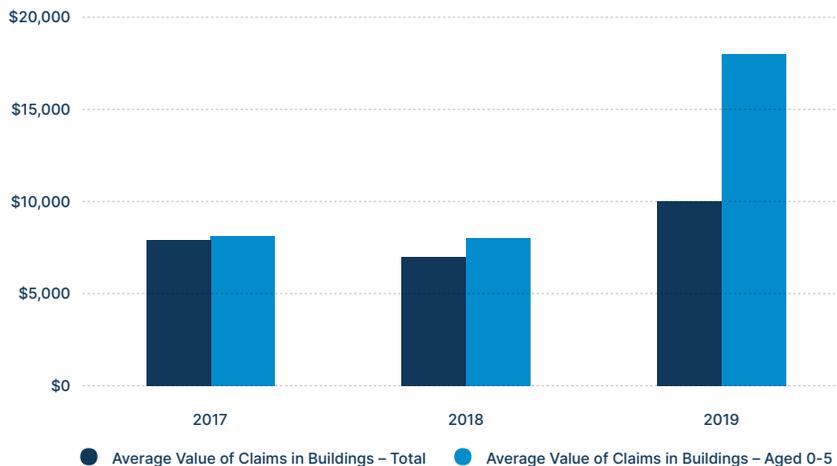
Choosing the appropriate insurance product for a claim helps to alleviate premium price pressures.

HOME WARRANTY INSURANCE

When BCFSA analysed the data obtained from the original data calls, it identified that the average dollar values of insurance claims for buildings aged 0-5 years was higher than that for buildings of all ages³³. In 2019, average difference in insurance claims between these two groups increased approximately \$6,000 over the previous year, as demonstrated in figure 11.

Average Value of Claims for All Buildings and Buildings Aged 0-5 Years³⁴

Figure 11



With the home warranty insurance providing some initial coverage for defects on new homes, the data raised the question of whether some claims made under strata property insurance policies could or should have been made under home warranty insurance policies. This might have reduced the overall losses being incurred by strata property insurers. Since no data exists to address this question, BCFSA raised this query during its engagement sessions with insurers and other stakeholders.

Under the *Homeowner Protection Act* and regulations, new homes built in B.C. on or after July 1, 1999, by licensed residential builders for sale must be covered by mandatory, third-party home warranty insurance. BCFSA must authorise the insurers that write home warranty insurance for this class of insurance.

The statutory minimum coverage under home warranty insurance includes:

- 2 years on labour and materials,
- 5 years on the building envelop, including water penetration, and
- 10 years on the structure of the home.

Home warranty insurance is not subject to a deductible.

³³ Due to the scope and purpose of the data call, the data did not provide insight into the question of how many claims could have been made under the home warranty insurance.

³⁴ Source: BCFSA – Original Data Calls

As a warranty program, home warranty insurance provides construction defect coverage on eligible new homes. Certain losses are excluded from the coverage. The exclusions include normal wear and tear, normal shrinkage of materials and construction, failure of an owner to prevent or minimise damage and damage caused by anyone other than the residential builder or by insects or rodents.

Strata-titled homes have two home warranty insurance policies: one on the home and the other on the common property. Non-common property in strata units is covered for 12 months, and the common property of strata buildings is covered for 15 months. Home warranty insurance generally excludes, among other things, landscaping and non-residential detached structures.

During the engagements, some participants expressed that it is not always clear whether a loss is caused by a manufacturer's defect or a lack of maintenance. If the root cause is a lack of maintenance by an owner, the loss is excluded from the home warranty insurance coverage. Strata council members are usually volunteers with a wide range of skills and abilities, elected by other owners. Due to a lack of knowledge around insurance products, some market participants found confusion among strata councils about whether a loss should be filed under the home warranty insurance coverage.

Another issue that has been identified is whether consequential damage is covered under home warranty insurance. Examples of consequential damage discussed include water damage to flooring or even leakage into other strata units. BCFSa is aware that the B.C. legislation does not provide the same certainty as the Alberta legislation does that consequential damage is covered. Alberta's legislation defines consequential damage. Some participants believe this lack of certainty regarding coverage of consequential damage under the home warranty insurance program may contribute to decisions to file a claim under the strata property insurance versus under home warranty insurance.

Home warranty insurance provides important protection and confidence for new homes in the market. BCFSa believes that more information is needed from industry to better understand whether claims should be filed under home warranty insurance rather than strata property insurance and the affect potential home warranty claims may be having on strata insurance losses. Further, filing a claim under a strata property insurance policy that could have been made under home warranty insurance can unnecessarily, negatively impact the strata property insurance claims history, causing future increases in premiums and possibly deductibles.

5. Innovation and Alternative Solutions

BCFSA believes alternative solutions and more innovation in the market is necessary to address supply challenges.

SELF-INSURANCE

Self-insurance is a proven alternative solution for market segments that have struggled to obtain consistent and reliable insurance coverage in regular commercial markets. B.C. permits two types of self-insurance structures: a reciprocal exchange structure and a captive insurance company.

RECIPROCAL EXCHANGE

A reciprocal exchange is a group of persons who insure each other under one or more reciprocal insurance contracts. Unlike commercial insurance companies, a reciprocal exchange is not necessarily a legal entity. Rather, it is a contractual risk-sharing arrangement. A reciprocal exchange must obtain a permit from BCFSA allowing it to operate in B.C. The permit requires annual renewal. An advisory board is usually tasked with the oversight responsibility, and a general manager is responsible for the day-to-day operation of the reciprocal exchange. While there is no prescribed amount of capital in the legislation, the capital a reciprocal exchange maintains must be sufficient to support the risks it undertakes.

In reviewing the current legislation applicable to strata corporations, in consultation with Ministry of Municipal Affairs and Housing, a reciprocal exchange structure cannot be used as the strata corporation would need to enter into reciprocal insurance agreements with other strata corporations, a practice not contemplated under the strata property legislation. However, BCFSA believes captive insurance could be used.

Alternative solutions may provide some strata properties more stable insurance and assist in risk mitigation practices.

CAPTIVE INSURANCE

A captive insurance company is an insurance company established to insure the risks of a related group of entities. There are three types of captive insurance companies recognised under the *B.C. Insurance (Captive Company) Act*:

- **Pure captive** is permitted to insure its parent company;
- **Association captive** requires an association, and the captive insures the association's members;
- **Sophisticated captive** insureds are a group of people who have expertise in insurance matters and have annual premiums of at least \$500,000.

In all three cases, corporations affiliated to the insureds and their directors, officers, employers, and agents/contractors are also covered.

Captives are required to be solvent and hold adequate capital. The prescribed minimum of capital (equity and reserves) is \$300,000. However, the actual capital a captive is required to maintain may be higher depending on the risks the company undertakes. A captive must be registered with BCFSFA before it can

commence insurance operations, and the registration requires annual renewal. A board of directors is required and responsible for the oversight duty. Captives typically use a manager who is responsible for the day-to-day operations of the captive company. Major insurance agencies sometimes undertake the captive management role.

Most strata corporations may not find it feasible to establish their own pure captive company, which can only insure its own risk. In addition, it is not likely for strata council members to have the requisite expertise in insurance to qualify as a sophisticated captive. On the other hand, multiple strata corporations may belong to an association (such as an owner association), which can form the captive and allow each member strata corporation to be insured by it.

The benefits and challenges of captives are provided in Figure 12.

Captive Structure		Figure 12
Benefits	Issues	
<ul style="list-style-type: none"> • Immediately provides supply that is lacking. 	<ul style="list-style-type: none"> • Requires capital to be sourced from the owners, which, especially at start up, can be challenging. 	
<ul style="list-style-type: none"> • Can create flexibility in designing the insurance contract, allowing more customisation to support or supplement the coverage, e.g. to provide deductible buy-down insurance or insure lower layers of the loss and reinsure to the total loss in the market. 	<ul style="list-style-type: none"> • An association captive is a risk-sharing mechanism, and stability in membership is critical, which includes a long-term financial commitment (capital contribution) to support long term pricing stability and a commitment to maintain the captive's long-term operation. 	
<ul style="list-style-type: none"> • Can provide more control on claims handling and risk mitigation as the captive may be responsible for any claim itself. 	<ul style="list-style-type: none"> • While price stability may be achieved, the captive structure may not necessarily result in lower premium rates. The objective of the captive members must be aligned to create the needed stability. 	
<ul style="list-style-type: none"> • Premium and capital that would normally be transferred to an insurer are retained in the captive. 	<ul style="list-style-type: none"> • Effective risk-sharing requires a level of risk diversification. For most captives, this is less of a concern as a pure captive the owner is ultimately taking on the risk itself. For most association style captives, the members have a similar risk profile. For strata corporations, they have to consider concentration risk and risk profiles of members. 	
<ul style="list-style-type: none"> • Shareholders/strata corporations share any profits resulting from the insurance operation. 	<ul style="list-style-type: none"> • The captive needs a board and management to manage the affairs of the company and pay for the expertise necessary to underwrite the risks and administer claims. 	

Captives should not be viewed as a mechanism to reduce premiums immediately. A captive should be viewed as a structure that can provide innovative insurance support or provide supply and encourage risk mitigation, supporting long-term pricing stability to be a successful enterprise for strata corporation's insurance needs. Insurance coverage may also be structured to meet specific needs of the insureds.

B.C. is the only jurisdiction in Canada with captive legislation. Since the creation of the captive legislation, substantial innovation has occurred in captive structures internationally, some of these newer structures could provide even greater flexibility for strata corporations. Further exploration on legal captive structures could be pursued for the B.C. market.



UNAUTHORISED INSURERS

BCFSA recognises that some strata may need to consider using an unauthorised insurer to fill supply requirements.

Care must be taken by insurance agents and strata councils in using unauthorised insurers to temporarily alleviate supply challenges.

An unauthorised insurer is any organisation not currently authorised to conduct insurance business in B.C. and is not regulated by the BCFSA. Insurance companies are required to be authorised by the BCFSA to provide confidence to the public that the insurer is appropriately regulated for solvency and business conduct. However, there are some exemptions to this requirement, including the use in certain circumstances of an unauthorised insurer. This exemption exists to permit consumers access to insurance that is not otherwise available in B.C.

There are risks in using an unauthorised insurer. Most of the risks can be addressed with careful selection that considers such factors as the insurers' solvency status, its market conduct history, and how it is regulated in its home jurisdiction. However, other risks include the fact that they may not be required to appear in court in Canada in the event of a claim dispute. The policyholder may have to try to seek restitution in the insurers' home country. (See Appendix 7 for a discussion on placing insurance with an unauthorised insurer)

BCFSA worked with the Insurance Council of B.C. and industry to determine ways that can allow temporary access to unauthorised insurers. It will require the insurance broker to enter into a binding written agreement with the BCFSA to ensure the strata corporation is fully aware of the risks of the placement, amongst other requirements. The agreement will permit the use of this type of market temporarily to assist with the current supply challenges. The use of an unauthorised insurer is expected to be the last resort to ensure that the public interest continues to be protected. It does not unduly cause the withdrawal of supply by the other insurers on the same subscription policy.

B.C. PRIVATE SECTOR INSURANCE COMPANY

BCFSA believes that market participants (global insurers, strata owners, investors) should consider establishing a B.C. incorporated private sector insurance company or reinsurer to provide additional supply. The supply can be targeted towards a specific part of the market, such as strata properties up to certain TIV, or toward the excess loss portion, the hard to fill portions, and/or the broader market. Additional supply is needed and BCFSA sees the creation of B.C. incorporated private sector insurers as a way to help address this issue.

BCFSA has re-evaluated the authorisation requirements to determine if there are any undue barriers that would prevent normal entry for a private sector insurer into the marketplace. One potential barrier is the time it takes an insurer to become authorised to do business in Canada, especially for foreign insurers. Foreign insurers and reinsurers can operate in Canada either by setting up a branch operation or form a Canadian subsidiary. If they choose to operate on a branch basis, they are first required to become authorised by the Federal regulator. Once Federal authorisation is granted, the insurer must seek authorisation from each of the provincial jurisdictions in which they wish to operate. The whole authorisation process can take over a year.

BCFSA believes that there are market opportunities for investors or foreign insurers to establish B.C. incorporated insurers or reinsurers that could serve the B.C. market and expand nationally.





MUTUAL INSURANCE COMPANIES

Another form of private-sector owned insurance companies are often formed by insurers themselves to provide supply – mutual insurance companies. A mutual insurance company is an insurance company formed and owned by its policyholders. It is not a share capital or stock company owned by shareholders. Instead, the profits earned by a mutual insurance company are either retained within the company or rebated to policyholders in the form of dividend distributions or reduced future premiums. The advantage of mutual insurance companies is they are dedicated to providing insurance coverage to its members and policyholders.

Currently, B.C.'s legislative framework has some restrictions on who can form a mutual insurance company in B.C., limited to persons who can obtain insurance coverage for fire damage to a rural property. This legislative restriction would need to change to allow owners of non-rural strata properties to form a mutual insurance company. Many of the same advantages and issues described earlier regarding captive insurance companies apply to a mutual insurance company. Still, one benefit is that a mutual company can also become authorised to do business in other Canadian jurisdictions allowing it to diversify risk.



PRODUCT INNOVATION

BCFSA believes that industry can and should be more innovative in its product offerings to address supply issues.

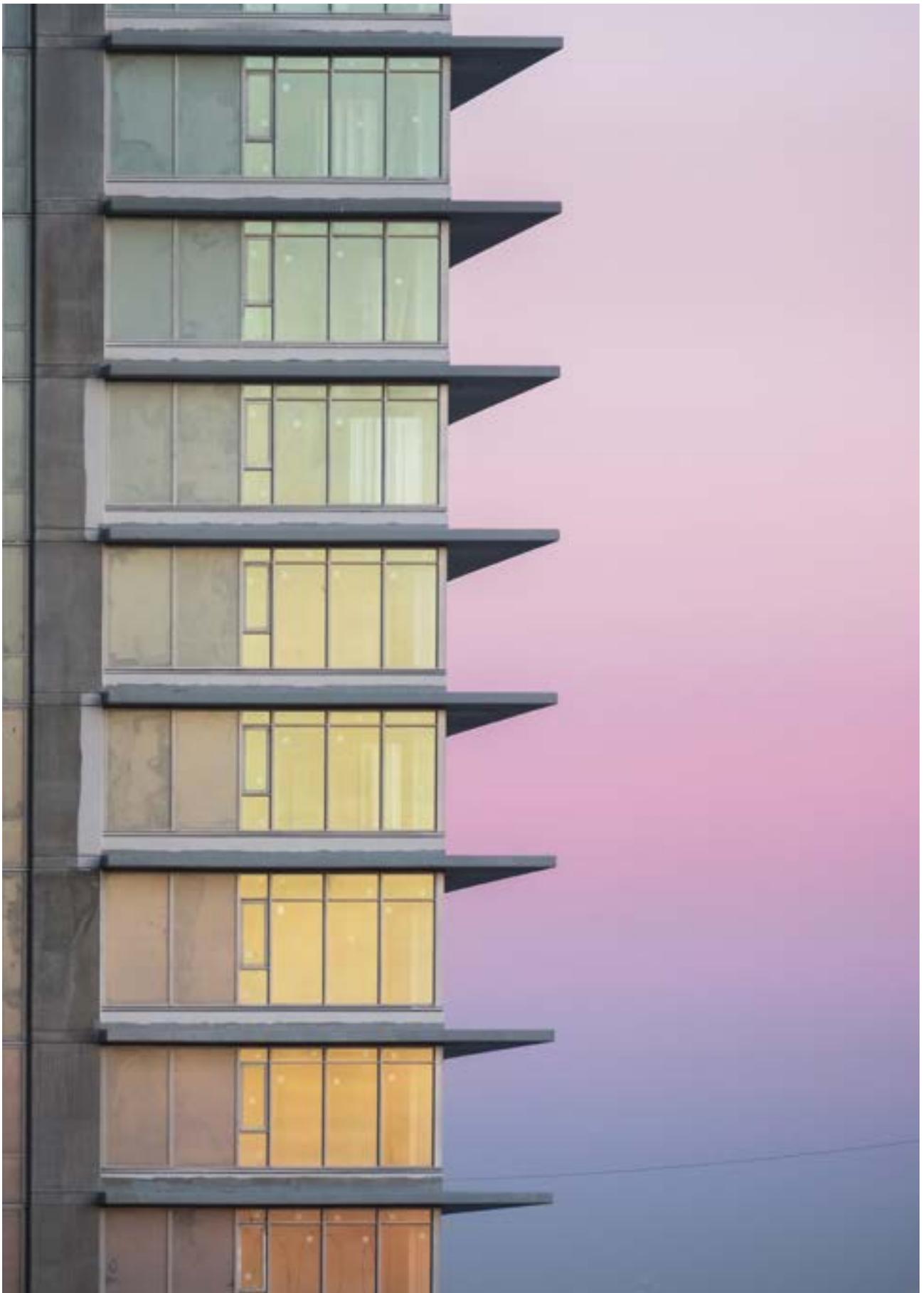
Product innovation could be beneficial for consumer choice in the market and increasing supply.

Currently, strata insurance is mostly offered in the form of a syndicated policy covering multiple risks. However, strata insurance can be arranged in other forms such as:

- **Co-insurance** – Both the insurer and the strata corporation agree to split claim costs in a set ratio.
- **Excess of loss policies** – Each insurer takes a layer of the risk at set dollar values. Each layer sits on top of another layer, so the insurers' exposure only occurs once the loss value reaches that dollar value of that layer.
- **Pooling or facultative insurance** – Similar to a subscription policy on one strata property. However, multiple strata properties are covered in a pool. An example is a facility association in private auto insurance covering high-risk drivers through an insurance pool.
- **Reinsurance** – A splitting out of the claim's loss risk and the catastrophic loss risk with different insurance arrangements for each.

These are more complex programs which may be costly to arrange and more difficult to manage without special expertise or independent advice. However, innovation should encourage more participation by insurers and increase supply. It may also reduce risk concentration, for example, exposure to earthquake risk if the insurer only participates in the claim's loss layers.

Each of these types of policy construction has its positives and negatives, and there may also be other forms or combinations of these types of policy construction. BCFSA strongly encourages industry to consider these and other innovative forms to provide more alternatives in the market over and above the commonly used subscription policy.



PRIVATE-PUBLIC PARTNERSHIPS (PPP)

A PPP is a partnership between government and private sector entities that provides public services. They are often used where the risk is too high for the private sector on its own.

BCFSA is aware that there has been some discussion in the media and has heard from some consumers who have contacted BCFSA about the use of a public insurance model to provide strata property insurance. Some of the considerations for such a model would be:

- **Can premiums be reduced?** Not necessarily. A public insurer might create some immediate relief through initial pricing, but in the medium and longer-term it will be exposed to the same risks as the private sector. This includes having to ensure prices cover costs in order for it to be financially viable as well as needing to arrange reinsurance coverage for catastrophic losses³⁵. Otherwise, the public insurer may not be in a position to pay claims. As in public automobile insurance, pricing will also need to reflect the differences in each property's risks. A public insurer will also face a different risk concentration issue than that of the private sector. It will take all of the concentration risk and catastrophic loss exposure versus that exposure being proportional to each insurer.

It is also unclear whether there would be significant operational or administrative cost saving compared to the private market. However, if it was established to operate on a not-for-profit basis and benefits were achieved from consolidating reinsurance buying power, some consumers may see a reduction in premiums and deductibles in a public model. Although some might be higher as other factors that influence a reduction in an insurer's price, such as building up market share, will not apply to a public insurer.

- **Can supply be increased?** Yes. A public insurer with sufficient public capital will be able to ensure supply needs are met as long as it can obtain the necessary reinsurance to cover all but the most extreme catastrophic events. However, to provide the supply to meet future demand, either periodic additional capital from government will be required or built up capital from profits will be necessary.
- **Can it provide more stability?** Yes, as far as supply, but not necessarily for premiums. A public insurer will be affected by most of the same factors that impact private-sector insurers. For example, changes in overall loss experiences, changes to reinsurance costs, and changes to earthquake and other catastrophic risk modelling will influence premiums regardless of whether provided through public or private insurance. Further, because a pure public insurer would be covering the province, it will incur losses from every catastrophic event instead of those isolated to the geographic market that the private sector insurers operate in. This could be mitigated with explicit provincial or federal backing or access to other dedicated forms of financial resources.

³⁵ A pure public insurance model in strata property insurance faces different challenges than it does in automobile insurance – for example overall risk concentration and excess loss and catastrophe risk exposure.

It is not clear that a pure public solution would create any substantive premium relief. A public solution will still face the same cost pressures related to claims losses. However, BCFSA believes a public-private partnership model should be explored to achieve long-term supply stability by addressing more extreme catastrophic risk exposure and reducing concentration risk of private insurers. As previously discussed, total aggregate insured value of strata properties is expected to increase, putting additional strain on the private sector market to obtain the necessary reinsurance, especially for earthquake risk. A PPP model could alleviate these issues by insuring the higher limits of excess loss, the more extreme catastrophic risk events, and providing temporary coverage for the higher risk properties insurers are reluctant to cover.

In many countries, governments play a role in the provision of insurance coverage for earthquake risk. Some of these programs have been specifically established to address catastrophe risks (earthquake and flood being the most common). It is well chronicled that losses from a mega-earthquake in B.C. will exceed the insurance sector's supply to pay claims and create systemic failure. The private sector is unable to prevent these systemic impacts without government support. As part of its *July 2020 Economic and Fiscal Snapshot*³⁶, the Federal government announced it would provide funds to develop insurance-based strategies for addressing broader natural disaster protection gaps, including for earthquakes.



³⁶ <https://www.canada.ca/content/dam/fin/publications/efs-peb/homepage/EFS2020-eng.pdf>

In some countries, programs have been established to address a broader range of natural (or even human-made) perils (e.g. flood, wildfires, hurricane, pandemics, etc.). In a few other countries, the government's involvement in providing insurance coverage for earthquakes results from government ownership of major insurance companies. Most of the programs that have been established involve some form of partnership or collaboration between central governments and private insurance companies. The programs focused on earthquake risk have generally been established following a major event that resulted in disruptions to earthquake insurance availability and/or revealed a significant level of uninsured earthquake exposure (see Appendix 8).

B.C. governments may directly provide coverage and manage the programs (i.e., act as a direct insurer) or support the provision of earthquake insurance by private insurers by providing some form of reinsurance or guarantee. Even where governments have taken a major role in covering the risk, private insurance companies often play an important role in policy distribution and/or loss assessment, or in the program's risk transfer aspects (i.e. assuming some of the risk covered by the program).

Most recently, CCIR has been discussing with the Federal Government the establishment of a Canadian catastrophe insurance program to address mega-catastrophic events.

PPPs are often used in insurance to pool higher risks in a market. For example, in Canada, the provinces with private sector automobile insurance have formed a risk-sharing pool that permits the pooling by insurers of drivers considered to be of higher risk³⁷. Each of the pools is administered by a common automobile facility association, which can also act as the last resort insurer. (i.e. a residual market), for those risks which the regular market does not have an appetite. Overall, this ensures all risks get insured. These types of pools and facility associations do not reduce premiums. Premiums are still charged at the market rates. In B.C., a facility association could act as the insurer of last resort and/or administer a pool created to cover higher-risk strata properties struggling to be fully insured. If the property was identified as one that was unable to be fully underwritten in the normal market, the insurers will agree to underwrite it on the basis that it will be put in the pool reducing their risk. All the insurers in the market would support the pool by contributing the premiums from those properties and agreeing to cover losses by the pool. This distributes the risk share to a larger group of insurers. As with the private sector automobile pools, this type of model could be set up in conjunction with other provinces having similar issues with strata insurance or other commercial insurance.

There may also be opportunities to use PPPs such as reinsuring a risk-sharing pool, providing coverage for the most extreme losses from an earthquake event or other catastrophe events, or acting as a last resort insurer to address concerns regarding underinsured properties and concentration risks.

³⁷ For a description of the Canadian private sector automobile facility association see <http://www.facilityassociation.com/about.asp>



6. Education

BCFSA believes there is a need for all stakeholders to improve their communication and focus on education to create more long-term stability in the market.

BCFSA identified gaps in the flow of information and knowledge of the strata insurance market that may be contributing to higher premiums in some instances.

A recurring theme raised during the engagement sessions focused on the lack of awareness by strata councils and strata owners of how insurers perceive of their strata property's risk. For example, in some cases, there seems to be a lack of communication between strata councils and brokers/insurers as to what strata councils have enacted as maintenance programs and risk mitigation strategies. Also, why maintenance programs and risk mitigation strategies have little to no impact on premium rates. Another example includes the lack of awareness by industry participants of the impact on premiums that new building technologies and materials cause.

The information flow between various stakeholder groups is not consistent and may lead to more costly premiums and deductibles. This can be compounded where strata corporations are relying on another party, such as strata property managers, to negotiate the insurance on its behalf. BCFSA heard an instance where the strata council was concerned over the premium increase, was not receiving desired information from the intermediary it was using, so they formed an insurance sub-committee to become better informed.

BCFSA summarised the information flow and knowledge gaps into the following categories:

- **Lack of consumer awareness.** Some strata councils and strata owners are often uninformed of the risks to their strata property. At times, this is caused by a lack of insurance knowledge of the council members and/or dependence on their strata property manager who also may lack the knowledge. Improvements are required to ensure strata council members and strata owners are better informed.
- **Lack of industry coordination.** Industry participants sometimes have differing perspectives. It is important that the different stakeholders discuss common issues.

Some of the primary knowledge gaps are provided in Appendix 9. BCFSA was encouraged to hear concurrence from all stakeholders that more can, and should, be done to improve information flow and overall market education. As information flow improves, it can lead to better risk management practices, a better understanding of the risks and, the potential for longer-term premium benefits.

ROLE DEFINITION AND RESPONSIBILITIES

BCFSA believes that a broader understanding of key stakeholders' roles and responsibilities will improve decisions regarding delegated accountabilities, create greater ownership of tasks, and equip strata councils, strata owners and insurers to make more informed decisions. In Appendix 9, BCFSA summarised potential actions to help further this dialogue among stakeholder groups.



ADDITIONAL GAPS IN INFORMATION IDENTIFIED

Point of Sale Information

BCSFA heard that some prospective owners may not be well informed of a strata property's insurance risks at the time of purchase. This can especially be true in a hot real estate market where time to commit to purchase is often compressed.

Under the strata legislation, some information is already mandated to be provided to prospective strata buyers under Form B: The Information Certificate³⁸ including the strata corporation's depreciation report³⁹. During stakeholder engagements, some participants saw the merit in having more information on the history of the strata property that could affect the potential future cost of insurance such as the prior loss history of a strata property, any home warranty claims, and insurance costs. Session participants saw how this could benefit everyone, including strata property managers, strata councils, owners, appraisers, insurance brokers, and insurers. Having quick access to an information record can facilitate better placement of strata property insurance and assist prospective buyers and sellers of strata units to understand of the full cost of ownership. BCFSA recognises that there would be additional costs associated with collecting and maintaining this type of additional information.

Any legally required documentation needs to be kept up to date and provided to the appropriate parties in a timely fashion. One party that has a potential role in making this type of information available would be real estate licensees. Real estate licensees already disclose important information to clients regarding properties being listed, and disclosure of this type of information would assist buyers and sellers make more informed decisions. Having such knowledge will also create better line of sight into ownership costs and more knowledge of what amount of funding may be required.

It is helpful to provide more transparency to strata councils and insurers on the actual risk profile of the strata property. Having a common understanding between the parties on their perceptions of the risk profile of the strata property can lead to more clarity on why it is being priced a certain way by insurers. Having consistency in this type of information can create the ability for insurers and brokers to better structure the strata property insurance, create more flexible products, and attract more supply to the market as it helps new insurer entrants obtain the necessary information to underwrite.

Timely access to important information can help consumers make more informed purchase decisions.

BY-LAWS AND BUILDING CODES

An inclusive planning dialogue provides a holistic view on risk and mitigates impacts on premiums.

BCSFA heard stakeholders express desire for more inclusive dialogue during municipal planning discussions. Insurer representatives expressed interest to being involved in discussions regarding new or amendments to building codes so they could provide information related to the impact the changes could have on insurance costs. Considering the insurer's perspective would provide a better dialogue on the potential impacts and on some potential mitigating actions that could also be considered.

Reducing Strata Property Insurance Requirements

BCFSA heard during the engagement sessions suggestions to reduce the strata insurance legislation's full insurance replacement value requirement to help ease supply constraints and reduce concerns about non-compliance by strata councils. Under the recent legislative changes, work will be undertaken by government to explore options that may permit a strata property to temporarily obtain less-than-full replacement coverage in certain circumstances.

If less than full replacement value is an option, awareness of who takes on the risk must be clear.

BCFSA believes it is important for strata councils and owners to understand the impacts of having less than full replacement value and who will be required to cover the insurance shortfall. It can have unexpected consequences. Under OSFI's B20 guidelines⁴⁰, federally regulated banks require property insurance as a condition of mortgage approval with expectations that it remains in place during the mortgage term. The requirement intends to ensure the mortgage lender is fully compensated in case of damage resulting in a loss to the strata unit property value. The lender secures the value of the mortgage loan against the strata unit's current and potential value (i.e. collateral), which considers the value and associated risks of the overall strata property.

If the required insurance is reduced to less than full coverage for the strata property, the associated risk would be transferred to the unit owner seeking the mortgage. This implies that the owner would thus bear the responsibility for directly compensating the lender for the potential cost resulting from damage and loss in value (i.e. to the unit based or damage to the strata building property). The unit owner may obtain additional insurance to help offset the costs. The lender may also choose to price in the risk into the mortgage debt-servicing costs or restrict lending based on insurance coverage. Regardless of any action, the burden of risk would be placed on the unit owner.

BCFSA also heard from some participants that at the time of mortgage renewal lenders are beginning to ask more questions regarding strata property risks (e.g. building materials used such as asbestos, type of wiring, etc.) and if the strata property is encountering challenges in obtaining full replacement value insurance. Although no additional data was collected to support these comments, this is an area to consider for further research.

⁴⁰ <https://www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/b20-nfo.aspx>

7. Conclusion

BCFSA believes that the market has foundational issues that need to be addressed before it will return to a healthy state:

- Claims loss experience needs to improve;
- The overall risk concentration insurers are facing must be lowered;
- Exposure to excess loss from earthquake risk in the market needs to be addressed; and
- There needs to be a better flow of information between stakeholders and improved education of strata councils and owners.

Fixing these issues will take time, and there is no easy solution. These improvements will require participation from all stakeholders, local, provincial and federal governments, insurers and insurance brokers/agents, strata councils, strata owners, and builders and developers.

The strata insurance market in B.C. is extremely important for B.C. residents and the provincial economy. An estimated 1.5 million B.C. residents live in strata properties, and with current projections of population growth, that number is expected to increase significantly.

While the focus of many stakeholders is on the current increase in premiums and deductibles, structural issues need to be addressed to ensure a healthy market for the long term. That is, a market where the supply of insurance is stable and sustainable by meeting the needs of owners through competition, innovation, with products that are readily available and affordably priced, and where customers are treated fairly.

It will take time to bring the market back to a healthy state, possibly years. The removal of Best Terms Pricing will help alleviate premium increases for some properties, its removal though will not bring overall premiums down. While a number of factors have caused premiums to increase, the key factor is claims costs. For a reduction in premiums and deductibles to occur, claim costs needs to improve and demonstrate a sustained improvement over time. Insurers, insurance brokers, municipalities, builders, renovators, developers, and industry associations should engage in discussions with government over ways to improve the loss experience both immediately and in the long term.

Stakeholders must immediately tackle some of the structural issues impacting supply. If left unaddressed, these issues may create greater gaps in the demand for strata insurance and its supply. Risk concentration will continue to impact the insurance supply and put pressure on both premiums and deductibles until its impacts can be reduced. In the interim, insurers and insurance brokers should look for more innovative ways to share risk and provide insurance, possibly through risk-sharing pools or to assist in risk diversification. Product innovation should be a key strategy to address structural issues.

There are opportunities to improve education and information sharing to benefit all participants in the market. Consumers could benefit from enhanced knowledge of their property's risk profile and a better understanding of impacts on premiums and deductibles. BCFSAs believes insurers, municipalities, builders, and developers could benefit from sharing information that can lead to more proactive risk mitigation in future strata property developments. Strata owners

and prospective buyers would benefit from having a better understanding of the complete costs of strata ownership, including potential future costs and the impact of insurance. Having easier access to information could facilitate quicker placement of strata property insurance and assist prospective buyers and sellers in making more informed decisions.

BCFSAs intends to continue its work on strata insurance, addressing some of the gaps it has identified regarding data availability, market oversight by insurers, and potential issues around home warranty education. Improved data will help stakeholders better understand what is occurring in the market. Enhancing market oversight by insurers and addressing some of the concerns with home warranties will ensure consumers are treated fairly.

The BCFSAs has been pleased to provide its findings on strata property insurance to the public and to the B.C. government.



8. BCFSA Next Steps

BCFSA encourages stakeholders to work collaboratively to address ongoing losses in the market by improving maintenance and risk mitigation practices of existing buildings and implementing better risk mitigation systems in new construction. This is critical to reduce upwards pressure on premiums and deductibles.

BCFSA will continue to work other Canadian jurisdictions:

- Improved data collection on strata insurance and B.C.'s home warranty insurance program
- Ways to reduce the insurer's exposure to earthquake and other catastrophic risk, including potential public-private risk-sharing mechanisms that will help to attract necessary supply
- Potential issues related to consequential damage and making claims under the New Home Warranty Insurance Program
- Capital entry requirements

BCFSA will provide advice to stakeholders on adding supply:

- Captive insurance legislation reviews for new models such as sponsored⁴¹ captives which would allow more flexibility over ownership and participation in a captive insurance market
- Other self-insurance models such as mutual insurers and reciprocal exchanges should be explored for use by strata properties
- The potential creation by government of a risk-sharing pool (e.g. facility association) akin to that used in the private sector automobile insurance market to insure higher-risk properties

⁴¹ <https://www2.gov.bc.ca/gov/content/housing-tenancy/strata-housing/renting-buying-selling/buying-and-selling-strata/paperwork-for-buyers-and-sellers/form-b-information-certificate>

BCFSA encourages industry stakeholders to:

- Improve point of sale disclosure, including potentially creating a consistent record of key information
- Increase the flow of information between strata councils, strata owners, and insurers/ insurance brokers
- Explore innovative and alternative methods to provide strata insurance
- Insurers and insurance agents/brokers need to work together to develop new products that will help them reduce their concentration risk and provide coverage to more clients. For example, products where the subscribers cover the normal losses and reinsurance covers the catastrophic exposure would reduce the catastrophic concentration risk for the insurers.

BCFSA encourages better collaboration between all stakeholders:

- Information sharing between insurers, insurance agents and brokers and strata councils and strata owners is needed to provide an understanding of how the insurers perceive the risks profile of the property and what could possibly be done to reduce the risk.
- Brokers and insurers need to make a concentrated effort to communicate risk information in a consistent manner to strata councils who in turn should inform the strata owners.
- Development by industry of education materials can assist strata councils and strata owners improve their knowledge about the insurance.



9. Appendices

APPENDIX 1, GLOSSARY

Claims Losses

The term used by industry to describe losses other than those related to a total loss. These are the frequently occurring losses, mostly minor claims.

Best Terms Pricing (BTP)

A practice where each insurer quoting on a strata property subscription policy obtains the same rate, typically the highest rate quoted by any of the insurers. The practice ensured each insurer obtained not only the same price on the policy but the same overall terms.

Canadian Council of Insurance Regulators (CCIR)

An association of provincial, territorial and the federal insurance company regulators from across Canada. The members work together on common issues.

Captive Insurance

A type of self insurance where a related group of entities establish an insurance company. Captive insurance companies are wholly owned and controlled by its insureds.

Catastrophic Losses

The term used by industry to describe losses from catastrophic events that generally impact multiple properties, e.g. windstorm, wildfire, flooding, earthquake. For the purpose of this report, a total loss of a single property would also be considered a catastrophic loss.

Contingency Reserve Fund

A mandatory fund under the Strata Property that strata corporations must maintain to pay for common expenses that usually occur less than once a year or do not usually occur. Fund expenditures are usually identified in advance by a depreciation report and must be approved by owners, unless it is for emergency repairs or insurance deductibles that are a common expense.

Home Warranty Insurance/Program

Mandatory insurance coverage for new homes that is provided by authorised insurance companies and is designed to cover certain defined risks, defects for the first two years, water penetration the first five years and building envelope failure within 10 years.

Insurance Agent / Broker

Means a person, other than an insurance company, who solicits, obtains or takes an application for insurance, or negotiates for or procures insurance, or signs or delivers a policy, or collects or receives a premium. For the purposes of this report, insurance agent and insurance broker are used interchangeably, and refer to the same type of person.

Mutual Insurance Company

An insurance company formed and owned by its policyholders. The profits earned by a mutual insurance company are either retained within the company or rebated to policyholders in the form of dividend distributions or reduced future premiums.

Private Public Partnership (PPP)

A partnership between government and private sector entities that provides public services.

Office of the Superintendent of Financial Institutions (OSFI)

The federal regulator for solvency and sets capital requirements for most insurers in the strata insurance market.

Probable Maximum Loss (PML)

The maximum loss that an insurer would be expected to incur on a policy. PML represents the worst-case scenario for an insurer and helps determine the premiums that a policyholder will have to pay on their insurance policy.

Reciprocal Exchange

A type of self-insurance where a group of persons who insure each other under one or more reciprocal insurance contracts. Unlike commercial insurance companies, a reciprocal exchange is not necessarily a legal entity. Rather, it is a contractual risk-sharing arrangement.

Reinsurance

A transfer of risk from one insurer to another, allowing the risk to be spread globally. The more properties an insurer underwrites the more overall risk it accumulates. Reinsurance backstops that risk accumulation by paying out in the event that substantive losses are incurred, for example from a catastrophic event like flooding, hurricanes, wildfires or earthquakes.

Return on Equity (ROE)

A measure of financial performance calculated by dividing net income by shareholders' equity. The higher the ROE, the more efficient a company is at generating income and growth from its equity financing.

Risk Concentration

The underwriting of a number of like risks, where the same or similar loss events could involve multiple subjects of insurance insured by the same insurer.

Strata Insurance

Strata corporation property insurance is mandatory coverage required under the Strata Property Act (SPA). The insurance does not cover the individual strata units which owners need to cover under an individual policy. For the purposes of this report, references to strata insurance should be read as strata corporation property insurance.

Strata Insurance Programs

Programs developed by specialised insurance brokers who understand strata insurance and the needs of strata corporations and have dedicated insurers to help supply coverage to the program.

Strata Property Act (SPA)

The legislation that provides the legal framework under which all strata corporations and strata owners must operate in British Columbia.

Subscription Policy

A type of policy where multiple insurers share the risk associated with providing the insurance coverage; each insurer subscribes to a percentage of the risk that they are prepared to accept on the policy.

Sub-broker

A special type of broker that assists the placing broker when the broker cannot fill a subscription through its own markets. Sub-brokers have access to markets not available to the primary broker.

Total Insured Value (TIV)

Represents the maximum an insurer would pay out for a total loss on a strata property policy. The calculation of TIV includes the total value of common property and assets, the cost of rebuilding, debris removal, living expenses for those displaced during the rebuild etc. Therefore, it is equal to or greater than replacement cost.

APPENDIX 2, HOW THE MARKET OPERATES

What is Strata Insurance?

Strata corporation property insurance is mandatory coverage required under the *Strata Property Act* (SPA). It must provide full replacement value of the common property and common assets of the strata corporation. The insurance does not address the personal insurance needs of strata owners or tenants who need to purchase their own individual policy to cover their possessions, and contents of the unit not covered under the strata insurance policy⁴². Earthquake shake coverage is not required under the strata insurance legislation, but it is often included in strata property coverage. Strata corporations that choose not to purchase earthquake coverage are still covered for fire damage following an earthquake. An estimated 1.5 million residents live in strata properties in B.C., and strata properties can range from under \$1 million to over \$200 million in insured value.

Who Provides Strata Insurance?

Strata insurance in B.C. is provided by the private sector, for-profit insurers, most of whom operate or are part of an international insurance group. Their size and scope give them the capability to provide insurance for the largest of risks, including strata insurance. The number of insurers providing significant supply is limited. Some insurers provide limited supply on a risk-by-risk basis.

Due to the values and risks involved, the insurers reinsure a substantive portion of the risk to specialty insurers known as reinsurers. These reinsurers back the insurers that underwrite the subscription policies by reinsuring the accumulated risk. Reinsurance is a transfer of risk from one insurer to another, allowing the risk to be spread globally.

How is Strata Insurance Provided?

For the purpose of this report, the discussion regarding strata insurance is focused mainly on properties with a higher number of units, (the duplex/triplex properties⁴³), where the insurance is written on a subscription policy basis. Each insurer subscribes to a percentage of the risk that they are prepared to accept on each property. Insurers mostly work with specialised insurance brokers who understand strata insurance and the needs of strata corporations and legal requirements.

There are primarily two types of markets. Most of the larger strata properties are insured through special programs developed by some insurance brokers and have dedicated supply for the program. The other market is provided by insurance brokers who operate on a risk-by-risk basis seeking placement through approaching insurers and obtaining participation. In both markets, the insurance broker acts as an intermediary between the strata corporation and insurers to negotiate and procure insurance. Insurance brokers often obtain most of their business from strata property managers acting on behalf of the strata corporations.

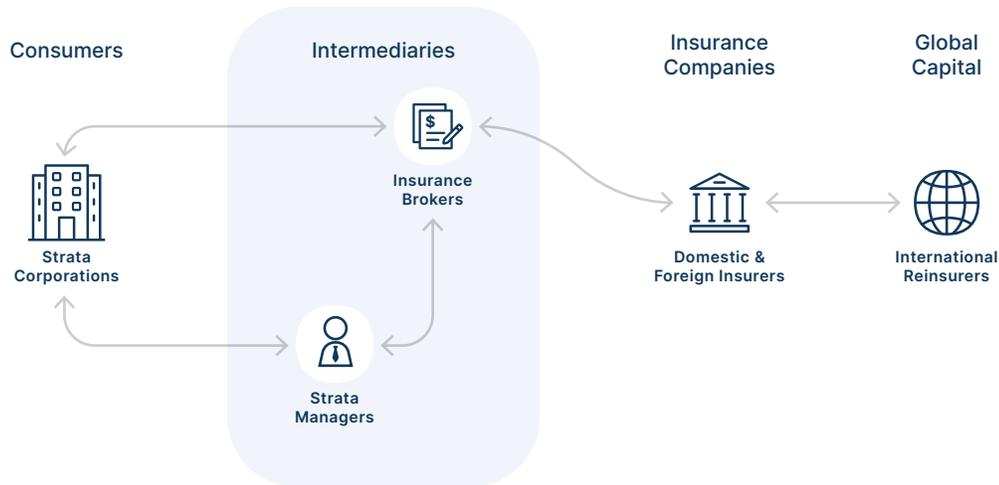
There is a third category of unique brokers. These brokers assist the placing broker when the broker cannot fill a subscription through its own markets. This is known as sub-brokering. These sub-brokers have access to markets not available to the primary broker.

⁴² More information about strata insurance for strata corporations and strata owners and tenants is available at the B.C. government's strata housing website <https://www2.gov.bc.ca/gov/content/housing-tenancy/strata-housing/operating-a-strata/finances-and-insurance/insurance>.

⁴³ It is important to note that strata-titled duplexes and triplexes are still legally required to obtain strata corporation insurance.

Strata Insurance Market⁴⁴

Figure 13



Insurance Brokers (Managing Underwriters)

A broker manages the entire subscription program – which provides a full view of all insurers on a strata property.

Multiple insurers participate in a program – their share varies by property.

How is Strata Insurance Regulated?

The insurance is provided by insurers authorised to do insurance business in B.C. BCFSAs regulates those insurers. BCFSAs applies a risk-based regulatory regime to protect consumers by ensuring the insurers are solvent and engaging in appropriate business practices. It also ensures unsuitable parties do not participate in the market. Premiums in the private sector insurance market are determined by the insurers and are not rate regulated. Most of the insurers operating in the province are companies located outside the province and subject to regulation by their primary regulators. BCFSAs works with those primary regulators and other regulators involved in Canada's insurance market to address common issues or issues specific to a particular insurer. The regulatory regimes that apply to the insurers, either by BCFSAs or by the primary regulator, can impact capital availability, risk mitigation strategies, and ultimately price and supply of insurance.

BCFSAs oversees private sector insurance companies who operate in the province, many of whom operate globally. Their size and scope allow them to provide insurance for the largest of risks, including risks pertaining to strata insurance.

Insurance regulation in Canada is a shared responsibility:

- Office of the Superintendent of Financial Institutions (OSFI) is the federal regulator for solvency and sets capital requirements for most insurers in the strata insurance market;
- The Insurance Council of B.C. regulates insurance agents, brokers and adjusters in the province; and
- Canadian Council of Insurance Regulators (CCIR) is an association of provincial insurance company regulators from across Canada. The members including B.C. work together on common issues.

WHO ELSE IS INVOLVED IN STRATA INSURANCE?

Strata Councils

A strata council is the elected executive body for a strata corporation representing the owners. Some of the functions it provides is developing the annual strata budget for approval by owners at the annual general meeting which includes proposed funding for contingency reserves and anticipated strata insurance premiums⁴⁵. As such, strata councils are a key player and are responsible for ensuring the strata corporation obtains appropriate insurance.

Strata Managers

Strata property managers in B.C. are licensed individuals that can assist a strata council in operating its strata corporation⁴⁶. The strata council can hire a strata manager to perform functions for it, including obtaining strata property insurance, managing property maintenance and dealing with insurance claims. The strata council is ultimately responsible for ensuring that its obligations under the Strata Property Act are fulfilled.

Other Participants

There are other parties that can influence how the market operates. For example, personal property insurers provide the insurance that covers the personal property of strata owners and tenants and also provide deductible buy down insurance. Condominium owner associations provide education and support to strata properties. Lenders depend on insurance to back the property pledged as security for a loan (e.g. mortgage or line of credit). Developers influence the quality and cost of the building, contribute to the initial contingency reserve fund and often arrange for the initial strata insurance coverage. Claims adjusters influence the claims costs and claims settlement processes. Appraisers are used to value the total replacement cost and other costs associated with a claim.



⁴⁵ Information about the annual budget process can be found at <https://www2.gov.bc.ca/gov/content/housing-tenancy/strata-housing/operating-a-strata/finances-and-insurance/the-contingency-reserve-fund-crf#contributions>

⁴⁶ More information on strata property managers can be found at Learn more about strata managers at the B.C. government's strata housing website: <https://www2.gov.bc.ca/gov/content/housing-tenancy/strata-housing/operating-a-strata/roles-and-responsibilities/strata-property-managers>

APPENDIX 3, KEY FINDINGS – INTERIM REPORT

Price

Premiums

BCFSA's interim findings indicated an average increase of 40 per cent year-over-year to strata insurance premiums province-wide and a 50 per cent increase in Metro Vancouver. This was based on data collected early in 2020. BCFSA's findings showed a majority (54 per cent) of strata properties experienced a premium increase of less than 30 per cent compared to premiums the previous year.

Premiums ⁴⁷		Figure 14
Range of Premium Increase	# of Strata Properties	Distribution of Properties by Premium Range
Less than 0%	78	1%
0% to 10%	249	4%
10% to 20%	1,282	22%
20% to 30%	1,487	26%
30% to 40%	926	16%
40% to 50%	864	15%
50% to 60%	-	0%
60% to 100%	543	9%
100% to 200%	-	0%
Over 200%	363	6%
Total	5,792	100%

Deductibles

BCFSA found in the interim report that deductibles were also significantly increasing, in some instance, over triple digits.

Premiums Year-Over-Year Change in Deductibles (Policies in Force) – January/February 2020 ⁴⁸						Figure 15
Building Type	All Losses Property	Flood	Water Damage	Sewer Back-Up	Earthquake	
Amenity	78%	19%	31%	31%	5%	
Bareland	244%	19%	49%	49%	5%	
Condos	130%	44%	135%	133%	11%	
Hi-Rise	124%	64%	96%	97%	8%	
Low-Rise	160%	62%	102%	102%	9%	
Townhouse	179%	58%	86%	85%	9%	

⁴⁷ Source: BCFSA – Original Data Calls

⁴⁸ Source: BCFSA – Original Data Calls; Building type definitions inconsistent across data provider.

Losses and Claims

BCFSA's findings indicated a convergence of local and global factors that are driving up the cost of strata insurance in B.C. The data that was gathered provided a picture of increasing strata insurance costs and an interim view of the many complex and underlying factors at play on a provincial, national and global level, from rising property values to earthquake risk. The data suggested insurers struggle with sustaining profitability in the strata insurance market due to losses from mostly minor claims.

Value of Claims by Building Age⁴⁹

Figure 16

Building age: All Years			Building age: 0 to 5 Years			Building age: 5 to 10 Years		
All Claims - Value			All Claims - Value			All Claims - Value		
Year	Average	Median	Year	Average	Median	Year	Average	Median
2015	\$13,048	\$2,546	2015	\$8,532	\$2,137	2015	\$8,473	\$2,625
2016	\$8,202	\$2,125	2016	\$5,601	\$2,882	2016	\$12,950	\$2,624
2017	\$8,923	\$2,414	2017	\$9,310	\$2,935	2017	\$15,389	\$2,314
2018	\$6,934	\$2,048	2018	\$8,970	\$2,439	2018	\$7,524	\$2,306
2019	\$10,015	\$2,115	2019	\$18,091	\$2,576	2019	\$4,248	\$1,863

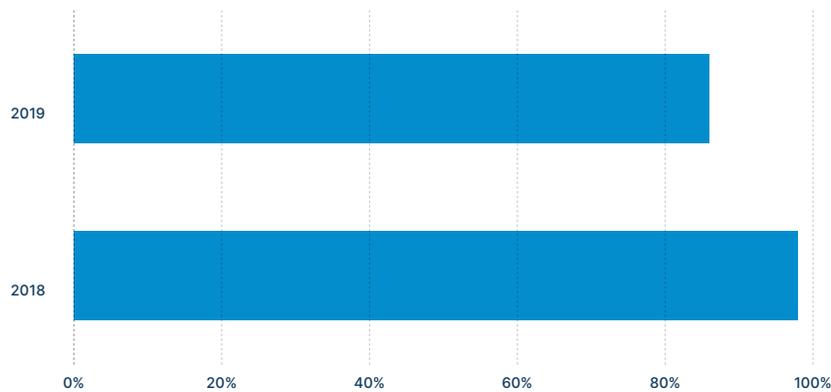
Building age: 10 to 20 Years			Building age: 20 to 50 Years			Building age: 50 Years +		
All Claims - Value			All Claims - Value			All Claims - Value		
Year	Average	Median	Year	Average	Median	Year	Average	Median
2015	\$21,828	\$2,744	2015	\$10,512	\$2,482	2015	\$7,261	\$3,028
2016	\$5,878	\$2,075	2016	\$8,483	\$1,953	2016	\$6,619	\$2,173
2017	\$7,323	\$2,507	2017	\$8,019	\$2,075	2017	\$11,414	\$3,528
2018	\$7,436	\$2,126	2018	\$6,364	\$1,803	2018	\$5,740	\$2,400
2019	\$13,113	\$2,488	2019	\$8,421	\$1,913	2019	\$7,451	\$2,002

A key metric of profitability is the combined ratio which measures how much an insurer pays out for claims losses and underwriting expenses in relation to the premium it earned. A combined ratio of 100 per cent or above represents an underwriting loss for insurers, a combined ratio of less than 100 per cent represents a profit. The average reported combined ratio was just over 100 per cent in 2019, close to 100 per cent in 2018 and over 100 per cent for 2017.

⁴⁹ Source: BCFSA – Original Data Calls; Building type definitions inconsistent across data provider.

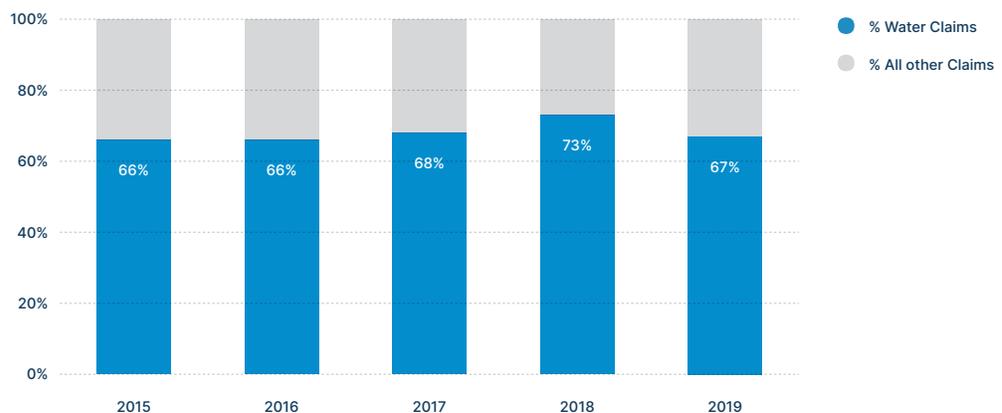
Insurers have adjusted premiums and deductibles in attempts to return to underwriting profitability. Insurers are also being more selective in the risks they write. Given the insurers operate nationally and most globally, if they do not believe they can achieve profitability in the strata insurance market in B.C., they may exit the market completely, making it much harder or impossible to obtain this insurance for British Columbians. The chart below represents the loss portion of the combined ratio. As shown, the loss portion is approaching 100% which not sustainable.

Average Loss Ratios %⁵⁰ **Figure 17**



A key driver of those losses was water damage from plumbing leaks and failures. This accounted for approximately 46 per cent of the total claim costs since 2017 (56 per cent alone in 2018). The average amount paid per water claim was relatively minor, approximately \$3,350 after the deductible. The number of water damage claims peaked in 2018 at over 11,000 separate claims, accounting for about 70 per cent of total direct claims. The data gathered suggested that strata insurance has been used to fill the gaps where proper, ongoing maintenance practices have not been implemented.

Water Claims Share (%) of Total Claims⁵¹ **Figure 18**



⁵⁰ Source: BCFSAs – Original Data Calls
⁵¹ Source: BCFSAs – Original Data Calls

Capital and Reinsurance Requirements

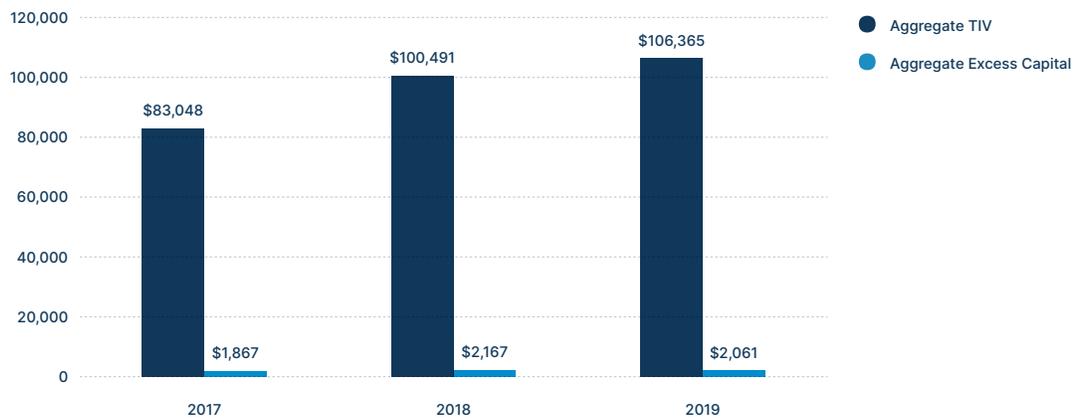
Another fundamental issue identified was the lack of supply of the insurance to serve the market adequately. It is quite possible that supply will contract further rather than increase.

Insurers cannot provide supply without reinsurance support. Their capital alone is not sufficient to cover the amount of risk insurers insure. For example, BCFSA found that the excess capital held by the insurers BCFSA sampled was approximately \$2.5 billion compared to the over \$100 billion in replacement cost of the B.C. strata properties they insure. To help cover this difference, insurers purchase insurance from other insurers called reinsurance who agree to help cover losses. BCFSA found that the insurers in the sample were currently ceding approximately 96 per cent of their Canadian earthquake risk to reinsurers. Insurers typically buy reinsurance at the corporate level for their overall risks.

Global reinsurers have identified B.C. as a high-risk market due to its earthquake exposure which is one of the factors increasing reinsurance costs and affecting corporate decisions on where these global insurers are willing to write risks.

Aggregate TIV & Aggregate Excess Capital (\$million)⁵²

Figure 19



⁵² Source: BCFSA – Original Data Calls, MSA Data

Best Terms Pricing

BCFSA identified a concern around a method used to construct strata policies that it needed to further explore, known as Best Terms Pricing.

Buildings Considered to be Higher Risk

BCFSA found that buildings considered to be higher risks were facing the most significant increases.

Year-Over-Year Change in Deductibles (Policies in Force) – January/February 2020 ⁵³						Figure 20
Construction Type	All Losses Property	Flood	Water Damage	Sewer Back-Up	Earthquake	
Fire Resistive	111%	61%	96%	96%	8%	
Frame	178%	59%	100%	99%	9%	
Masonry	55%	33%	64%	64%	4%	
Mixed	218%	86%	83%	83%	8%	

APPENDIX 4, IDENTIFIED SUPPLY AND DEMAND DRIVERS

Identified Supply and Demand Drivers to the Strata Property Insurance Crisis⁵⁴

Figure 21

Driver	Relative Significance to Crisis	Ability to Address
Supply		
Historical Loss Experience	 <p>Historical loss experience in the strata market, though negative, was not the only driver of the current affordability crisis but it was the most significant factor. The historically competitive market, coupled with unattractive loss ratios have primed this segment of the commercial property market for correction.</p>	 <p>Historical loss experience cannot be altered but the conditions under which poor loss experience arose could be addressed going forward. For example, looking at how to prevent water leaks from spreading to other units could reduce claims costs going forward (or to ensure new construction warranty provisions are better understood to potentially move some claims out of the strata insurance market).</p>
Insurer Capital Requirements		
Catastrophic Risk Modeling	<p>Increased exposure concentration leads to growing concerns regarding industry systemic risk arising from a potential 1/500 Cascadia Subduction Zone event, increased catastrophic model Probable Maximum Losses and accordant rises in catastrophe reinsurance pricing. An increased scientific understanding of liquefaction risk and significant catastrophic loss activity internationally have added to concerns.</p>	<p>Ultimately these issues all stem from the current science of earthquake risk which is indisputably absent further to developments in our collective scientific knowledge base. However, efforts could be made to alter regulatory requirements or to develop public-private solutions for risk transfer in the province.</p>
Catastrophic Reinsurance Pricing		
Demand		
Increasing Concentration of Risk	 <p>The growth in concentration of earthquake risk in catastrophe-exposed areas of B.C. is being driven by population growth which is causing urban densification and sprawl. This growth in exposure is being exacerbated by property value increases in the Vancouver real estate market which appears to result from an imbalance in the supply of, and demand for housing in the city. Ultimately, this exposure concentration is the dominant underlying cause of the strata property insurance pricing issue since it contributes to the worsening of various supply drivers mentioned above.</p>	 <p>Many efforts have already been made to slow the demand for housing in the province and by some accounts these efforts are working, helped along by COVID-19. However, curbing real estate demand is only half of the equation – to address the housing affordability issue (irrespective of the insurance affordability issue), further development of new housing supply will likely be needed, and the impact is likely to further exacerbate the insurance risk concentration issue.</p>
Increasing Insured Value		

⁵⁴ Source: Oliver Wyman

APPENDIX 5, IMPACT OF BTP ON STRATA PREMIUMS

The following figure shows the impact BTP has on strata property premiums

BTP Table #2 – Detailed ⁵⁵					Figure 22
Price Difference Paid per Strata Unit	# of Properties	# of Units	Average \$ Difference / # of Properties	% of Properties Sampled	
< Quote Rate	2	120	\$(24,426)	0.4%	
No Impact	28	1,351	\$-	5.3%	
\$0 - \$100	171	9,280	\$2,574	32.4%	
\$100 - \$200	122	7,336	\$8,860	23.1%	
\$200 - \$300	70	4,830	\$17,123	13.3%	
\$300 - \$400	39	2,685	\$23,802	7.4%	
\$400 - \$500	26	1,695	\$28,997	4.9%	
\$500 - \$600	25	1,955	\$42,854	4.7%	
\$600 - \$700	17	1,238	\$46,475	3.2%	
\$700 - \$800	7	275	\$29,845	1.3%	
\$800 - \$900	5	368	\$62,103	0.9%	
\$900 - \$1,000	4	425	\$97,575	0.8%	
\$1,000 - \$1,500	8	480	\$70,417	1.5%	
\$1,500 - \$2,000	1	93	\$162,320	0.2%	
\$2,000 - \$3,000	1 (bareland)	1	\$2,866	0.2%	
> \$3,000	1	18	\$54,896	0.2%	

⁵⁵ Source: BCFSAs – BTP Data Calls

APPENDIX 6, OVERSIGHT AND INFORMATION GAPS

BCFSA has identified the following oversight and information gaps that may need to be addressed.

Oversight and Information Gaps		
Potential Gaps Raised With Delegated Authorities		Identified Gaps
Regulatory Responsibility	BCFSA is responsible for overseeing private sector insurance companies while the Insurance Council regulates insurance brokers and agents.	NO GAP
	BCFSA often coordinates with other provincial regulators through CCIR to establish expectations or best practices that those participating in the insurance business are expected to follow. BCFSA and CCIR members have not explicitly expressed expectations for insurer oversight of delegated responsibilities in the property and casualty insurance market.	REGULATORY GAP
Insurer vs Broker vs Client Responsibility	Insurers are responsible for ensuring that brokers that assume delegated responsibilities comply with regulatory requirements related to those delegated authorities. This requires appropriate controls and continued oversight. Insurers must ensure expectations and obligations are clear in their contractual arrangements with brokers and appropriate risk management practices are in place to ensure brokers are complying with the insurer's expectations. If insurers expectations are not clear and compliance effectively monitored, there could be potential oversight gaps.	POTENTIAL OVERSIGHT GAPS
	Brokers have an interest in effectively managing specialised insurance programs to ensure insurers' continued participation. BCFSA heard insurance brokers can also serve as risk managers, providing advice to strata corporations regarding appropriate risk mitigation measures that should be taken. However, this may require a more direct relationship between strata councils and insurance brokers to ensure appropriate information is being conveyed and understood by both parties. BCFSA heard during the engagement sessions that this information flow is often challenging given property managers often act as intermediaries between the strata corporation and the broker.	INFORMATION GAP
	Strata corporations control the implementation of risk mitigation measures and maintenance programs which influence insurance costs. BCFSA heard during the engagement sessions strata councils are not always sure how the actions they take affect the prices they are offered. In other cases, BCFSA heard that the efforts of strata corporations are not being fully recognised by insurers and brokers.	INFORMATION GAP
Lack of Transparency – Underwriting Discipline	Concerns with underwriting discipline, particularly during the soft market cycle, were raised during the engagement sessions. Although risk assessments are a primary factor determining insurance prices, BCFSA heard that there is a lack of transparency regarding how pricing decisions are made and a belief by owners that there is no differentiation in pricing with all strata's receiving the same price regardless of their risk profile. This perception can partially stem from the suppression of prices that was occurring during the soft market where many properties were significantly underpriced. A lack of belief that insurers are looking at each strata property's risk profile can cause strata corporations to be less active in addressing maintenance issues, leading to more losses and higher insurance premiums for the property as the strata insurance market has hardened. Underwriting discipline in both a hard market and soft market can reduce disruptive market distortions.	OVERSIGHT GAP

Oversight and Information Gaps

Potential Gaps Raised With Delegated Authorities

Identified Gaps

Lack of Transparency – Underwriting Discipline - Sub-Broking	Similar concerns of those directly above were raised regarding sub-brokers and the influence of these arrangements on policy terms. During the current hard market, stakeholders told BCFSA that sub-brokers filling gaps on programs are quoting higher prices and thus were often setting the final price much higher than if it may have been had it been fully subscribed without them. Underwriting discipline in both a hard market and soft market can reduce disruptive market distortions.	OVERSIGHT GAP
Data Management – Insurer Responsibility	Another concern with delegated authority is the collection, storage, and use of data. BCFSA found some insurers rely on the broker to have the data and do not maintain it themselves or in a readily accessible manner. If the insurer places too much reliance on data kept by the broker it raises concerns about underwriting decisions, oversight and control issues and insurers monitoring the data to ensure consumers are being treated fairly. BCFSA believes there is a need for insurers to enhance data collection and management practices. This could include insurers collecting data directly from customers, maintain better in-house data bases, and to utilise the data as direct inputs into their business decisions.	OVERSIGHT GAP
Flow of Information	Strata insurance requires specialised knowledge, including understanding of the risks associated with particularly properties. In our engagement sessions, BCFSA heard that it is not always clear whether the insurers (or brokers) have the information and knowledge of a property's loss history or it's maintenance programs. Some of this may stem from information flow gaps described earlier and some from a need for strata corporations to be better informed as to the information it needs to provide to the broker.	INFORMATION GAP
Lack of Transparency– Market Stability	In our discussions with industry representatives, they affirmed that broker managed strata insurance programs have frequent turnover in participating insurers who are constantly re-evaluating their willingness to continue to participate in a broker's program. Some insurers leave the program due to poor performance while others may come and go based on other factors. Better underwriting discipline could create more stability for the program and insurer participation.	OVERSIGHT GAP

APPENDIX 7, ALTERNATIVE SOLUTIONS

Placing Insurance with an Unauthorised Insurer

Section 76 of the FIA permits an insurance agent to place a client's insurance with an insurer that is not authorised by the BCFSa in certain circumstances. It is meant to be a last resort option only used when the insurance cannot be placed with an insurer(s) authorised by the BCFSa. The insurance agent can only explore this option if the client is the one that requests it be considered. The insurance agent cannot be the one to initiate a discussion on using an unauthorised insurer or solicit the client to place coverage with an unauthorised insurer. This is to prevent some of the harm that has occurred in the past where some insureds were placing their insurance with unauthorised insurance strictly to get a reduced price without the clients being fully aware of the risks involved. BCFSa and the Insurance Council have both provided expectations to insurance agents regarding the use of an unauthorised insurer.

BCFSa expects that prior to placing coverage with an unauthorised insurer, the insurance agent has conducted due diligence on the insurer and provides proper disclosure to their client. In addition, BCFSa expects the insurance agent has no on-going business relationship with the unauthorised insurer and has considered the regulatory framework of the insurer's home jurisdiction, its financial solvency and market conduct practices, and the practical and legal factors affecting the enforceability of the contractual obligation in a B.C. court of law.

There are other legislative requirements that apply as well. The FIA requires the insurance agent to keep a record of the particulars of the contract and to periodically file information with the BCFSa regarding any placements. The insurer is required to seek BCFSa's approval before the insurer may inspect, adjust or appraise a loss under the contract. In addition, there is an extra insurance premium tax levied for unauthorised insurers that must be paid by the policyholder not the insurer.

APPENDIX 8, COUNTRIES WITH EARTHQUAKE COVERAGE PROGRAMS

A number of countries have created programs to provide earthquake coverage.

- Countries or regions with mega-earthquake risk exposure programs: California (U.S.), China, Japan, New Zealand, Chinese Taipei, and Turkey.
- Countries with programs for a broad range of natural perils: Albania, France, Iceland, Macedonia, Romania, Serbia, Spain, and Switzerland.
- Countries with earthquake coverage via government ownership of insurance companies: Costa Rica and Sri Lanka.

Examples of Earthquake Programs Created Following a Major Event:

- New Zealand Earthquake Commission was established following the Wairarapa Earthquake of 1942.
- Japan Earthquake Reinsurance was established following the devastation caused by the Niigata earthquake in 1964.
- California Earthquake Authority came about as a result of insurance market disruptions following the Northridge earthquake in 1994.
- Taiwan Residential Earthquake Insurance Fund was created in the aftermath of the Chi Chi earthquake in Chinese Taipei in 1999.
- Turkish Catastrophe Insurance Pool was developed in the aftermath of the 1999 Marmara earthquake.
- In 2015, the China Insurance Regulatory Commission and the Chinese Ministry of Finance established a China Residential Earthquake Insurance Pool which issues basic earthquake coverage for urban residents across the country through participating insurers.

APPENDIX 9, INFORMATION FLOW AND KNOWLEDGE GAPS

BCFSA identified information flow gaps and knowledge gaps among strata insurance stakeholders. The following figure provides some examples.

Information Flow Gaps and Knowledge Gaps		Figure 23
Stakeholder	Identified Information Flow and Knowledge Gaps	
Insurers and Brokers → Strata Council	Explain the impact of external factors on changes to premiums (e.g. earthquake risk, hazards and costs associated with building technologies or materials, etc.).	
	Ensure a clear understanding of the difference between strata property insurance coverage versus individual unit owner insurance.	
Property Managers → Strata Council	Educate strata council members on risk management, including strategies to mitigate claims, and assist with maintenance requirements.	
	Be current on insurance contract structure and obligations in order to communicate contract requirements and pricing (premium & deductible) pressures to strata councils.	
Strata Council → Strata Owners	Increase awareness of insurance products, coverage, and strata council obligations, for example at town halls, or at annual general meetings.	

BCFSA also identified areas where a better understanding of stakeholder roles and responsibilities may provide for better market stability.

Information Flow Gaps and Knowledge Gaps *Figure 24*

Stakeholders	Enhancements to Role Definition & Responsibilities
Legislation	<p>Consistency in the definition of a standard strata unit may provide for better accountability and reduce the confusion on which insurance product applies (i.e. strata corporation or the strata owner's personal insurance).</p> <hr/> <p>Incentives for strata councils to implement strategies for, and adopt a culture of, risk management.</p> <hr/> <p>Consider mandated education for strata councils and possibly term limits or reviews for larger strata properties (e.g. refer to recent changes adopted in Ontario).</p>
Insurers and Brokers	<p>Provide plain language insurance contracts to support awareness.</p> <hr/> <p>Implement risk mitigation actions, i.e. provide a list of strata property vulnerabilities to support risk management.</p> <hr/> <p>Implement incentives to improve the risk profile of a strata property.</p>
Strata Property Managers	<p>Consider if strata property managers that are involved in negotiating or procuring strata insurance for strata councils should be required to hold a restricted insurance agent's licence.</p> <hr/> <p>Review, and if appropriate, adjust the definition and training of a strata property manager to match the current role they are fulfilling in practice.</p>
Strata Councils	<p>Clarify the responsibilities of a strata property manager versus strata council, e.g. increase expectations for information to be communicated by the strata property manager regarding the potential placement of the strata insurance to enhance the strata council's knowledge of the potential terms and conditions of the insurance.</p> <hr/> <p>Build a culture of risk management by helping to manage and mitigate risks and potential costs, including training sessions on general and emergency maintenance to strata owners.</p>
Other	<p>Developers to look at potential ways to reduce or mitigate damage from spreading should a water leak occur.</p> <hr/> <p>Appraisers to consider restoration costs and other costs associated with rebuilding due to claims or catastrophic losses.</p>

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2800-555 West Hastings Street
Vancouver B.C. V6B 4N6

604 660 3555

Toll free 866 206 3030

bcfsa@bcfsa.ca