

Honourable Carole James
Minister of Finance and Deputy Premier

Ref. No.: 0616

June 16, 2020

Dear Minister:

RE: BC Strata Property Insurance Market – Interim Findings

BC Financial Services Authority (BCFSA) is pleased to report its interim findings on the strata insurance market in British Columbia (BC). At the direction of the Province, BCFSA, as the financial services regulator, initiated inquiries with the insurance sector this year to determine the cause of market pricing changes. In this report, which provides the first in-depth analysis of the issue throughout BC, we offer our interim findings and observations.

Over the coming weeks, BCFSA will be engaging further with stakeholders to explore and further validate its interim findings including the various causes along with possible regulatory and industry solutions. The final report is expected to be released in the fall of 2020.

Our findings to date indicate the following:

- Premiums have risen on average by approximately 40 per cent across the province over the past year while deductibles have increased up to triple-digits over the same period. (50 per cent in Metro Vancouver)
- Price pressures will continue. Buildings considered to be higher risk are expected to face the most significant increases as well as the possibility of not being able to obtain full, or in rare cases any, insurance coverage.
- Insurers are incurring losses mostly from minor claims (particularly those resulting from water damage) due to poor building maintenance practices and initial construction quality issues.
- Methods used to construct a strata policy also seem to be resulting in higher premiums for some properties, especially for those that are higher risk.
- New building construction, building material changes, and rising replacement costs have put further strain on industry profitability.
- Excessive exposure to earthquake risk in British Columbia has prompted insurers to reduce the amount of strata insurance they offer in the province.
- There is not enough capacity in the strata insurance market to support future expected demand.

Overall, in our opinion, the state of the strata insurance market in BC is “unhealthy”. That is, a market that fails to meet the goals of sustainability, affordability and availability. Our findings also show that all the participants involved in this market have a role to play to return it to a healthy state.

The Strata Insurance Market in British Columbia

Strata insurance in BC is provided by private sector, for-profit insurers, most of whom operate on a global basis. 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 capacity (in other words, those that make the market by “offering” strata insurance in BC) is limited to nine or ten companies and are mainly headquartered outside Canada. Other insurers provide limited capacity on a risk by risk basis.

Strata insurance is written on a subscription policy basis. That is, each insurer subscribes to a percentage of the risk that they are prepared to accept on each property. Insurers mostly work with specialized insurance brokers who understand strata insurance and the needs of strata corporations.

There are three main brokers in the strata insurance market in BC. These brokers have developed their own special programs aimed at strata insurance. The brokers obtain most of their business from strata property managers acting on behalf of the strata corporations. If a broker is unable to fully insure a property with the insurers it normally works with, it may seek out coverage from speciality providers. Insurers are not obligated to provide strata insurance.

In BC, strata insurance generates approximately \$300 million in premiums and covers well in excess of \$100 billion of insured property value. It is mandatory insurance under the *Strata Property Act* (SPA) and must provide full replacement value of the common property and common assets of the strata corporation. The insurance does not cover the individual strata units which owners need to cover under an individual policy. Earthquake coverage is not required under the SPA, 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 BC and properties can range from under \$1 million to over \$200 million in insured value.

Strata insurance can impact housing affordability for both homeowners and renters and the cost of individual homeowners’ condominium insurance. Lack of availability can place both at risk in the event of a loss.

BCFSA is the regulatory agency responsible for overseeing private sector insurance companies who operate in the province. BCFSA works to protect consumers by ensuring insurers are solvent, they engage in appropriate business practices, and monitor the suitability of insurers in the province. Rates in the private sector insurance market are determined by the insurers and are not rate regulated. BCFSA works with other regulators involved in the insurance market in BC and in Canada.

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 BC (Insurance Council) 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 work together on common issues.

Strata Insurance Inquiries

In February 2020, at the request of the Province, BCFSA initiated inquiries under section 213 of the *Financial Institutions Act*. Working with the three major brokers and with the larger insurers in the strata insurance market, inquiries were aimed at obtaining data and other information regarding the pricing increases and the lack of availability. Detailed information on this specific market is not normally collected as part of regulatory filings. The data calls were representative sample based, designed to draw broad market observations of the strata insurance industry in BC.

Strata Insurance Increases

BCFSA's interim findings indicate 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.

BCFSA's findings show a majority (54 per cent) of strata properties experienced a premium increase of less than 30 per cent compared to premiums the previous year. 31 per cent of strata properties captured by our data call saw increases in the 30 – 50 per cent range, 9 per cent of properties faced year-over-year increases of 50 – 100 per cent, and 6 per cent of properties saw strata insurance premium increases in excess of 100 per cent compared to the previous year.

Strata Insurance Losses

BCFSA's interim findings indicate a convergence of local and global factors that are driving up the cost of strata insurance in British Columbia. The data that has been gathered provides 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.

Data suggests that insurers have struggled with sustaining profitability in the strata insurance market due to losses from mostly minor claims. A key metric of profitability is the combined ratio which measures how much an insurer pays out for losses and expenses in relation to the premium it earned. A combined ratio of 100 per cent or above represents a 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. Insurers have adjusted premiums and deductibles in an attempt to return to a 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 BC, they may exit the market completely, making it much harder or impossible to obtain this insurance for British Columbians.

A key driver of those losses is 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 is 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 suggests that strata insurance has been used to fill the gaps where proper, ongoing maintenance practices have not been implemented.

Insurers have also focused on new buildings as being of higher risk. The data sample indicated average claims cost for buildings less than five-years-old was \$18,000 compared to \$10,000 for all ages. This may be a result of strata insurers absorbing costs that could be covered under the new home warranty programs. Claims are being directed to strata insurance, in part due to uncertainty as to whether the new home warranty will cover the loss.

It is often unclear whether the cause of the loss was from a construction defect or poor maintenance. Industry raised questions regarding lack of clarity over what forms part of an individual strata unit, and the uncertainty that new home warranty covers consequential damage due to poor construction. Strata insurers are now appearing to be more reluctant to insure new buildings less than five-years-old. Other buildings being heavily scrutinized include those that are less fire resistant, older buildings, and buildings that have poor maintenance records.

Strata Insurance Capacity

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

Insurers cannot provide capacity without reinsurance support. That is, their capital alone is not sufficient for the amount of risk insurers are exposed to in BC. The excess capital of the insurers we sampled is approximately \$2.5 billion compared to the over \$100 billion of strata property value they insure. Insurers manage this risk by purchasing reinsurance, whereby other companies purchase portions of an insurer's risk portfolio. The insurers sampled are 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. Reinsurance costs have been increasing globally and are likely to increase further due to the global increase in the frequency and amount of losses from catastrophic events and from new earthquake risk research.

Global reinsurers have identified BC as a high-risk market and the costs for reinsurance is affecting corporate decisions on where to allocate their capital. Choices made by insurers on capital allocation and market participation are being made on a global basis and often by head offices outside Canada. There is pressure to reduce the exposure to BC earthquake risk and improve profitability. Without solutions that reduce insurers' exposure to earthquake risk, there will not be enough capacity to support demand.

Method to Construct Strata Policies

While the above noted factors provide justification for some strata insurance premium increases, BCFSA has also identified a concern around a method used to construct strata policies that it wants to further

explore. In a contract involving a number of insurers each insuring a portion of risk, standardized terms that apply to all participating insurers are needed in order for that contract to work. To create this standardization of terms, a method known as *Best Terms Pricing* is used by industry.

When each insurer quotes on a strata property, it sets out the amount of risk it is prepared to accept (participation percentage) and a rate charge (price per insured dollar). The quotes from all the insurers involved form the basis of the insurance premium paid by strata homeowners. The quotes are conditional quotes, based on all the insurers receiving the same terms. Instead of the premium being set by the quote of each insurer, or by an average of all quotes, under *Best Terms Pricing* the final price is set by the highest rate quoted by any of the insurers on the policy.

The method of determining prices is used across the country for strata and some other types of commercial insurance. However, its impact seems to be compounded in a market where capacity is scarce, and insurers are highly selective on risk. This can lead to an increase in the spread between average bids and the highest bids, which results in higher prices. This pricing method is believed to be a factor in why a number of the properties in BC have experienced significant premium increases. As part of its upcoming engagement with stakeholders, BCFSa will be exploring *Best Terms Pricing* to better understand its impacts not only on pricing (positive and negative) but also on capacity in BC.

Conclusion - Unhealthy Market

A healthy market is one that meets the goals of sustainability, affordability and availability. It is a market where consumers' needs are met by products and innovation made readily available and affordably priced and where customers are treated fairly. The supply of insurance is stable and sustainable.

The current unhealthy state of the BC strata insurance market is not fulfilling the needs of British Columbians, nor is it profitable for the insurance industry. All participants involved in this market have a role to play to return it to a healthy state. BCFSa intends to undertake further consultations with stakeholders in the market to look at what can be done to improve the overall state of the market.

BCFSa looks forward to providing its final report in the fall of 2020.

Regards,

Blair Morrison
Chief Executive Officer

cc: The Honourable Selina Robinson,
Minister of Municipal Affairs and Housing