Cassels

Controlling Increasing Strata Insurance Costs in British Columbia

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On September 13, 2020, the Government of British Columbia issued an announcement, advising that regulatory changes (the Regulatory Changes) will be adopted to address the increasing strata insurance costs in British Columbia.

Background

Prior to announcing the Regulatory Changes, the British Columbia legislature passed Bill 14 – 2020: *Municipal Affairs and Housing Statutes Amendment Act (No. 2), 2020* (the Bill). The Bill amends insurance-related provisions of the following two pieces of legislation: *Strata Property Act* (SPA) and the *Financial Institutions Act* (FIA).

The Regulatory Changes and the Bill result from an interim report issued by the British Columbia Financial Services Authority (BCFSA) in June of 2020 (the Interim Report). The purpose of the Interim Report was to canvass the insurance sector to determine the causes of strata insurance market pricing increases. The essential finding of the Interim Report is that strata premiums have risen significantly throughout British Columbia: premiums have risen on average over the past year by approximately 40%. Ultimately, the BCFSA concluded that the strata insurance market in the province is “unhealthy.”

Some of the reasons cited in the Interim Report for the price increase are as follows:

- methods used to construct a strata policy;
- excessive exposure to earthquake risk in British Columbia; and
- many high-risk buildings.

These factors, among others, effectively reduce capacity of insurers for, and the availability of, strata insurance in the British Columbia market.

The BCFSA has advised that its final report on this matter is expected to be released in the fall of 2020.

Corresponding Changes to Related Guidelines

Set out below are the Regulatory Changes that are likely to have a direct impact on the insurance community, including insurers, insurance agents or insurance salespersons. Please note there are other important changes set out in the Regulatory Changes which should be reviewed by insurers, insurance agents, and insurance salespersons; however, such changes are beyond the scope of this discussion.

- *Strata Insurance Referrals*: With immediate effect, in connection with the placement of a strata policy, insurers, agents, and insurance salespersons are prohibited from paying or allowing to be paid, or offering or promising, a referral fee to a person who is not a licensed agent or licensed salesperson.
- Effective as of November 1, 2020,

a. *Commission Disclosure*: The amount of commission an insurance agent is entitled to with respect to the placing of a strata policy (or a reasonable estimate of the same) must be disclosed to the strata corporation at the time of placing the strata policy.

b. *Notice of Non-renewal/Material Changes*: Insurers and insurance agents are required to provide strata corporations with 30-days' advance notice of non-renewal of, and any material changes to, strata policies.

c. *Regulatory Enforcement*: Failure to disclose commissions to the strata corporation or provide notice of non-renewal/material change or any payment of a referral fee in contravention of the FIA could result in reprimand, suspension or cancellation of a license, attachment of conditions to a license, or the imposition of a fine not to exceed $50k for a corporation and $25k for an individual.

Strata Insurance Pricing

Due to the size and nature of the risk that a typical strata insurance policy covers, strata insurance is commonly underwritten on a subscription policy basis, meaning that multiple insurers subscribe to a percentage of the risk covered by the strata policy. As set out in the Interim Report, it is not uncommon for up to nine to ten insurers to subscribe to any one strata policy in British Columbia.

Insurers have tried to simplify the process of constructing a strata policy by seeking standardized terms that apply to all insurers participating in such strata policy. Consequently, some insurers adopted the method of "best terms pricing." The method of best terms pricing works as follows. Each of the insurers quoting on a strata policy submits its quote for the portion of the risk it is willing to insure. This quoting process will establish the premium to be paid by the strata homeowners. However, because such quotes are conditional on all insurers receiving the same terms (e.g. premium), the premium is set by the highest rate quoted instead of using, for example, an average of the quotes.

The Interim Report found that, while the practice of best terms pricing is used throughout Canada, material adverse consequences arise (i.e., significant increases in premiums) when capacity in a market is scarce

and insurers are selective with respect to risks.

BCFSA Issued Undertakings and Industry Considerations

While the above-described Regulatory Changes are designed to control strata insurance premiums and provide pricing transparency in the marketplace, it is worth noting that none of the Regulatory Changes directly governs strata insurance premiums. While strata insurance is mandated under the SPA, strata insurance is underwritten in the private sector. Consequently, strata insurance premiums are not directly regulated.

Notwithstanding the foregoing, BCFSA, through its supervisory and oversight powers, is directly monitoring the market conduct of licensed insurers participating in the British Columbia strata insurance market and may indirectly regulate pricing by requesting an undertaking of such insurance companies. BCFSA is within its mandate to require insurers to execute an undertaking under Section 208 of the FIA, whereby the subject insurer must undertake not to use best terms pricing in connection with the construction of a strata policy.

In the event that the BCFSA exercises its right to request an undertaking from an insurer participating in the strata insurance market in British Columbia, the insurer should carefully consider the nature of its business and the content of the undertaking in question, to ensure that the undertaking does not unreasonably interfere with its business operations and that the insurer has sufficient time to comply with the undertaking. Some matters to consider prior to executing an undertaking are as follows:

- the scope of the definition of “best terms pricing” and reasonable exceptions to prohibited conduct;
- the implementation of controls with respect to third-party intermediaries’ exercise of underwriting authority on behalf of an insurer, to ensure continuing compliance with the undertaking by such insurer; and
- the availability of classifying the undertaking and its contents as privileged supervisory information under the FIA.

The above is not an exhaustive list of considerations to table before executing an undertaking. Rather, the above are simply examples of some considerations that an insurer should contemplate, with the advice of legal counsel, before executing an undertaking.

This publication is a general summary of the law. It does not replace legal advice tailored to your specific circumstances.