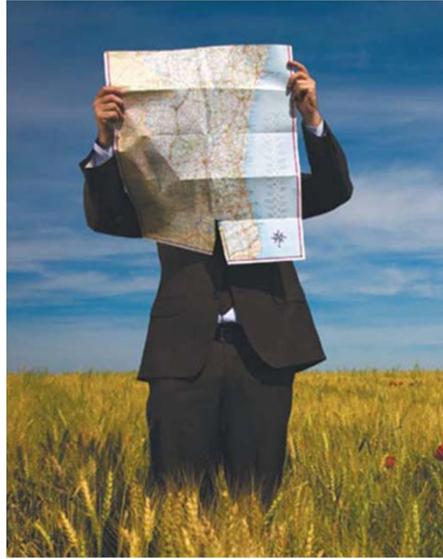


Do You Need Directions, Sir?



Insurance: Are Your Assets Covered?

Brought to you by:



Agenda

- Legal Framework of Insurance Requirements
- First Party vs. Third Party Coverage
- Property Coverage
- Crime Coverage
- Automobile Coverage
- General Liability Coverage
- Directors and Officers Coverage
- Workers Compensation Coverage
- Umbrella Coverage

How to Successfully Navigate Through Your Association's Insurance

1. Understand and apply the legal framework for Community Association Insurance
2. Create a master package policy for your Community Association which includes:
 - Property coverage
 - Crime Coverage
 - Commercial Automobile coverage
 - General Liability coverage
 - Umbrella coverage
 - Directors and Officers coverage
 - Workers Compensation coverage

Legal Framework for Insurance Requirements

1. **State enabling statutes** – Some states, including Pennsylvania, require that property coverage for buildings include the developer’s original specifications. This policy form is known as a single entity contract.
2. **Governing documents** – Are there specific requirements for liability limits? Is boiler and machinery coverage required? Is a waiver of subrogation against unit owners required? Failure to be in compliance with document requirements could be seen as a breach of fiduciary responsibility by the board of directors.
3. **Governmental requirements** – A variety of local, state and federal laws affect insurance purchases. Building codes and health ordinances are common at the local level. Workers Compensation is a common state-level example. Flood insurance is the best known example at the federal level.
4. **Secondary market and lender requirements** – FannieMae and FreddieMac as well as the Federal Housing Administration (FHA) and the Department of Veterans Affairs (VA) have extensive insurance requirements in their Seller Guides. Specific guidelines include those for property and crime coverage.
5. **Contractual Obligations** – Community associations may have assumed liability with municipalities for canopy or awning structures or in the contract with their community association management company. These types of contractual exposures are usually very insurance, but, like most risks, they need first to be recognized.
6. **Good business judgment** – Good business judgment is essential to risk management. The absence of an explicit requirement to purchase insurance coverage in the face of any exposure to loss will not excuse the board from breach-of-duty charges.

First Party versus Third Party Coverage

- First Party Coverage
 - Coverage to protect the Community Association in the event that the Community Association suffers a loss to It's property or financial well-being.
 - Example: ABC Condominium association has a fire and reports a claim to repair or replace the damaged property.

- Third Party Coverage
 - Coverage that protects the Community Association from claims made against them by a 3rd party.
 - Example: A visitor slips and falls on the property of ABC Condominium. That visitor files a claim against ABC Association.

Property Coverage: Definition of a “Unit”

Bare Walls

Provides coverage for common and limited common elements. It *excludes* property within the **unfinished interior surface** of the perimeter walls, floors and ceilings of units or private storage areas, additions, alterations and structural repairs, finishes, coating and coverings of walls, floors, ceilings, and permanently installed appliances and fixtures.

Original Specifications

Provides for common elements, limited common elements, and property included in units and private storage areas which were **initially installed in accordance with the association’s original plans and specifications** or a replacement of like kind and quality.

All In

Provides coverage for common elements, limited common elements, property included in units and private storage areas and improvements, betterments, additions, alterations and upgrades **made at the expense of the unit owner**, regardless of when they were installed.

Property Coverage

The Association's review of property covered should examine what items are covered, for what perils and for what coverage limits.

- **Buildings** – Could include residences, club houses, meeting centers, boat houses, carports, garages, sewage treatment facilities, and heating and air conditioning plants. Could also include foundations; pipes, wires, conduits, and utilities whether above ground or below; heating, ventilating and cooling systems; sprinkler, fire protection and security systems; permanently installed building machinery and equipment; balconies; porches; decks; and patios.
- **Structures** – Could include arbors, awnings or canopies, bridges, bulkheads, cabanas, courts for handball, courts for racquet sports, flagpoles, fences, walkways, roadways, foundations, gatehouses, gazebos, piers, docks and wharves, pump houses, recreation fixtures, retaining walls, swimming pools and statues.
- **Other Property** – Could include antennas and satellite dishes, electronic data processing equipment and software, fine arts, indoor and outdoor furnishings, glass, personal effects, property of others, property off premises, signs, and trees, plants and shrubs.
- **Loss of Income** – Provides coverage to replace the lost income during the period when damage to the premises or other property prevent this income from being earned. For example, loss of maintenance fees when a unit is damaged by fire.
- **Extra Expense** – Provides coverage for the additional expenses needed to continue the operation of the association following a loss. The expense of a temporary office, phone lines and equipment rental would be an extra expense.

Property Coverage: Valuation of Loss

- **Replacement Cost** – Allows for recovery of the loss on the basis of actual replacement without regard for depreciation. Property values are considered on the basis of new for old, subject to a specific policy limit.
- **Guaranteed Replacement Cost** – Allows for replacement cost with no limit. The coverage form will not state a specific property limit and allows recovery of a loss to be whatever the replacement cost is at that time.
- **Actual Cash Value** – Allows for the cost of new materials at the time of loss, plus labor and other charges, less depreciation for wear and tear, use and obsolescence.
- **Blanket Coverage** – Enables a number of objects of insurance (buildings and/or contents) to be grouped together and insured for a single amount.
- **Agreed Amount or Agreed Value** – Coverage which waives any coinsurance clause in the insurance contract and eliminates the possibility of a coinsurance penalty if property is not insured to value at the time of loss. Note that some policies have no coinsurance clause and are automatically written on an agreed value basis.
- **Increased Cost of Construction** – As a property ages, it will become subject to updated building codes. In the event of a loss, reconstruction may be required to meet current codes. For example, a sprinkler system in a building or handicapped facilities in a restroom may be required for rebuilding.

Property Coverage: Cause of Loss

- **Special Form** – This coverage form is also known as “all risk” or “open peril” and provides protection for all perils except those specifically excluded. While the special form is the broadest available, there are many variations in perils excluded such as: sewer back-up, artificially generated electric current or mysterious disappearance for property of others. Standard exclusions include flood, earth movement, war and military action, nuclear reaction and material factors such as wear and tear, rust, corrosion, deterioration, hidden or latent defects, settling, cracking, bulging, shrinking or expanding.
- **Contingent Liability from Building Laws** – To understand this coverage, one must recall that the special form, replacement cost policy will repair or replace those items damaged by the peril of fire, wind, etc. However, if a regulatory authority condemns a whole building rather than allowing the repair or replacement of the damaged portion of the building, the whole building is lost. Contingent Liability coverage is needed to rebuild the undamaged portion of the building while the standard policy form will rebuild the damaged portion of the building.
- **Demolition Costs** – When the Contingent Liability clause becomes operative, the undamaged portion of the building must be razed before it can be rebuilt. Demolition Cost coverage affords this protection.

Boiler and Machinery Coverage

- Boiler and machinery coverage provides coverage for exposures which are normally excluded in the property coverage form.
- Boiler, pressure vessels and mechanical equipment including compressors, pumps, fans, blowers, engines, turbines and wheels can be covered for mechanical breakdown perils. Most boiler forms will provide coverage for individual heating and air conditioning units, as well. Loss of income and extra expenses incurred as a result of a mechanical breakdown can also be covered.
- Common terminology necessary to understand boiler and machinery coverage include:
 - **Accident** – A sudden accidental breakdown of the object or part which manifests itself by physical damage and necessitates repair or replacement of the object or part.
 - **Repair or Replacement** – Reimburses the association for the amount actually expended to repair or replace damaged property. Payment is normally made for the lowest of the costs either to repair or replace the object or part.
 - **Extra Expenses** – Expenses incurred to continue operations after an insured accident; i.e., rental equipment.
 - **Expediting Expenses** – Expenses incurred to get the association back in operation in the shortest time possible; i.e., air freight fees.
 - **Joint Loss Agreement** – Provides prompt payment of a claim for the association when the package and boiler and machinery

Crime Coverage

- Also known as Employee Dishonesty or Fidelity Bond
- Employee dishonesty coverage indemnifies the association for loss of money, securities, or any other property due to acts of fraud, dishonesty, forgery, theft, larceny, embezzlement, wrongful abstraction, or willful misapplication or misappropriation, or any criminal act.
- Coverage is provided only for the association's employees, unless it is specifically broadened. Directors and officers of the association and employees of the community management firm who handle the association funds should also be covered. Association documents and/or FNMA guidelines may specifically require that coverage be broadened.
- Mortgagee requirements are getting more stringent due to current economic conditions.

Fannie Mae Insurance Guidelines for Crime Coverage

1. The policy must cover the maximum funds that are in the custody of the homeowners' association (or co-op corporation) or its management agent at any time while the policy is in force
2. A lesser amount of coverage is acceptable if the project's legal documents require the HOA/Condo and any Management company to adhere to one or more of the following financial controls
 - Separate bank accounts are maintained for the working account and the reserve account, each with appropriate access controls, and the bank in which funds are deposited send copies of the monthly bank statements directly to the HOA/Condo
 - The management company maintains separate records and bank accounts for each homeowners' HOA/Condo that uses its services, and the management company does not have the authority to draw checks on, or transfer funds from, the HOA/Condo's reserve account
 - Two members of the Board of Directors must sign any checks written on the reserve account
 - Even then, the fidelity insurance coverage must equal at least the sum of three months of assessments on all units in the project

Courtesy of the Fannie Mae Single Family Selling Guide – March 2, 2010



FHA Insurance Guidelines

- **Hazard Insurance:** The homeowners association (HOA) is required to maintain adequate “master or blanket” **property insurance in an amount equal to 100% of current replacement cost of the condominium** exclusive of land, foundation, excavation and other items normally excluded from coverage. **If the HOA does not maintain 100% coverage, the unit owner may not obtain “gap” coverage to meet this requirement.**
- **HO-6 Coverage:** In cases where the master policy does not include interior unit coverage, including replacement of interior improvements and betterment coverage to insure improvements that the borrower may have made to the unit, the borrower must obtain a “walls-in” coverage policy (HO-6 policy).
- **Liability Insurance:** The HOA is required to maintain comprehensive general liability insurance covering all of the common elements, commercial space owned and leased by the owner’s association, and public ways of the condominium project.
- **Fidelity Bond/Fidelity Insurance:** Fidelity Bond/Fidelity Insurance is required for new and established condominium projects with 20 or more units. The HOA must maintain this insurance for all officers, directors, and employees of the association and all other persons handling or responsible for funds administered by the association. **The coverage must be no less than a sum equal to three months aggregate assessments on all units plus reserve funds.**

Courtesy of the U.S Department of Housing and Urban Development – November 6, 2009



FHA Flood Insurance Guidelines

Flood Insurance: Insurance coverage equal to the replacement cost of the project less land costs or up to the National Flood Insurance Program (NFIP) standard of \$250,000 per unit, whichever is less. In the insuring of a residential condominium building in a regular program community, the maximum limit of building coverage is \$250,000 times the number of units in the building (not to exceed the building's replacement cost). The HOA, not the borrower or individual unit owner, is responsible for obtaining and maintaining adequate flood insurance under the NFIP on buildings located in a Special Flood Hazard Area (SFHA). The flood insurance coverage must protect the interest of borrowers who hold title to an individual unit as well as the common areas of the condominium project. If the FHA Roster Appraiser reports that buildings in a condominium project are located in a SFHA the lender is responsible for ensuring that the HOA obtains and maintains adequate flood insurance on buildings located within the SFHA, per Mortgagee Letter 2009-37.

Determining Need for Flood Insurance

- Mortgagees must determine whether the property improvements (dwelling and related structures/equipment essential to the value of the property and subject to flood damage) are located in a 100-year flood plain. If the property is in a 100-year flood plain, flood insurance is required, per Mortgagee Letter 2009-37. To demonstrate and document that the property is not located in a 100-year flood plain and not subject to flood insurance requirements, the mortgagee must obtain:
 - A final Letter of Map Amendment (LOMA) or
 - A final Letter of Map Revision (LOMR)

Courtesy of the U.S Department of Housing and Urban Development – November 6, 2009



Commercial Automobile: First Party Coverage

- **Collision** – Covers damage to the automobile when the automobile hits, or is hit by, another vehicle or object
- **Comprehensive** – Includes all direct and accidental losses not caused by collision. Examples include:
 - Contact with Bird or Animal
 - Falling or flying objects
 - Theft
 - Fire, Windstorm, Hail, Water or Flood
 - Vandalism
 - Vandalism
 - Riot
 - Breakage of glass

Commercial Automobile: Third Party Coverage

- Protects the association from liability for operation of automobiles that it hires, rents, leases or borrows.
- If the association has no owned automobiles, non-owned and hired automobile coverage should still be secured. Often these coverages can be included on the master package policy.
 - **Non-Owned Automobile** – Provides protection against the exposure of the association from liability for operation of autos that it does not own. For example, a claim could be made against the association when an employee is involved in an auto accident while on association business.
 - **Hired Automobile-** Protects the association from liability for operation of automobiles that it hires, rents, leases or borrows.

General Liability: Coverage Basics

- Liability coverage insures against third party claims arising from alleged bodily injury or property damage to members of the public.
- The insurance company has the duty to defend the association against any claim which alleges injury or seeks damages regardless of whether the association is negligent
- A comprehensive general form is preferred as it covers all operations of the association and is not restricted to the association's premises.
- Liability Limits:
 - **Occurrence** – An occurrence means an accident that results in injury or damage neither expected nor intended from the standpoint of the insured.
 - **General Aggregate** – The general aggregate limit is the most the insurance company will pay for any and all liability occurrences or losses under the policy during any one policy year.

General Liability: Extensions of Coverage

- o **Additional Insureds** – Provides employees and property managers acting within the scope of their duties the same liability protection afforded the association.
- o **Advertising Liability** – Protects the association against injury arising from advertising activities including slander, defamation of character or libel.
- o **Contractual Liability** – Provides coverage if the association has entered into any contracts where it agrees to indemnify or hold harmless the other party.
- o **Cross Liability** – Provides protection if an owner or member of the association sues the association for bodily injury damages occurring on a common area as a result of negligence by either a unit owner or the association.
- o **Garagekeepers' Legal Liability** – Provides protection for the automobiles of unit owners or guests that are in the care, custody or control of the association, such as attendants that park cars. Coverage is provided for such perils as collision, vandalism and theft.
- o **Host Liquor Liability** – Provides coverage for liability that may arise if the association sponsors events where liquor is consumed or served.
- o **Independent Contractors Liability** – Protects the association from loss due to liability arising from operations of subcontractors.
- o **Medical Payments** – Provides coverage for medical expenses of members of the public injured on the common property whether or not the association is liable.
- o **Personal Injury** – Extends bodily injury to include false arrest, detention or imprisonment, malicious prosecution, libel, slander, defamation of character, invasion of privacy, wrongful eviction and wrongful entry. Some forms may also include coverage for humiliation and discrimination.
- o **Property Damage Legal Liability** – Provides coverage for the association for property of others in the association's care, custody or control at the time of loss. Some forms limit coverage to the peril of fire only.
- o **Severability of Interest** – Precludes the insurance company from denying liability because of negligent acts of the association or a unit owner.
- o **Employee Benefits Liability**-Employee benefits liability provides coverage for errors and omissions which may occur in the administration of the association's employee benefits program. Usually written on a claims made form, the coverage will respond, for example, when in the event of an administrative error an employee is not added to the group health policy and the employee or covered family member suffers a serious illness or accident.

Umbrella Liability

- The umbrella liability policy provides coverage in excess of general or primary liability and other coverages which could include automobile liability, employers' liability (workers' compensation), and directors and officers liability.
- An umbrella policy becomes effective when primary or underlying limits have been exhausted, or when a claim develops that is not covered by primary insurance but is covered by the umbrella policy.
- It is important to distinguish the breadth of the umbrella coverage form. It may be an excess form which is the same as the primary coverage, it may be a following form or it may be a form that is broader than the primary policy.
- Determine whether defense costs are provided in addition to policy limits. Establish whether there is a self-insured retention which applies to coverage not included on the underlying or primary policy.

Directors & Officers Liability

Basic Definition

- Directors and Officers Liability provides protection against claims alleging loss arising from mismanagement or wrongful acts.
- A wrongful act means any breach of duty, neglect, error, misstatement, misleading statement, omission or other act done or wrongfully attempted by the association.
- **Employment Practices Liability:** Employment practices liability provides coverage against claims arising from alleged improper employment practices, including wrongful termination, discrimination and sexual harassment to employees of the association. (D&O)

Scope of Coverage

- **Claims Made Form** – Provides protection for claims made or presented to the insurance company while the policy is in force, without regard to when the event occurred. Most D&O policies today are written on a claims made form.
- **Full Prior Acts** – Protection for losses which occurred before the policy inception on a claims made coverage form. Full prior acts coverage eliminates a retroactive date.
- **Retention** – Amount of claim payment for which the association is responsible. The retention may be in addition to a policy deductible.
- **Persons Insured** – Should include the association; directors and officers, past and present (elected or appointed); employees; committee chairs and members; and other association members acting at board direction.

Directors & Officers Liability

How It Pays

- **Indemnity Contract** – The insurance company will indemnify the association for any costs for which the association becomes legally liable. The association is responsible for hiring and paying legal counsel until indemnified by the insurance company. Indemnification may not occur until the claim is concluded.
- **Pay on Behalf of Contract** – The insurance company will choose legal counsel, handle the claim, and pay any costs for which the association becomes legally liable including costs of the defense.
- **Defense Costs** – Determine whether defenses costs are included in the policy limit or paid in addition to the policy limit.

Exclusion Review

- The coverage provided by directors and officers liability forms varies greatly. The extent of coverage provided or not provided can be determined by reviewing policy exclusions. Those exclusions may include:
 - Failure to maintain adequate insurance
 - Non-monetary damages (the most common type of D&O claim today)
 - Discrimination
 - Injunctive relief
 - Wrongful termination