# Fitting the Pieces

## A Solid Strategy Puts an Association's Insurance Pieces in Place: Part II

*by Joel W. Meskin, CIRMS*

***EDITOR'S NOTE: In the February issue, author and attorney Joel W. Meskin wrote on "The Community Association Insurance Puzzle: Where to Begin?" In this issue, Mr. Meskin concludes with a discussion of the types of insurance coverage available and helps associations learn where to fit the pieces. The insurance puzzle is both complex and is not an exact science. In the association context, the key is informed decision making. The more the board knows about insurance and its potential exposures, the better chance it will have the coverage that it needs. --JD***

*Once you have received the documents, the laws and the exposures, it is time to review what insurance is currently in place. What should be done next, if you do not already have one, is to put together an insurance schedule. This should include the following: type of coverage, insurer, A.M. Best rating, policy number, effective date, limits and premium.*

### Property Coverage

Property coverage is probably the most common coverage that people are concerned with. Specifically, when you close on your unit, you are required to provide your lender with evidence of the master insurance covering the building; whether a condominium or cooperative. If it is a single family homeowners association, you would be required to purchase a homeowner's policy. This coverage is very critical and is very dependent on where you are in the country. Does the policy include full replacement cost coverage, building ordinance coverage, all risk coverage or specified perils? Do you have sewer backup coverage? Do you need flood, windstorm and earthquake?

Important questions to ask also include: Are you insured to value? Who has done an appraisal, if anyone? Who has determined the replacement cost number? There is no short cut. You need to be aware of agents who may be claiming that the replacement value is less, because they want to present a lower premium to entice you.

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## General Liability

The general liability coverage is critical. What makes a community association is the existence of commonly owned property. Why this is critical is that you do not individually control the common area. Thus, you are placing trust in the association and its management mechanism to properly maintain and control the common areas. Although you may not be subject in most states to being personally sued for an action arising out of alleged damages involving the common area (such as a slip and fall, or damage to a third party's property), you, as an association member, will ultimately be responsible for any non-insured or an undersigned incident. The most common example would be a judgment in excess of the association's limit of liability. This is all too possible in this day and age of runaway judgment awards.

For example, let's say there is a horrific incident where someone drowns in a pool. If there is a $5 million judgment and there is only $1 million in general liability coverage, the excess judgment will have to be satisfied in some alternative manner. Most likely, this will be done by the way of the board issuing a special assessment against the association members. This special assessment, if it is large, or extended over a long period of time, may impact the value of the unit in the eyes of potential purchasers. In addition, any reserve funds or monies may be at risk to satisfy the judgment. Thus, an otherwise diligent association, which has done things by the book and have properly funded capital reserve accounts may find those accounts used to satisfy otherwise uninsured losses.

In the general liability context, some of the key issues to look for are: the definition of insured – does it include the non-compensated directors and officers, volunteers or committee members; and the existence of personal injury coverage, which in conjunction with the definition of insured may determine the extent to which personal injury coverage will be critical to include within the Director's & Officer's policy.

## Director's & Officer's Liability Insurance

The Director's & Officer's Liability Insurance (D&O), although not one of the largest ticket items from a premium standpoint, is both one of the most critical and one of the most complicated. The coverage is critical, because the association wants to attract the best people to join the board and manage two of your greatest assets: your home and your lifestyle. If you do not have talented people in those roles, you will have to take a more active role to monitor these investments. It is one of the most complicated, because there is more variance in the types of coverage available than with other community association insurance products.

The first step in the evaluation is whether the D&O policy the association has is an endorsement imbedded in a package policy or whether it is a stand-alone policy. As a general rule (although not an absolute rule), the coverage that is imbedded in a package policy tends to provide much more narrow coverage. This is not an area where the association should be attempting to save a few hundred dollars.

The association must also beware when they are purchasing these package policies with an imbedded coverage for other reasons as well. First, the broker selling the package policy may only have this coverage to sell and therefore is not going to take the time to tell you about coverage they do not have. Second, since this is not a high ticket item; the agent may not be motivated to sell you a broader policy where they will only be making a few more dollars. It is a cost/benefits analysis for the agent.

The imbedded policies tend to provide much more narrow coverage. For example, the imbedded policies tend to be limited as follows:

*The definition of insured is limited to the board during the policy period;*
*The insuring agreement is limited to "non-monetary" claims;*
*The policy excludes personal injury coverage;*
*The policy may be a reimbursement policy with no defense obligation;*
*The policy excludes claims involving the failure to maintain or obtain insurance;*
*The policy excludes claims involving the breach of third-party contracts.*

The other option is the stand-alone D&O policy. The D&O stand-alone polices, although not all created equal, generally provide much of the coverage that is not included in the imbedded product discussed above. What is a true shame is that the cost differential between the stand-alone policy and the imbedded coverage is minimal.

## Fidelity/Crime Coverage

The good news is that Fidelity and Crime issues are not a chronic problem in the community association context.

The single most effective risk management tool is the separation of duties,

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including the distribution of duplicate bank statements going to different individuals to obviate any motivation by one individual to take advantage of opportunities.

On the insurance side, there are two separate sides to the potential coverage. First is the fidelity coverage, which is coverage when an employee or someone included in the definition of employee, steals from the association. On the other side, are crime coverage's which mirror the fidelity coverage, but is triggered when a non-employee steals. In the community association context, it is critical the definition of "employee" includes "directors and officers," committee members, volunteers, property managers and other employees. The crime side is often ignored and many associations do not have crime coverage. The last key issue with fidelity/crime coverage is the requisite limits of coverage. This should be governed by the following basic formula:

The association should have limits equal to the greater of the following:

- The amount required by the association's governing documents;
- The amount required by statute; or
- Three times the monthly operating budget plus the amounts of any cash on hand and all reserve funds.

## Other Insurance

In addition to the coverage's above, there are other possible insurance coverage's that an association may need on a case by case basis:

- Workers Compensation
- Automobile Liability
- Elevator or other mechanical break-down insurance
- Fiduciary Coverage (if there is a defined benefits plan)

The insurance puzzle is both complex and not an exact science. In the association context, the key is informed decision making. The more the board knows about insurance and its potential exposures, the better chance it will have the coverage that it needs.

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