



# THE PRICE OF INSURANCE VS. THE COST OF INSURANCE

## PAY AN AMOUNT CERTAIN NOW, OR BE SURPRISED LATER

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Community associations are creatures of budget. The primary purpose of a budget is to provide certainty and avoid surprises as the board complies with its obligation to protect, preserve, and enhance the association assets.

More often than not, board members primarily focus on “price” when purchasing insurance. However, “price” is only relevant if the options presented substantially provide the same coverage—apples for apples; or there are never any claims.

### **Caveat: Remember Not All Insurance is Created Equal!**

The reality is most boards never make the ultimate insurance decision, because they defer this task to the CAM. Not only do they defer to the CAM for insurance decisions, they do not meet in person with the community association insurance professional. It is one thing to defer the insurance leg work to the CAM, however, it is another thing for the CAM to make the insurance purchase and maintenance decisions on their own. In my humble opinion, focusing primarily on the point of sale premium should be the last decision. The key obligation is to determine whether the insurance proposal is proper coverage to protect, preserve, and enhance the association assets.

### **CAUTION: Board Members Beware**

More often than not, the management agreement with the Association requires that the association unilaterally indemnify the Management Company and the CAM for claims arising out of services provided.

The board is obligated to protect, preserve, and enhance the association assets. Primarily focusing on price in the insurance decision process is counterintuitive to this duty. Where in the governing documents does it provide that the board has a duty to save the association money when purchasing insurance? Nowhere! Rather, the duty is to determine what insurance will best protect the association assets.

Boards are authorized to seek counsel from professionals when an issue is beyond the knowledge of the average board member. Insurance is one of those issues.

Moreover, why wouldn't a board always seek counsel from a community association professional? Why not obtain counsel from a community association insurance professional who does not charge?

The “cost of insurance” is not the same as the “point of sale premium.” The “cost of insurance” is the total amount the association incurs at the time of a loss or claim plus the value of peace of mind that the association receives during the claims process. If the board made sure they purchased the best coverage for the association, the cost of insurance will have been a good deal. However, if the focus was the point of sale as opposed to coverage, there is a very possible reality that the cost of insurance could be significantly higher than the price, because the association will be self-insured for the coverage that was sacrificed for the cheaper price.

Caveat: More important for associations than “point of sale insurance premiums” is not being surprised by uncovered claims!

### **CAUTION: CAMs Beware!**

Many management agreements expressly provide that the CAMs assume the task of purchasing and maintaining the association's insurance program. In other situations, many management companies take on this role voluntarily and may involve preferred insurance business partners in the process.

This practice in and of itself is not necessarily a problem. However, there are a number of traps for the unwary, including who is ultimately responsible for any errors in the purchase and maintenance of insurance. The key individuals that should be most concerned here are management company “owner” and Boards.

#### **1. Indemnification**

Most management agreements have an indemnity provision that provides that if the CAM is sued for something it did for or on behalf of the association, the insured needs to provide the CAM defense and indemnity. Accordingly, the managed association must be able to fund that obligation. Many CAMs and Boards “assume” that this can be funded by the association's Directors and Officers policy where the CAM is almost certain to be

added as an additional insured, or are included in the policy definition of insured. As a result, the funding of the obligation owed the CAM is by the association's assets, special assessments, or a loan.

It is also important that the Management Company or CAM understand the indemnity provisions of your state. Not all states will allow indemnification for someone's active negligence, and if they do allow indemnity provisions of your state. Not all states will allow indemnification for someone's active negligence, and if they do allow indemnity for active negligence, that provision must be expressly set forth in the agreement, and in some states follow a certain formula.

## **2. Community Association D&O Policy**

Most boards, Management Companies, and CAMs "assume" that since the management company was working on behalf of the association, and since it is an additional insured on the D&O policy, that the CAM will be covered and that is how the insurance claim against the CAM, for whom the association agreed to provide defense and indemnity will be funded.

Unfortunately, virtually every D&O policy on the market "excludes" coverage for claims by the association against the management company for CAM. Even worse is that there are some D&O policies where the management company or CAM is not even covered under a policy.

## **3. Management Company/CAM Professional Liability Insurance**

Virtually all CAM Professional Liability Insurance "expressly excludes" any claims arising out of insurance claims. This should make sense, because a professional liability policy is intended to cover the professional from its industry professional services. CAMs are not licensed insurance professionals.

## **4. Conflict of Interest**

Some management companies or CAMs have their own preferred insurance professional who in turn has its own preferred insurance carrier. There are also some where the insurance is a division, affiliate, or subsidiary of a management company. These may in fact provide the best products to protect the association's assets. However, there are two key requirements. First, any such relationships must be expressly disclosed to the association board. Second, under this scenario, the management company or CAM must still conduct its due diligence as to the best available coverage, and not just the best price.

## **5. Business Good Will**

There are "Good Will" issues that can arise from insurance issues. First, very often the management agreement has a unilateral indemnity agreement flowing from the association to the management company or CAM. Theoretically, if the CAM does not purchase and maintain the appropriate coverage, it is still protected, because the association must defend and indemnify the management company or CAM. Who will tell the board

that the management company is being sued, but they have to defend them? If the management company is not concerned about losing the client, there is no problem. Does the management company and CAM have an obligation to disclose this to the association before the agreement is entered?

Second, what will the neighbor associations or other associations think when they hear about this? What will the impact be on the association property values?

## **6. Management Company CEOs Beware**

One of the biggest mysteries I have encountered in my years in this industry is why there are management company CEOs, executives, and owners who do not make it one of the highest priorities to make sure the association's insurance program is the best. Management companies spend so much time making sure they are additional insureds on the association insurance policies, but they do not make sure the association's policy is the best. The management company and the CAM's coverage is only as good as the associations.

## **Take Aways**

Community Association Insurance Professionals do not charge to meet, counsel, or present to your Board. Make the Insurance Professional's E&O on the line, not the Management Company or CAM. The Insurance Professional, not the CAM, is the licensed insurance expert.

Boards should exploit the community association insurance professionals for two reasons. First, boards owe a fiduciary duty to the association, like relying on a licensed community association insurance professional. By doing so, the board develops a strong defense to a strong business judgment defense. Second, the counsel is free.

CAMS should never sign an application on behalf of an association. The association does not pay the Management Company or the CAM.

Always make the board review the application, make any changes they need, and have the appropriate board member sign the application.

Not all insurance is created equal.