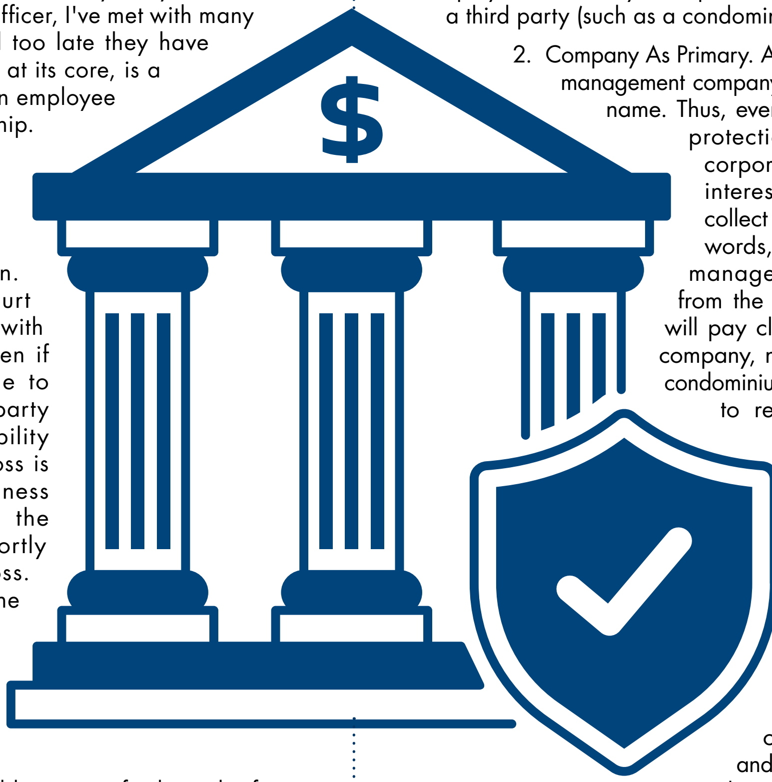
FIDELITY INSURANCE FOR CONDO CORPORATIONS

If you are a Condominium Corporation (CC) Board member or CC unit owner you may find yourself asking: What is Fidelity Insurance and why should my Condominium Corporation consider Fidelity Insurance?

Fidelity bonding insurance, often referred to as employee dishonesty insurance, is a kind of insurance that protects businesses from fraudulent acts committed by people that may have a trust relationship or employee-employer relationship. If that relationship is breached by a criminal act, such as fraud, criminal mischief, or data theft, that results in financial damage or loss, this insurance is intended to protect the policyholder.

Trust is paramount in all business dealings and managing a CC is no different. As a CC volunteer board of directors, you often don't have the time or resources available to search out references to determine the trustworthiness of everyone your CC must rely upon. As a former police officer, I've met with many business owners that realized too late they have been the victim of a crime that at its core, is a breach of trust committed by an employee or someone in a trust relationship.

While a police service might be able to charge someone with a criminal act and a conviction might be gained, restitution is far from certain. Police investigations and court proceedings could take years, with no certainty of restitution. Even if ordered, would you be able to collect from the responsible party if they have no assets or ability to pay a court order? If the loss is significant, harm to the business and those dependent upon the business may occur very shortly after the discovery of the loss. A recent case in point from the Manitoba Court of Kings Bench illustrates the potential for loss perfectly. While the exact circumstances of the loss are not one a CC would ever experience, the core fact remains, the loss occurred because of a breach of trust.



In this article, I relied upon the expert advice of one of our CCI Manitoba Board Members, Seth Henoch. Seth is the Vice-President, Client Executive, Real Estate Division of BFL Canada. Seth sets out a very good analysis of the benefits of fidelity insurance. If you're a CC with business relationships, for example, a property management company, maintenance contractors or anyone on the board that has financial authority, fidelity insurance might be worth serious consideration.

A property management firm can carry a fidelity bond, however, this is intended to protect the property management firm as the employer from a dishonest/fraudulent act from one of their employees. The basic premise of a fidelity bond is to protect the employer from the employee. Coverage is purchased by the employer to protect themselves.

In the case of a condominium corporation, the relationship is somewhat similar. The best way to view it is that the condominium corporation is the entity that wants its own money protected. The property manager is not an employee per se, but they have been hired to manage the affairs of the corporation. Somewhat of an employee by contract. Using the same principles of the employer purchasing their fidelity bond to protect themselves from theft by their employee would apply here. The corporation purchasing its fidelity bond coverage is the best way to approach it.

Management companies should carry fidelity bonds but there are significant potential problems if a condominium corporation relies on a management company's fidelity bond to protect the corporation from losses resulting from the dishonest acts of management principals or management company employees. The following are some of those problems:

1. Coverage Not Assured. Most policies are designed to cover theft of management company monies by management company employees. Normally, their policies will not cover the funds of a third party (such as a condominium corporation).
2. Company As Primary. A fidelity bond carried by a management company will be in the company's name. Thus, even if the policy offers theft protection, the condominium corporation has no insurable interest and cannot directly collect from the insurer. In other words, if an employee of the management company steals from the condominium, the policy will pay claims to the management company, not the condominium. The condominium corporation would have to rely on the management company to reimburse the board for the loss. Depending on the carrier, condominium corporations can be added as "Joint Loss Payees" on a management company's bond. If the insurer agrees, it will pay jointly to the condominium corporation and the management company in the event of a covered loss.
3. Principals Not Covered. Traditional management company policies do not insure against theft by company principals — principals cannot insure against their own misconduct, only that of their employees. That puts condominium corporations at risk if the owner of the company is the one embezzling funds.
4. Coverage Limits. Most condominium bylaws in other provinces, and some in Manitoba, require a condominium corporation to carry full limits of fidelity bond equal to the sum of the reserve fund balance at the start of the corporation's current fiscal year, and the balance of the operating account at the beginning of the corporation's current fiscal year. Many Condominium Acts have the requirement as well and you can review the Alberta Act (62.5 (3)(b) if you want a reference. How would a board know that a management company's bond is sufficient without full financial knowledge of the reserves and condo fees of all condominiums managed by the company? If the management company has a

million-dollar bond, a small portfolio of large corporations would easily blow past that limit, thereby leaving all condominiums at risk and violating legislative requirements. Moreover, the bigger the management company, the bigger the problem. Many insurance policies I have seen have $100,000 or $200,000 Crime coverage for this which in many cases is not sufficient, our BFL Canada program has a minimum of $1,000,000 but we always review with the board and/or property managers to ensure it is sufficient.

Because of the risks described above and because most fidelity bond policies do not automatically include the property manager in their coverage, boards must ask the insurance broker to include in their fidelity bond a "property manager extension endorsement." Putting the fidelity bond in the condominium corporation's name with a "property manager extension endorsement" means the corporation has the right to submit a claim, control coverage limits and receive notification in the event the policy is cancelled or modified. Our BFL Manuscript policy wording includes this already.

Here are some base points to consider:

CONDOMINIUM CORPORATION:

- The funds for an individual corporation belong to the corporation, and as such should be insured by the Corporation.
- Placing coverage under the corporation's policy allows for protection from theft of corporation funds from an employee, director, officer, or property manager (but not all insurers provide this in their policy wording).
- The Corporation owns the policy and therefore as the Policy owner, is the only entity that has the right to cancel this policy.
- The Corporation can ensure that the correct limit is insured, and make changes to the limit at any time.

PROPERTY MANAGER:

- Your property manager, as an agent to the Corporation, manages Corporation Funds, as authorized by the Board.
- Your property manager may have a fidelity bond, of which the intent is to protect the owner of the management company from his employees stealing from him.
- A fidelity bond provided by the manager will not protect the Corporation if a director or officer absconds with Condominium funds.
- A fidelity bond provided by the manager may not have a limit that reflects the exposure of the individual condominium.
- A fidelity bond provided by the manager can be changed or cancelled by the manager at any time, without notice to the corporation.

Fidelity insurance is a component of your CC's risk management practices. By having a clear understanding of your insurance policy and working with your CC's insurance professional, your risk of sustaining a loss because of someone's dishonesty or misconduct will be minimal.

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