

Report

FEATURE

Claims Reserves Strengthened

The Insurance Corporation's actuary has set a claims reserve of \$11.3 million for the policy year ended February 28, 2009, a 26% increase over the previous year's reserve of \$8.9 million. The claims reserve is the actuary's estimate of the cost that will be incurred, in addition to the amount already paid, in order to eventually close the 511 claims that were open as of February 28, 2009.

The two most significant factors impacting claims costs are the frequency and the severity of the claims. Frequency was not a factor in the claims reserve increase, in that there were actually slightly fewer open claims at this year end than the previous three year ends (see Figure 1). In addition, the number of claims reported during the policy year did not increase significantly (363 claims reported compared to 359 the previous year).

However, potential severity did play a role in the increase in reserves. Since 2003, when the policy limits were increased from \$100,000 to \$1 million per claim, each policy year has seen an increase in the number of claims remaining open at year end that were subject to the higher limit. Only six of the claims open at February 28, 2009 were still subject to the \$100,000 limit. As the proportion of claims capped at \$100,000 diminishes, the potential for larger payouts increases along

Open Claims at Year End Compared to Claims Reserves



Figure 1

with claims volatility (volatility reflects the greater range within which claims may be resolved because of the increased limits). Increased claims volatility makes estimating the claims reserves more difficult because of the potential for one or two unusually large settlements to skew the results. Adding to this is the inevitability that currently falling real estate prices will aggravate the eventual cost of the claims now open. To compensate for this, it was deemed prudent to adopt a more conservative approach and raise the reserves to the high end of the estimated range they fall within.

This increase in reserves has resulted in the Insurance Corporation showing an annual loss for the first time since 1998 (see financial statements on page 2), which will in turn

result in an income tax refund of \$1.2 million. Because the Insurance Corporation had equity at the end of the last policy year of \$7.4 million, which acts as a premium stabilization fund, no premium increase is contemplated at this time. Even with the increase in reserves, the Insurance Corporation's equity stands

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Real Estate Errors and Omissions Insurance Corporation

Balance Sheet

As at February 28, 2009	2009	2008
ASSETS		
Cash equivalents	\$ -	\$ -
Investments	20,759,623	21,265,932
	<u>20,759,623</u>	<u>21,265,932</u>
Cash	333,512	502,806
Deductibles and accrued interest receivable	239,528	254,269
Income taxes recoverable	1,162,230	-
Prepaid expenses	33,213	31,151
Equipment	174,087	186,048
Future income taxes	160,493	118,240
Total assets	\$22,862,686	\$22,358,446
LIABILITIES AND EQUITY		
Liabilities		
Accounts payable and accrued liabilities	\$ 413,758	\$ 261,539
Income taxes payable	-	120,923
Unearned premiums	5,215,504	5,648,990
Reserves for policy and claims liabilities	11,312,000	8,965,000
Total liabilities	16,941,262	14,996,452
Equity		
Surplus	6,381,430	7,123,111
Accumulated other comprehensive (loss) income	(460,006)	238,883
	<u>5,921,424</u>	<u>7,361,994</u>
	\$22,862,686	\$22,358,446

Statement of Operations and Comprehensive Loss

Year ended February 28, 2009	2009	2008
REVENUE		
Earned premiums	\$5,580,044	\$ 5,296,549
EXPENSES		
Claims and underwriting expenses	4,082,471	3,168,671
Increase in reserve for unpaid claims and adjusting expenses	2,369,000	318,000
Decrease in provision for premium deficiency	(22,000)	(247,000)
Administrative expenses	1,227,523	1,021,213
	<u>7,656,994</u>	<u>4,260,884</u>
Operating underwriting (loss) income	(2,076,950)	1,035,665
Other income (expenses)		
Investment income	1,027,882	1,488,686
Investment management fees	(82,017)	(97,048)
	<u>945,865</u>	<u>1,391,638</u>
(Loss) Earnings before income taxes	(1,131,085)	2,427,303
Income tax (recovery) expense	(389,404)	797,909
Net (loss) earnings	(741,681)	1,629,394
Unrealized loss on the Real Estate Errors and Omissions Insurance Fund, net of income tax recovery of \$353,681 (2008: \$50,583)	(682,768)	(87,939)
Reclassification adjustment for realized gains/losses included in the net (loss) earnings, net of income taxes of \$7,158 (2008: \$192,800)	(16,121)	(335,185)
Comprehensive (loss) income	\$ (1,440,570)	\$ 1,206,270

These financial statements are excerpts from our complete audited financial statements, which are available on our webpage at www.reeic.com (password = eno) or by contacting our Office Administrator at 604 891-3155.



Accepted Offers and Backup Offers – Be Careful

GREG BLANCHARD, WHITELAW TWINING

This article discusses the situation where there is an accepted offer to purchase property, a backup offer for the same property, and the parties to the accepted offer agree to change that contract. This was the background of the recent Provincial Court of British Columbia decision in *Wright v. Hamster*.

The Claimants made an offer to purchase the Defendant's property that was subject to the collapse or non-completion of an earlier accepted offer, which was in turn subject to financing by a certain date. The parties to the first contract subsequently agreed to extend the time to remove the subject to financing clause. The deal completed pursuant to the first contract.

The Claimants took the position that the Defendants had, by agreeing to extend the time for removal of the subject to financing clause, collapsed the first contract.

In considering this question, the Court referred to the British Columbia Court of Appeal decision in *B.D. Management Ltd. v. Tajico Holdings Ltd.* which dealt with a similar fact situation. The backup offer in the *B.D. Management* case was:

“Subject to the non-completion or collapse of the offer to purchase from N. on or before November 25, 1983 that had been accepted by the vendor.”

The seller and N. had agreed in writing to increase the amount of the deposit by \$25,000 and to extend the completion date. The purchaser under the backup offer claimed that these amendments

constituted a collapse or non-completion of the agreement between N. and the seller.

The Court found that the amendments in question were “all of a character which affirm and do not reject the original contract” and concluded that the parties “did nothing other than to amend a contract in certain non-fundamental details while affirming the continuing existence of that contract.”

**ANY PROPOSED AMENDMENT
TO AN ORIGINAL ACCEPTED
OFFER WHEN THERE IS A
BACKUP CONTRACT IN PLACE
SHOULD BE APPROACHED
WITH CAUTION**

The Court in the *Wright* case concluded that the amendment at issue in that case was “not of a character which rejects the original (Pollard) deal, but is of a character which affirms it.” It was “an amendment to a still subsisting agreement.”

In both of these decisions the Court dealt with a backup offer which was subject to the “non-completion or collapse” of the earlier accepted offer. It is interesting to note that the *Licensee Practice Manual*, 6th Edition, 2006 recommends different wording for this type of subject clause in a backup offer. The suggested wording is:

“Subject to the Seller ceasing to be obligated in any way under the previously accepted Contract of Purchase and Sale on the subject property by ____ (date). This condition is for the sole benefit of the Seller.”

Whether or not this wording is, in substance, materially different than the wording of the subject clauses in the *Wright* and *B.D. Management* cases is uncertain. However, any proposed amendment to an original accepted offer when there is a backup contract in place should be approached with caution. Some changes to the original agreement could arguably be of such a character that, if agreed to, would result in the “seller ceasing to be obligated under the previously accepted contract of purchase and sale.” For example, a change to the price, or the parties, could fall into this category.

In circumstances where there is a backup contract in place, and a seller or a buyer under the original contract seeks to change the terms of that contract, the seller's agent and the buyer's agent should recommend that their respective clients seek legal advice on the proposed change. There is always a risk that the change may end the original contract, thus putting the backup contract in first place. The seller may be put in the unfortunate situation of having agreed to sell the property to two different buyers. It would be wrong for a licensee to conclude that the *Hamster* and *B.D. Management* decisions stand for the proposition that any change to an original contract will not cause its collapse.

New Chair Elected

The Directors of the Insurance Corporation have elected Brian Thompson as Chair of the Board effective February 1, 2009.



Mr. Thompson is a Managing Broker of Dexter Associates Realty in Vancouver and has been active in the real estate industry for over 30 years. He is a past Chair of the Real Estate Council and a past Director of the B.C. Real Estate Association.

Also elected, as Vice-Chair, was Len Visser. Mr. Visser is an associate broker with and part owner of Century 21 Ace Agencies Ltd. in Abbotsford and has been active in the real estate industry since 1967. He is a past President of the Fraser Valley Real Estate Board and a past Chair of the Broker's Council of the FVREB.

Brian Thompson, *Chair*

FEATURE

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at \$5.9 million, or the equivalent of more than one year's earned premium. However, these volatile economic times call for a particularly close monitoring of claims develop-

ment so that adverse trends can be identified early on. If a trend towards adverse loss development becomes apparent, appropriate steps will be taken to ensure that the Insurance Corporation's equity is not further eroded.

BCREA Education Grant

The Insurance Corporation's Directors have approved a loss prevention education grant to BCREA of \$193,020 to revise the Real Estate E & O Insurance Legal

Update and the Real Estate E & O Insurance Commercial Legal Update courses for 2010. The funding will also cover the speaker's fees for 105 sessions of these courses.

CANADA POST
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RiskReport

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MISSION STATEMENT

Our mission is to provide cost-effective professional liability insurance for the protection of the real estate industry and thereby the public.