

**Subcommittee on Building Management
(Third Party Risks Insurance) Regulation**

Matters Arising from Meeting on 16 October 2007

At the meeting of the Subcommittee on 16 October 2007, Members raised a number of questions about the Building Management (Third Party Risks Insurance) Regulation (the Regulation). Below are the responses of the Administration to these questions.

Level of Insurance Premium

2. Members have enquired about the difference in insurance premium when the statutory minimum insured amount is set at \$5 million and \$10 million. The Hong Kong Federation of Insurers (HKFI) advised that, based on the experiences of its member companies, the change in the insurance premium may not be directly proportionate to the change in the insured amount. And it differs from company to company depending on many factors such as the cost of capital, distribution of risks and above all the prevailing market situation. As a very rough indication, with an insured amount of \$5 million instead of \$10 million, the insurance premium may drop by around 10% to 30%. This percentage may however vary with different insurance companies and the conditions of the building as said before.

3. Members have also requested to have more information regarding the level of insurance premium in the market. Again, the level of insurance premium depends on a host of factors including the use of building and maintenance conditions of the building. As a very rough indication, the HKFI advised that assuming a building of ten storeys and 20 flats with good maintenance conditions, the insurance premium may take like some \$5,000 to over \$10,000 for an insured amount of \$10 million. It is important to note that the above levels are a general amount for indicative and reference purposes only. Different insurance companies may offer different premium, depending on their assessment of various factors, such as the age of the building, the use of the building, the maintenance conditions etc.

Unauthorized Building Works

4. The Administration is of the strong view that owners' corporations (OCs) should not be mandatorily required to procure a third party risks insurance policy which covers liabilities relating to unauthorized building works (UBWs). UBWs are illegal works by reference to the Buildings Ordinance (Cap. 123). Should we stipulate in the Regulation that the insurance policy has to cover liabilities arising from UBWs, it would imply that the Government condones the existence of these unauthorized strictures.

5. Some Members suggested that the Regulation was primarily put forth to address the problem of UBWs, and hence the mandatory insurance coverage should include UBWs. We would like to point out that the main objective of introducing a new provision in the Building Management (Amendment) Ordinance 2000 requiring OCs to procure third party risks insurance is to, as with other provisions in the Building Management Ordinance (BMO), promote better building management. The message that we want to bring out with the enactment of the provision and the Regulation is to raise public's awareness of the importance of proper management and maintenance of their buildings, and having proper protection against the accidental possibility of third party's death or bodily injury at the common parts of the buildings. It is not the aim of the Regulation to replace owners' basic duties to properly manage and maintain their own properties, which include removal of unauthorized building works (UBWs) from the buildings.

6. The Government's policy on UBWs is that all UBWs, which are unlawful structure, should be removed and demolished. Owners should be encouraged to properly manage and maintain their buildings and remove any UBWs. Over the past years, the Buildings Department has adopted a three-prong approach to address the problem of UBWs, namely to take immediate enforcement action against all UBWs found under construction or newly constructed; proactively conduct large scale clearance operations to achieve progressive reduction of existing UBWs and launch education and publicity campaigns to promote public's awareness in this aspect. In the past five years (from 2002 to 2006), the Buildings Department have demolished around 217 000 UBWs.

7. In the future years, Buildings Department will continue its effort in combating UBWs. Since 2006, the Buildings Department has been allocated a total of \$830 million over a period of five years, for the purpose of removing UBWs and stepping up enforcement action. The Buildings Department aims at demolishing around 36 000 UBWs per year through its large scale operations.

8. Apart from the effort of the Buildings Department, the Hong Kong Housing Society and the Urban Renewal Authority have also introduced various loan scheme and incentives scheme to assist owners in carrying out maintenance works. For example, under the Building Maintenance Incentive Scheme put forward by the Hong Kong Housing Society, owner of each flat of the eligible buildings can receive a grant of up to \$3,000 for them to carry out maintenance and repair works in the common parts of the building. Free professional and technical support are also provided to the buildings concerned.

9. If OCs are required by the law to procure insurance for UBWs, it would indirectly encourage the continual existence of UBWs as these UBWs are now “protected” under the insurance policies. On the other hand, if mandatory insurance on third party risks is not required to cover UBWs, OCs will know clearly that they will not be protected by the insurance policies for death or bodily injury caused to third parties by the UBWs. This will serve as a strong incentive for the OCs to deal with the UBW problem.

10. If OCs are required by law to procure third party risks insurance for UBWs, the insurance premium will certainly go up for all the buildings (and not only those buildings which have UBWs). This will mean cross-subsidy of the poorly maintained buildings by those properly maintained ones which is very unfair for the latter.

11. It is also important to note that the insurance industry does not support including UBWs in the mandatory third party risks insurance under the Regulation. The HKFI advised that concurring to Government’s policy, it objects to the inclusion of UBWs under the mandatory insurance coverage as it is inappropriate to impose by law a mandatory requirement to procure insurance for unlawful building works.

12. Members have enquired about a situation where the developer has built an UBW in the common parts of the building and it is not feasible for the OC to demolish the UBW. As it is not mandatory for the insurance policy to cover the liability arising out of UBWs, the existence of the UBW in the building may not render it impossible for the OC to procure third party risks insurance.

Reasonable Diligence under Section 6 of the Regulation

13. Section 6(3) of the Regulation provides that if the insurance policy purports to restrict the insurance of the OC by reference to the condition or maintenance of the building, the use of the building and the existence of a statutory instrument in relation to the building, such restrictions will be of no effect, unless the policy also requires the OC to exercise reasonable diligence and that the death or bodily injury that gives rise to the liability is directly caused by the OC's contravention of that requirement.

14. During the discussion of the draft Regulation at the Bills Committee on Building Management (Amendment) Bill 2005, Members have expressed concerns over the definition of the term "reasonable diligence" and whether insurance companies may easily reject claims by third parties on the ground that the OC has failed to exercise reasonable diligence.

15. To address Members' concern, we have included a new provision, section 6(4), in the Regulation. According to section 6(4), an OC is considered as having exercised reasonable diligence unless it recognizes a situation that requires measures to be taken and yet, does not take measures or takes measures that it knows to be inadequate, or it is reckless as to whether measures or adequate measures are taken. In other words, for there to be breach of the requirement of reasonable diligence, the OC's conduct must have been reckless, in the sense that it has recognized the danger and the need to take measures and yet does not care whether or not measures are taken and the danger is averted.

16. Furthermore, for the restrictions in the insurance policy to be effective, it is not enough to just claim that the OC has not exercised reasonable diligence, but it also has to be proved that the death or bodily injury that gives rise to the liability is directly caused by the OC's contravention of the requirement to exercise reasonable diligence. This means that even if the OC has not exercised reasonable diligence to keep certain parts of a building in good condition and maintenance, the

insurance of the OC in relation to other parts of the building will not be affected.

17. As advised by the HKFI, it is already a common practice for the existing third party risks insurance policy to have a clause requiring the assured to exercise reasonable diligence to keep the building in a good condition. This is to reinforce the message that even with an insurance policy in force, the assured should still carry out its basic duties to property manage and maintain their own properties. It is noticed that so far, the market has been operating effectively and it is not a common case for insurance companies to reject the claims on the ground that the assured has not exercised reasonable diligence.

18. Members have enquired whether members of a management committee (MC) would be held liable for the consequence of failing to take any follow-up action upon receipt of the removal order of an UBW. This depends on the particular circumstances of each case, such as whether the OC is held liable for the death of or bodily injury to the third party in the first place, whether the UBW is covered by the insurance policy, whether the liability is directly caused by the OC's contravention of the requirement to exercise reasonable diligence to comply with the order, whether the MC members have been reckless etc. The court will take into account all the circumstances of the case in making the decision.

19. That said, it is important to point out that MC members are appointed by the owners to handle the business of the OC and they have a fiduciary responsibility to all owners. Section 18(1) of the Building Management Ordinance (BMO) provides that the OC shall have the duty to maintain the common parts in a state of good maintenance condition and carry out any maintenance work as may be ordered by the Administration. And according to section 29 of the BMO, the powers and duties conferred or imposed by the BMO shall be exercised and performed on behalf of the OC by the MC. As such, the MC members have a duty under the BMO to carry out effective management of the common parts of the building. To ignore the receipt of a maintenance order and refuse to carry out any necessary follow-up action is certainly undesirable and detrimental to effective management of the building.

Obligation to Procure Insurance

20. Section 28 of the BMO (which has yet to come into operation) as amended by the Building Management (Amendment) Ordinance 2007 requires all OCs to procure and keep in force third party risks insurance policies in relation to the common parts of the building. If OCs failed to

comply with this requirement, every member of the MC shall be guilty of an offence and shall be liable on conviction to a fine at level 5. Should member of the MC prove that the offence was committed without his consent or connivance; and that he has exercised all such due diligence to prevent the contravention of section 28(1) as he ought to have exercised in the circumstances, he will not be guilty of the offence.

21. Members have enquired whether it would be a defence for the OC if it claimed that it has failed to procure the mandatory third party risks insurance because of unreasonably high insurance premium. This depends on the particular situation of the case concerned and it is subject to the court to decide what is meant by “unreasonably high” insurance premium and whether the MC members have exercised due diligence to prevent the commission of the offence. For example, the court may consider whether the MC has tried to explore with other insurance companies for a lower premium or made an effort to step up the management and maintenance of the building which may lower the insurance premium.

22. Members also enquired whether the MC members may claim to have exercised due diligence once the MC has put forward the procurement proposal to the meeting of the corporation even though the resolution is voted down by the OC. We would like to point out that it is in the interest of the OC to procure third party risks insurance so that it would be accorded with better protection against the accidental possibility of third party’s death or bodily injury at the common parts of their buildings. And the powers and duties conferred by or imposed by the BMO shall be exercised and performed on behalf of the OC by the MC. We believe that owners will make a rational choice having regard to the protection offered by the insurance and the legal requirement in the Regulation. In any case, whether the MC has exercised reasonable diligence in procuring the insurance is subject to the court’s decision having regard to the particular circumstances of the case.

Market Competition

23. As advised by the HKFI, there are currently 89 insurers authorized to provide third party risks insurance for buildings in the market. There are sufficient companies in the market to ensure effective market competition.