

INDEPENDENT REVIEW OF STRATA INSURANCE PRACTICES

Phase 2 – Remuneration of intermediaries: Conclusions and recommendations



December 2022

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Foreword

About this initiative

Strata insurance in Australia is a growing class of insurance business as a result of the rising popularity and development of multi-owner properties across the country.

As a result, strata insurance has become a very competitive business, especially among insurance brokers, underwriting agencies and strata managers. At the same time it has generated two vibrant debates in recent times –

- strata managers commonly receive rebates of broker commissions and simultaneously brokers charge fees to owners' corporations: both of these practices are confusing and controversial*
- affordability and availability of strata insurance are problematic for some segments of the strata insurance industry.*

Brief to independent adviser

The Steadfast Group is conscious of these debates and wishes to see each of them explored in some depth and to contribute to solutions to them. To that end, Steadfast has engaged John Trowbridge to undertake an independent review of these issues. He has agreed to examine them, in consultation with interested stakeholders, with a view to proposing ways forward that can be taken on board by participants in the industry.

This paper

This paper is the second step in a journey intended to carry the strata management and insurance industries through a review in three phases.

Phase 1 related to the disclosure practices of intermediaries, Phase 2 (this paper) is about the remuneration of intermediaries and Phase 3 will be about competition, affordability and availability of strata insurance.

The views, findings and recommendations in the paper are those of the author and are independent of the Steadfast Group and its commercial interests.

Steadfast's interest

Steadfast Group's interest in this project is commercially relevant to the Group's interests in both specialist brokers and specialist underwriting agencies active in strata insurance but it goes beyond the Group's direct interests. Steadfast believes that the market is to some extent dysfunctional through its value chain from customer (lot owners) to strata managers to brokers to underwriting agencies to insurers. Most of the issues under question have arisen gradually through the historical evolution of the market.

Steadfast wishes to see these issues thoroughly investigated, in conjunction with experts in the Steadfast sphere of interest and other stakeholders including strata managers, owners of strata properties, brokers and underwriting agencies not in the Steadfast camp.

The overriding goal is to identify meaningful initiatives aimed at overcoming the structural issues that are of concern to both the Steadfast Group and many other participants in this market.

The author

John Trowbridge has a distinguished career as an actuary, consultant, executive, company director and regulator, working mainly in financial services with an emphasis on insurance-related businesses. He founded Trowbridge Consulting in the 1980s, becoming a leading actuarial and management consulting firm in Australia and Asia, specialising in insurance and merging with Deloitte in 2000.

He has held senior executive positions at QBE and Suncorp and, from 2006 to 2010, he was the APRA Member for insurance. He chaired the Australian Government's review of natural disaster insurance following the 2011 floods and in 2015 he chaired an industry working group to recommend reforms in the life insurance industry which came into effect in 2018. Last year he conducted an independent strategic review for the Insurance Council on the affordability and availability of commercial lines of insurance in Australia.

**Robert Kelly, Managing Director & CEO
Steadfast Group Limited
December 2022**

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Executive summary

This paper comprises Phase 2 of an independent review and investigation by the author into the functioning of the strata insurance market. It follows a Phase 1 Paper released on 6 July and it is the second step of a journey that is in three phases –

- Phase 1: the disclosure practices of intermediaries
- Phase 2 (this paper): the remuneration of intermediaries and possible reforms
- Phase 3: competition, affordability and availability of strata insurance.

Reviewing Phase 1

The goal of Phase 1 was to identify disclosure limitations and to recommend ways forward aimed at achieving transparent disclosure for strata property owners and their strata committees.

The Phase 1 paper found that, where strata manager and broker are both involved, the unorthodox structure of the strata insurance market, which embraces a *commission rebate/broker fee system*, is confusing -

- it is *convoluted* because, frequently, part or all of the commission is paid to the strata manager (SM) and a separate broker fee is charged to remunerate the broker for the broker's services: this is the *commission rebate/broker fee system*
- It is *complicated* because frequently not all of the commission is rebated to the SM, the remainder being retained by the broker.
- It is *compounded* in many cases by opaque or incomplete disclosure to the owners' corporation of insurance-related transactions.

The Phase 1 paper sought to ameliorate the first of these points and overcome the second and third by recommending a **transparent disclosure regime** comprising, for each owners' corporation –

- standardised financial disclosures and disclosure process
- description of scope of services of the SM and broker
- explanation of the business model of the SM and broker
- a disclosure matrix describing when and how these disclosures should be made.

The main recommendations are that -

- Financial disclosures in the form of broker quotations and invoices be prepared by reference to standard templates containing a minimum set of eight items with standard definitions
- Brokers and strata managers arrange to ensure timely transmission of quotations and invoices to the strata committee during the annual insurance renewal process
- Broker presentations of quotations be accompanied by a statement of scope of services by strata manager and broker and also by a description of how the strata manager and broker operate together
- SCA and NIBA consider the recommendations in detail and give effect to decisions they take on a self-regulatory basis by establishing guidance notes or practice standards for their respective members.

A small yet important part of the financial disclosures is for all parties to avoid misuse of terminology by being clear and accurate on what is the "premium", being the amount presented by the underwriter to the broker (excluding any broker fees), and whether the premium is gross or net of commission.

Details of the recommended disclosure regime are reproduced in the appendices to this paper.

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Since release of the Phase 1 paper, there has been support from many SCA members, NIBA members, interested strata lot owners and consumer groups for transparent disclosure, along the lines advocated in that paper. For example, the SCA in its submission to the Quality of Advice Review¹ states that -

“SCA has expressed its support for the adoption of the standard invoice template nationwide, as an effective measure to ensure that all aspects of the invoice and associated costs are disclosed. This level of disclosure detail should be matched as part of the quoting process in renewing policies. The format, with the inclusion of standardised terminology and definitions should allow for a stronger practice of disclosure within the industry, improving clarity, consistency, and transparency. practice of disclosure within the industry, improving clarity, consistency, and transparency.”

The expected outcome of this regime is a substantial improvement in understanding across the strata insurance spectrum, from owners’ corporation to strata committee, strata manager, broker and underwriter, along with regulators, consumer groups and strata owners generally.

Overview of Phase 2

Phase 2 identifies three conflicts of interest and expresses my conclusions that one of these, broker commissions, is a manageable conflict but that the other two need to be addressed. These two are where

- (1) the SM agrees with the broker on a share of commission to be rebated to the SM and
- (2) the broker agrees with the SM on a broker fee that is additional to the commission.

Together they comprise the *commission rebate/broker fee system*.

A recent variant of this system also exists, the *composite commission & broker fee system*, where a jointly operated intermediate entity receives commissions and broker fees and either shares them as fees on a policy by policy basis or accumulates them and then periodically passes them to the strata manager and broker as dividends, profit shares or similar.

Following analysis of these conflicts, I have come to the view that the *commission rebate/broker fee system* should be phased out.

Arising from this conclusion and associated considerations, I am recommending that this *commission rebate/broker fee system* be phased out in three stages comprising –

- Stage 1: introducing transparent disclosure (Phase 1)
- Stage 2: consolidating disclosure and preparing to phase out the system (2023 to 2024)
- Stage 3: phasing out the system via structural realignment – the transition (from 2024)

These conclusions and recommendations are explained in summary form below and elaborated in various parts of the body of this report.

¹ Quality of Advice Review, Treasury, 2022 arising from Hayne Royal Commission recommendations of February 2019: Consultation Paper - Proposals for Reform published August 2022 and Proposals for Reform: Conflicted Remuneration published October 2022

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Embarking on Phase 2

With the support for transparent disclosure as advocated in Phase 1, one may ask whether anything more needs to be done until this disclosure regime is in place and operational. There are, however, additional issues to be considered. In particular, it was noted in the Phase 1 paper that, in concentrating on disclosure, the paper offered explanations but no judgments or assessments about levels of remuneration or other aspects of strata insurance intermediary practices. It was to be left to Phase 2 to consider several issues of which the most prominent are —

- the *appropriateness of current financial arrangements* and
- *possible conflicts of interest*.

The current financial practice that dominates today's market, namely the *commission rebate/broker fee system*, has emerged over two or three decades not by design but from an inherited pre-broker past practice.

Investigations during Phase 2 have led me to the overall conclusion that this system of remuneration, used by many SMs and brokers, does raise questions of appropriateness and conflicts of interest that need to be addressed.

In today's environment, this practice is confusing and in my view warrants a 'reset' that will be beneficial to all participants in the strata insurance supply chain.

Appropriateness and conflicts of interest

In terms of levels of remuneration for SMs and brokers, *the commission rebate/broker fee system* can result in over-compensation of either party and examples have come to light of remuneration levels that, to the outside observer, appear to be excessive. It is difficult, however, to assess them with confidence or precision because of four factors:

- the practice by many SMs of subsidising their other (non-insurance) services to their client OCs with some portion of the commission rebates they receive from the broker
- conflicts of interest for SMs and brokers within this system but no clarity in individual cases of the part they play in the financial arrangements.
- the "black box" nature of the intermediate entities when the *composite commission & broker fee system* is being used
- the inaccurate use by some brokers and strata managers of the term "premium" and the lack of clarity in some cases as to whether the underwriter's premium is gross or net of commission.

We therefore need to ask whether the conflicts of interest are material (i.e. do they or can they lead to outcomes that are unfavourable to OCs and their owners)?

A secondary question that arises is whether, if any changes were made to the current system to respond to potential unfavourable consequences of the conflicts of interest, would the changes detract from or add to the current 'ecosystem'²?

Conflicts of interest

An explanation of conflicts of interest in general and the associated issues for strata insurance are set out in Parts 5 and 6 of this paper.

²This 'ecosystem' is where strata manager and broker maintain a constructive and collaborative relationship that many SMs and brokers have developed to service the insurance interests of their OC clients. It includes the annual collecting of relevant information, assessing insurance needs, arranging and delivering quotations, insurance advice and placement. It also includes dealing with claims which is a critical and time consuming function when adverse events occur.

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In strata insurance, there are three conflicts of interest within the mainstream SM and broker remuneration arrangements -

1. Broker commissions
2. Commission rebates from brokers to SMs
3. Broker fees that are additional to commissions.

When conflicts are identified, they need to be analysed as to their significance and an assessment made as to what, if anything, should be done about them. There are two types of solution. One is to manage the conflict, meaning actively minimising or mitigating its potential effects. I believe this solution is applicable to broker commissions generally³ and I see them as secondary to the two strata insurance conflicts.

The other type of solution is to replace the source of the conflict with an alternative that either eliminates the conflict or reduces it to a manageable level. After extensive consideration, I have concluded that this second solution is required for the two strata insurance conflicts, as explained in some depth in this paper. The paper is a purposeful contribution to dealing with these conflicts.

Main potential benefits of maintaining current arrangements

The main propositions in favour of not disturbing the current system are –

- it operates effectively on the whole. It delivers efficiencies in many cases in the appointment of brokers and in the collaboration between SM and broker that generally deliver good insurance outcomes for OCs
- Disturbing this system may have unexpected adverse consequences within the SM and broker markets, possibly including –
 - some competent SMs and brokers deserting the market and creating a capacity shortage
 - diminishing the benefits of the pooling effect or cross subsidisation of intermediary charges across portfolios: commissions and fees are usually calculated as percentages of premium, such that, when for example claims or other activities requiring extra services arise, there are no additional charges or fees payable by the OC.
- There is a certain market stability that has emerged in the existing remuneration structures across the industry. Any material change to these structures may lead to both SMs and brokers having to reorient their businesses in ways that may be disruptive during their planning and execution.
- The forthcoming introduction of the Phase 1 disclosure regime, along with enhancements to NIBA's Code of Practice for brokers including written terms of engagement conveyed to OCs, are positive developments. They can be expected to succeed in generating stronger management of conflicts of interest by SMs and brokers and improved understanding of the system by owners.
- The Phase 1 disclosure initiatives may limit the conflicts and should be given time for their effectiveness to be assessed.

Main potential benefits of making some changes

The main propositions in favour of making some changes to the current system are –

- The system contains two primary conflicts of interest, which are –
 - the SM and the broker agree on a share of the broker's commission to be rebated to the SM and

³ Broker commissions are accepted practice within the general insurance industry and, while containing potential conflicts of interest, they are not specific to strata insurance and I regard them as manageable generally, under conditions, for a range of reasons not explored in this paper.

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- the broker and the SM agree on a fee for the broker when the broker's retained commission after SM rebate does not cover the broker's cost of services.

These two conflicts are inherent in the *commission rebate/broker fee system* and they exist because most of the agreements involved are made between SM and broker with little or no involvement of the strata committee.

- These two conflicts of interest are significant and create a case for making changes that would minimise or eliminate these conflicts.
- With almost no exceptions, all lot owners and other consumer representatives that have offered submissions to this review (mostly during Phase 1) expressed dissatisfaction not only with poor disclosure (about to be rectified) but also with the convoluted nature of the current system. The optics of the system, irrespective of its merits, whereby brokers receive revenue from two sources (a commission from the underwriter and fee from the client), then remit a major part of the commission to the SM, are perplexing to say the least.
- The system's convoluted structure is a clear impediment to its comprehension by both lay people and insurance practitioners alike.
- The system distorts competition in the strata management market because commission rebates enable strata managers to present prices for their total services that are artificially reduced by subsidies from the insurance commission rebates

Some have argued that these two conflicts could indeed be managed effectively under the new disclosure regime recommended in Phase 1 when fully implemented. The proposition is that we should wait to see how well disclosure works and reconsider the situation after that. It also assumes that there would be data or evidence to illustrate that the conflicts are manageable. I don't believe that such evidence could ever be found and that these conflicts are endemic.

The outcome of Phase 2 – main conclusions

I have considered all of the above propositions for and against change and examined them in some depth. My main conclusions are that –

1. It is relevant to acknowledge the strength of the propositions in favour of continuing with the current system and its positive attributes.
2. it is important to recognise the significance of the two primary conflicts of interest regarding the *commission rebate/broker fee system* –
 - *The SM agrees on a share of commission with the broker*
It is anomalous that, firstly, the SM arranges to receive a significant part of remuneration by agreement with the broker instead of with the OC as client and, secondly, the SM's remuneration is not related to the value of the services to be provided (i.e. it does not meet 'the value of services principle'⁴).
 - *The broker agrees on a broker fee with the SM that is additional to the commission*
It is unsatisfactory that the broker gives away a significant part of commission and then enters into a second agreement to arrive at a broker fee that, in conjunction with any retained commission, funds the broker's cost of services.

⁴ The 'value of services principle' refers to a pricing approach where the price sought for the goods and services being provided is commensurate with the value of those goods and services.

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3. **While acknowledging the favourable attributes of current arrangements, I believe that these two conflicts of interest cannot be satisfactorily managed across the strata industry. Consequently steps should be taken to phase out the source of the two conflicts, which is the convolution of the *commission rebate/broker fee system*.**
4. To phase out this system will require a **structural realignment** of remuneration aimed at minimising the conflicts of interest while simultaneously –
 - satisfying owners that they have some influence over SM and broker appointments and their terms of engagement and that they are being well served by their SMs and brokers at fair prices for the insurance advice, placement and other services provided
 - maintaining fair compensation for SMs and brokers for the services they each provide, and
 - maintaining a constructive and collaborative relationship that many SMs and brokers have developed to service the interests of their OC clients.

The main outcome would be greater accountability of SM and broker to the OC. It would be a matter for SMs and brokers to ensure that there would be no adverse effects on the scope and the nature of the services being provided.

5. To meet the conditions at Point 4 will require –
 - Designing or specifying one or more alternatives to the *commission rebate/broker fee system*.

To replace this system with something different that minimises or eliminates the two conflicts would require that, in general –

- brokers be remunerated by commissions only (from the underwriter) or alternatively by fees only (from the OC) but not both and
 - SMs be remunerated partially or wholly by fees from the OC (partially if the broker agrees to rebate a portion of the commission).
- Preparing a well constructed **transition process** that firstly embraces the transparent disclosure regime recommended in Phase 1, a process that will likely take some 12 to 18 months.
6. Three models are put forward as potential alternatives: a *broker commission/SM hybrid model*, a *single fee model* and a *dual fee model*.

All three models carry some conflict risk and also some compliance risk relating to transparent disclosure. Nevertheless all three overcome convolution of the *commission rebate/broker fee system* and would achieve the primary goal of diminishing greatly the two primary conflicts.

7. It is contended that –
 - these three remuneration models could be applied without disturbing the benefits to their OC clients of the current SM/broker 'ecosystem', and
 - the scale of the changes advocated is not radical-it is difficult to identify any fundamental reason why there would be adverse consequences to OCs and owners or inability of the SM and broker markets to adapt to the changes proposed.
 - dealing constructively with the conflicts as proposed is likely to be a positive for strata managers and insurance brokers, building greater trust and confidence along with more favourable public recognition.

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The outcome of Phase 2 - recommendations

Arising from the above conclusions, I am recommending that, as already stated, the *commission rebate/broker fee system* be phased out and that this outcome be achieved in three stages –

Stage 1: introducing transparent disclosure

- Bring the existing commission and fee arrangements into the open so that owners and their SCs can readily see and understand them, via the Phase 1 recommendations for **transparent disclosure** to the SC accompanied by **effective communication** between the SM and the SC and OC
- The Phase 1 recommendations be introduced and adopted by all strata managers and brokers as soon as possible,

Stage 2: consolidating the disclosure regime and preparing to phase out the system (2023 to 2024)

- A review be carried out in late 2023 of the implementation and effectiveness of the disclosure regime
- SMs and brokers plan and prepare during 2023 to restructure their remuneration
 - those SMs and brokers currently using the *commission rebate/broker fee system* prepare to make a transition to a *broker commission/hybrid SM model* or a *fees only model*
 - those SMs and brokers already operating on a *fees only model* realign their fees to correspond to the ‘value of services principle’.
- To preserve the self-regulatory nature of strata insurance operations, both SCA and NIBA prepare guidance notes or practice standards in support of the decisions they take on structural realignment

Stage 3: phasing out the system via structural realignment – the transition (from 2024)

- For each of their OC clients, SMs and brokers carry out the transition planned at Stage 2 so as to have it fully implemented through the 2024 and 2025 renewal cycles.

This third stage represents a deferral of remuneration reforms and should enable the new transparent disclosure regime to become bedded down before reforms are introduced.

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Acknowledgments, reliances and limitations

This project has been sponsored by Steadfast but its conduct, findings and proposals have been arrived at independently of Steadfast and its commercial interests.

Much of the investigative work undertaken for this project has involved reviewing submissions, holding interviews, dialogue and supply of information enabling me to draw together a reasonably comprehensive picture of the intermediary market for strata insurance. There has been extensive dialogue with a range of brokers, strata managers and numerous others. This range of input has facilitated understanding, analysis and assessment of the characteristics including strengths and weaknesses of current practices and potential avenues for reform of disclosure practices.

Acknowledgments

Cooperation and assistance from a range of representatives of the SM and broking fraternities as well as others have been invaluable. Of particular note is the active interest of both the SCA (Strata Communities Association) and NIBA (National Insurance Brokers Association) in supporting this project through cooperation, supplying information from members to facilitate this work and participating in workshops.

Steadfast's role has been crucial. The Group's sponsorship is fundamental to the scope, access to information and quality of this project. That is because I have been able to obtain confidential information from numerous sources connected with Steadfast and also others in the wider insurance industry and strata management industry. Much of this information could not have been made available in any way other than with Steadfast's active support and assistance. Part of the evidence is the extensive range of submission material that has been sent to me in confidence. As a result, I have been able to utilise first-hand authoritative information while simultaneously respecting the commercial confidentiality of that information for the purposes of the project. The same applies to discussions with individuals from strata owners, strata managers, brokers, insurance executives and others.

Independence

While facilitating this level of access for me, Steadfast has also been fastidious in not just respecting but also supporting my independence throughout.

All conclusions, findings and recommendations are my own and are independent of the SCA, NIBA and the Steadfast Group.

Reliances and limitations

I have relied on much of the information made available to me by others during this project and my own assessment of that information. I have sought additional information and explanations in many situations, while also testing all information for accuracy and reliability where I could. I make no representation, however, as to the accuracy or completeness of the information. The paper does not provide financial product or other advice. It is subject to copyright and may not be reproduced without my prior written consent.

To the maximum extent permitted by law, I am not liable for any loss or damage incurred by any person as a result of use of or access to this paper or its contents, including any error in any information, opinion or recommendation contained herein.

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PART 1: Introduction to Phase 2

The Executive Summary and Foreword give the background to this Phase 2 paper and the Executive Summary gives a brief synopsis of Phase 1.

The strata insurance business is different from other classes of insurance business and it is also conducted differently. In summary –

Strata industry structure –

- Compulsory insurance (State legislative requirement)
- Replacement value cover for buildings (State legislative requirement)
- Multiple independent parties (lot owners) for a single insurance programme
- Hybrid retail/commercial insurance product
- Two intermediaries in most cases (strata manager and broker).

Insurance market structure –

- Most strata managers usually play an important role in the insurance process
- Brokers play an important role in arranging the insurances and dealing with claims
- Remuneration for both parties is often via broker fees in addition to insurer commissions and in many cases has been increasing in recent years
- Strata insurance is a specialist market:
 - almost all business is written by specialist underwriting agencies rather than directly with insurers
 - the majority of business is handled by brokers (estimated about 80% by premium volume)
 - a significant part of the broker market is in the hands of specialist brokers.

The unusual features of the strata insurance business and its current market structure have led to two key issues to be dealt with for intermediaries. They are *remuneration practices* and *disclosure practices* –

Remuneration practices relate to the business models of strata managers and brokers regarding both the structure and the quantum of remuneration, and

Disclosure practices refer to the transparency of remuneration and related information across the strata insurance chain.

Both of these topics warrant investigation and review but they have been dealt with sequentially rather than together because disclosure and its transparency must be addressed irrespective of any possible reforms to strata insurance remuneration or other intermediary practices. It is an essential precursor to considering possible remuneration reforms and to exploring affordability and availability of strata insurance. Hence the conduct this review in 3 phases –

Phase 1: disclosure according to current practices

Phase 2: possible reforms to remuneration and other intermediary practices

Phase 3: competition, affordability and availability.

Phases 1 and 2 are not connected directly with the affordability and availability of strata insurance (Phase 3) but rather the way that the intermediary market (SMs and brokers) operates regarding insurance.

Findings and recommendations for Phase 1 were published on 7 July. Phase 1 was aimed at generating an understanding of current practices, a critique of those practices and proposals for improved future practices. It therefore concentrated on *transparent disclosure* and offered explanations but no judgements or assessments about levels of remuneration or other aspects of strata insurance intermediary practices

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It was to be left to Phase 2 to consider—

- the appropriateness of current financial arrangements
- possible conflicts of interest
 - ... *these two topics have become dominant in this Phase 2*

Investigations during Phase 2 have led to the overall conclusion that the current financial arrangements in the form of the *commission rebate/broker fee system* used by many SMs and brokers should not be perpetuated. The reasons relate to conflicts of interest that need to be diminished or eliminated. These matters are explained in subsequent parts of this paper.

Other matters nominated for Phase 2 were -

- the range of business models of SMs and brokers or their effectiveness
- the range and value of services supplied by SMs and brokers, including claims services
- levels of remuneration for strata managers and brokers
- levels of efficiency of different SM and broker business models.

These matters are covered only indirectly in this paper because it is to be expected that implementation of the transparent disclosure regime recommended in Phase 1 in conjunction with structural realignment of intermediary remuneration recommended in this paper will go a long way towards dealing with each of them –

- the Phase 1 recommendations on transparent disclosure should lead to greater accountability of SMs and brokers to their OC clients and
 - the Phase 2 recommendations should lead to an extension of that accountability and a more competitive and efficient strata insurance intermediary market.
-

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PART 2: Market history and evolution

The current practices in strata insurance are evolutionary –

- Strata title became a property class in 1961.
- Strata insurance was initially a suite of individual insurances as for other commercial insurances.
- In the 1970s tailored packages of insurance for strata properties emerged.
- In 1978, CHU became Australia’s first strata insurance specialist (and has retained market leadership ever since).
- CHU operated for many years directly with strata managers, appointing them as agents, educating them on insurance matters and paying them commissions for work done in assisting the insurance process – no brokers involved in the early days.
- Other underwriters began to enter the market, with SUU being the most prominent in the 1990s and others emerging since. The market is dominated by underwriting agencies that enable insurers to participate in the market without having to develop the full in-house expertise to underwrite the business directly.
- Brokers also began to enter the market in the 1990s. Some began to specialise and that trend has grown in the last decade. NSW legislation in 2015 requiring strata managers to obtain 3 insurance quotes has accelerated the involvement of brokers in NSW and across the country.
- Because strata managers had become accustomed to receiving commissions, brokers found themselves rebating some or all of their commissions to obtain their broker appointments and then charging ‘broker fees’ to obtain remuneration for their own services.

General description regarding the product and its distribution

To quote from SCA’s submission of April 2019 to the ACCC’s investigation into insurance in Northern Australia -

“Insurance commissions have been a feature of most strata management business models from the industry’s earliest days. Strata title was first created as a property class in 1961 in Australia. Insurance for strata initially required multiple separate policies including Fire & Perils, Public Liability, and Personal Accident for Voluntary Workers which was inefficient and carried a high risk of non-compliance as coverage was not tailored to the strata legislation. In the late 1970’s a more efficient and tailored single package policy was developed. Specialised strata managers, then also a new type of property professional, were soon identified as ideal intermediaries both due to their business acumen, knowledge of the risk, record keeping, especially in relation to past claims incidents and of course access to a larger potential customer base.

“A key question for strata insurance has been, ‘who is the customer?’ All members in the body corporate bear joint and several unlimited liability but responsibility for adequate insurance protection falls to the volunteer officers on the strata committee. These volunteers change over time as units are bought and sold and office bearers retire. The levels of business acumen and insurance knowledge appropriate to the size and complexity of the risk and associated liabilities to be insured also vary considerably.

“The tailored strata package policy distributed largely by strata managers (as Authorised Representatives or Distributors of insurance companies or brokers) and specialist strata insurance intermediaries and brokers has evolved through market competition and appetite for managers’ aggregate portfolios to offer protection well in excess of legislative requirements with inclusions such as Office Bearers Liability and Legal Defence Expenses.”

.....

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“With the implementation of the Financial Services Reform Act (2001) in 2002, arrangements between insurers and strata managers were formalised through the Authorised Representative (AR) mechanism. These are typically not exclusive arrangements and most strata managers are authorised by all the insurers’ specialist intermediaries (underwriting agencies and brokers) they deal with on a regular basis. The AR mechanism provides an ideal platform for ongoing education of managers and to keep up with the changing insurance advice landscape.

“A more recent trend, driven in part by the increasing size and complexity of buildings under management, has been for strata managers to enter into a variety of commercial arrangements or partnerships with broking firms where the workload, in terms of sourcing insurance and managing claims, is shared along with the commission revenue.”

Further description of market structure

When the specialist strata insurance market began to develop, particularly through the initiative of CHU in the late 1970s, it was a direct market (no brokers) where CHU, acting as an underwriting agency, dealt directly with strata managers. The typical arrangement was a 20% commission paid by CHU to the strata manager with CHU working in conjunction with the strata manager to assess the insurance needs of the owners’ corporation and then to secure the requisite insurances.

The market operated in this manner for some years. CHU was the only specialist strata insurance underwriting agency and it developed the market, with a generally healthy synergy of increasing penetration and increasing specialist expertise. The expertise and experience related not only to the insurance needs of the managers and owners of strata buildings when arranging insurance but also to the specialist claims services that apply in this market.

This market development occurred alongside increasing legislative and regulatory requirements imposed by State and Territory governments around the country, generally in the name of consumer protection. These requirements exist principally to ensure that individual owners are protected by adequate insurances for the building and for other insurable risks of the owners in the context of there being a need for a single uniform set of insurance protection for the owners collectively, avoiding the need and the impracticality of individual owners taking out their own separate insurances. It is this dynamic that has led to the legislative requirement for strata insurance to be compulsory and for the building cover to be at replacement value.

The strata insurance market has of course been growing as apartment living gains in popularity and also with the advent of increasing numbers of commercial strata properties and mixed-use strata properties (residential and commercial).

In the last decade, broker involvement has increased substantially and it has accelerated in the last five years following legislative changes, in particular the NSW 2015 legislative amendments which required strata managers to obtain three insurance quotes each year. It is estimated that today more than 70% of owners’ corporations by number and 80% by premium volume are written through brokers.

Emergence of the broker/strata manager joint involvement

When brokers were first involved, they handled the insurance relationship for the strata manager and shared commission with the strata manager, typically by rebating 10% to 15% of the commission to the strata manager and retaining the other 5% to 10% for themselves. As the market grew, however, and the three broker requirement, which extended in practice beyond NSW even though it is not legislated in all states, brokers realised that they were becoming increasingly valuable to strata managers: the SMs often struggled to obtain three quotes and to deal effectively with insurers and underwriting agencies

SMs have therefore become increasingly willing to use brokers but have also resisted attempts by brokers to reduce their share of rebated commissions. At the same time brokers have wanted to become better remunerated for their own services. **These pressures have contributed to the continuation and in some cases expansion of commission rebates from brokers to SMs and to the growth in scale of broker fees in strata insurance.**

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Part 3: Phase 2 objectives

Intermediary goals

The overarching goal for all intermediaries (SMs and brokers) has to be to achieve value for the customer:

- Value means required level of insurance advice and other services at best price for those services -
 - Does not necessarily mean lowest price and should reflect the full scope and quality of services being offered
- Requires looking at the system from the customer's perspective.

Hence the primary goal of this project relating to intermediary remuneration is to encourage improved practices for the benefit of lot owners by ensuring that the remuneration system delivers best outcomes for owners and simultaneously maintains the benefits of the current SM - broker ecosystem⁵

To achieve this goal will require –

- (1) Satisfying owners that they have some choices and are being well served by their SMs and brokers at prices for insurance services that are commensurate with the value of these services
- (2) Delivering fair compensation to SMs and brokers
- (3) Identifying and responding to conflicts of interest
- (4) identifying one or more alternatives to the status quo that would -
 - a. optimise competition, service quality and intermediary efficiency
 - b. minimise or eliminate conflicts of interest
 - c. overcome if possible the current convoluted arrangement
- (5) Proposing mechanisms for delivering on any workable variations or alternatives to the status quo.

The following paragraphs consider each of these conditions in relation to owners' corporations that have appointed both a strata manager and a broker.

- (1) Satisfying owners that they are being well served

Limitations of disclosure to strata committees and lot owners have led to many owners not knowing how well they are being served as to scope and quality of insurance services and pricing of these services.

The transparent disclosure regime recommended in Phase 1 is aimed at rectifying the lack of knowledge and understanding for lot owners that will enable them to assess these matters.

Armed with improved knowledge and understanding, owners should be better placed to exercise choice and to ensure alignment of the advice and other insurance services offered with their needs and objectives.

⁵ This 'ecosystem' is where strata manager and broker maintain a constructive and collaborative relationship that many SMs and brokers have developed to service the interests of their OC clients.

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(2) Fair compensation for SMs and brokers –

It is notable that, under the *commission rebate/broker fee system*, the typical SM pricing structure is reliant on insurance commissions instead of, as is usual for other professional and commercial services, being commensurate with the value of the services provided.

It is likely that in most cases the SMs and brokers are not being under-compensated but there is anecdotal evidence that some are being over-compensated. The evidence is the openly discussed practice in the industry of strata managers subsidising the cost of other services from the commission rebates.

The current market is therefore anomalous in setting prices that in many cases are not related to the value of services but instead subsidise other services.

This topic is influenced, however, by the conflicts of interest that exist in the *commission rebate/broker fee system*, which is discussed at some length in subsequent parts of this paper

(3) Conflicts of interest

Conflicts of interest are a major topic in any review of strata manager and broker remuneration. They stand at the centre of questions about intermediary remuneration and, because of their significance, they are treated separately in the next parts of this paper.

(4) Alternatives to the current system

Alternatives are consequential on how conflicts of interest might be treated in future. They are considered later in Part 5 of this paper.

(5) Delivering the alternatives – consequential on (4).

The next parts of this paper consider these five conditions in the following order –

- Conflicts of interest and their implications
 - Alternatives
 - Fair compensation
 - Satisfying owners
 - Delivery of alternatives
-

PART 4: Understanding the commission rebate/broker fee system

Market structure

The market structure for strata insurance is different from that for all other insurances largely because of the multi-owner nature of strata properties and the participation of both strata managers and brokers in the chain from insurer to client.

Relative to other insurances, the presence of two intermediaries, the strata manager and the broker, acting on behalf of the client (the OC). has the effect of transforming the financial arrangements between the OC and these parties -

For other classes of insurance where a commission is payable, the broker is generally remunerated in full by commission paid by the insurer. Any 'broker fees' are additional, usually small and proportionate to the service provided.

BUT for strata insurance where there is a strata manager and a broker –

- Where a commission is payable, the market practice that has developed is that the broker generally remunerates the SM by passing most or all of the commission to the strata manager and then charges a 'broker fee' to the owners through the strata manager. In these cases the broker fee is material and may be as high as the commission itself (which is typically 20% of the premium).
... this is the ***commission rebate/broker fee system***
- A recent variant of this system is where commission and broker fee are paid on a policy by policy basis to a third party owned by the SM or broker or both in a venture that either shares them as fees on a policy by policy basis or accumulates them and then pays them out periodically in agreed shares as dividend payments or profit shares or similar to the SM and broker; under some of these arrangements, some brokers appear to claim that there are no commissions to the SM
... this is the ***composite commission & broker fee system***
- Where a fee is payable instead of a commission, the market practice is that the broker generally arranges for a broker fee that is shared with the strata manager, often on a 50-50 basis, and obtains premium from the underwriter net of commission.
... this is a ***fees only model***

The *commission rebate/broker fee system* is poorly understood generally by SCs and OCs. It is one of the stimuli for this project.

Estimates indicate that the *commission rebate/broker fee system* and the *composite commission & broker fee system* are used in some 80% of the market by premium where SMs and brokers are both engaged, with the remainder employing the fees only model.

Some exceptions

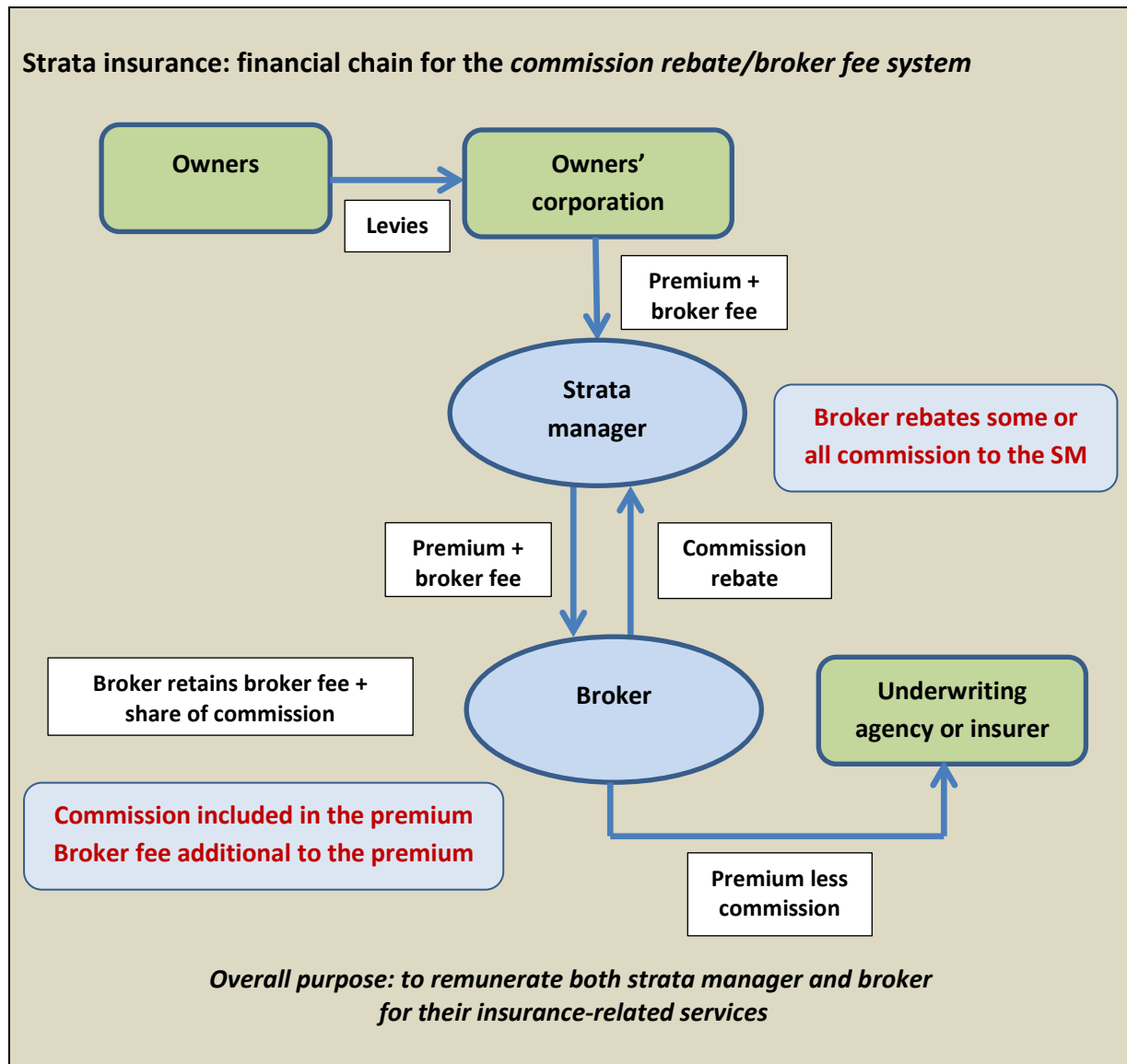
There are exceptions to the above arrangements, for example –

- *SM only*: in cases where there is a strata manager but no broker, the strata manager will need to undertake the full insurance process and will usually receive a full commission directly from the underwriter
- *Broker only or no intermediary*: not all owners' corporations engage strata managers (although it is generally only the smaller ones that do not) and in these cases the SC would deal directly with a broker or underwriter

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- some multi-owner properties are not strata title but for insurance purposes the situation is essentially the same as for strata properties (and in this document 'strata' is used as shorthand for all multi-owner properties).

See below two diagrams of the **strata insurance financial chain**.



To explore how the *commission rebate/broker fee system* works, there are two features of interest –

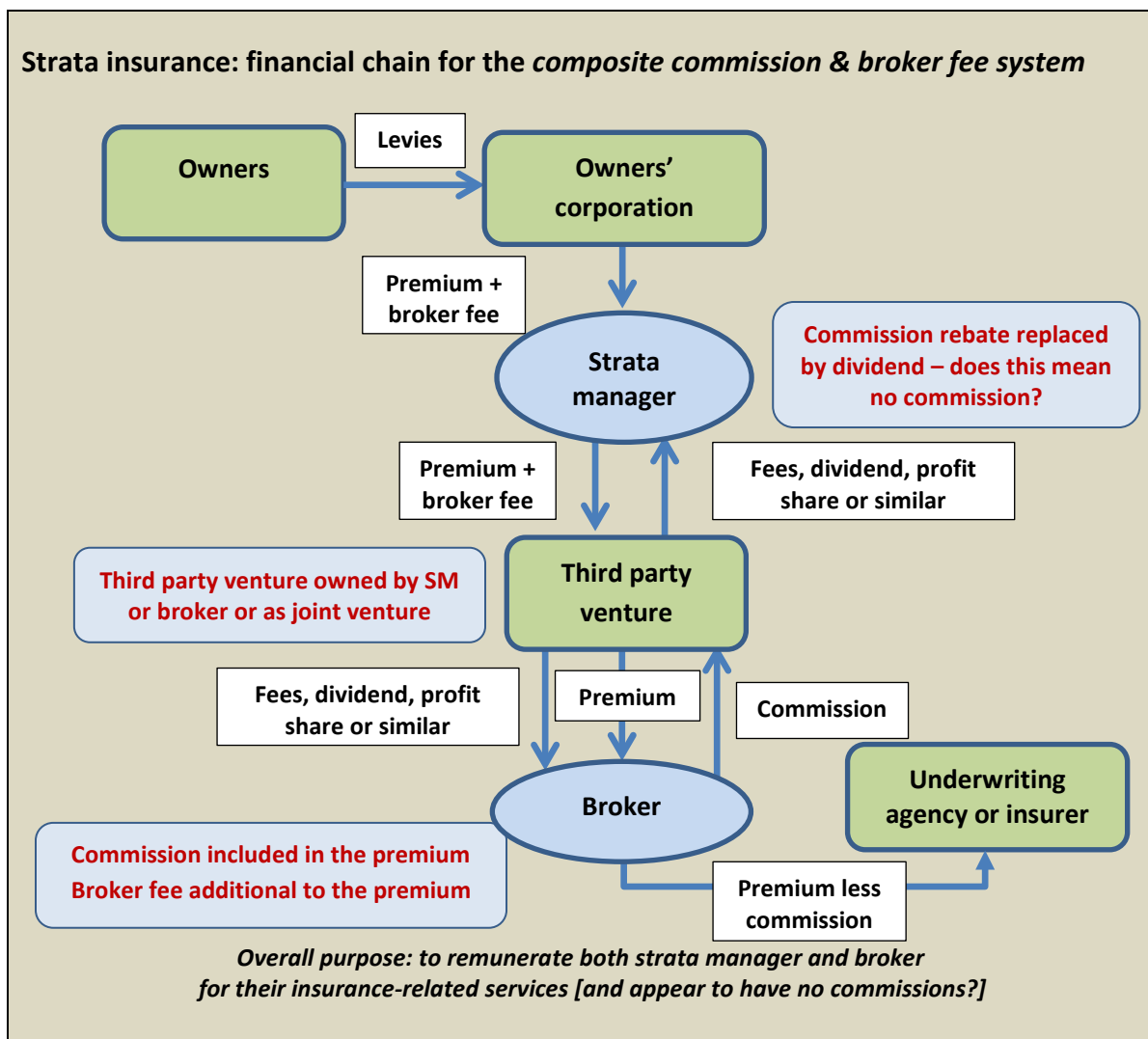
- (1) **the SM and broker agree on a share of the broker's commission that will be rebated to the SM**
 - the SM share of the broker's commission is usually significant and sometimes it is the whole commission or even more
 - the SM controls the broker relationship and as a result has strong bargaining power with brokers
 - the SM has an incentive to maximise or increase the SM's share of the broker's 20% commission
 - market SM commission shares (also referred to as rebates) have crept up over the last few years and are frequently 15% or more (and in some cases known to be more than 20%)

and

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- (2) **the broker and the SM agree on a fee for the broker** when the broker's retained commission after SM rebate does not cover the broker's cost of services
- the broker fee agreed with the SM is additional to the commission and is often significant
 - as broker fees are not standard, brokers and SMs can generally arrange the broker fee between themselves
- ...note that the SM is acting both as agent of the OC as client and agent of the broker*
- the fee level is an incentive for the broker and can be said to compensate the broker for ceding a high share of commission to the SM
 - broker fees are usually a percentage of premium in the same manner as commissions. They are commonly in the range 5% to 15% of base premium although some reach or exceed 20%.

Hence total intermediary charges including commission are typically in the range 25% to 35% of base premium while some reach or exceed 40%.



These two remuneration components (commission and broker fee) can be seen to complement each other and this system has become an established and indeed an entrenched part of the market –

- In (1), the broker treats the SM and not the OC as the client and offers the SM a commission rebate that satisfies the SM;
- In (2), the SM assists the broker to arrive at a fee that satisfies the broker.

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In each case, it is rare for the OC or SC to be a party to the negotiation, despite the OC being the party that pays the fee and the SC being the party that ultimately approves insurance charges.

The primary reason for this system and perhaps the best explanation and justification for it, for both SMs and brokers, is that it is a more or less natural evolution of a system that began without brokers. Over the last 10 to 20 years, the market has progressively embraced brokers as an important part of the strata insurance supply chain. For most present day SMs and brokers, it is simply a system they inherited when they joined the industry.

- see also Part 2: Market history and evolution

One of the outcomes of this evolving market structure is that often the management agreement arranged by the SM with the OC delegates to the SM a wide authority including engaging setting the fee and commission arrangements with the insurance broker. There is therefore generally a lack of accountability of SM and broker for the insurance-related remuneration paid by the client.

The commissioning of this review is a signal that it is time to stand back and reassess this system in the light of

- broker involvement that is now some 80% of the market and increasing, and
- remuneration arrangements that were perhaps unremarkable some years ago but have now evolved to the point where *conflicts of interest* need to be fully explored.

Conflicts of interest are explained in the next Part.

PART 5: A framework for evaluating intermediary remuneration

The previous Part explained the way that broker commissions supplemented by broker fees are arranged and used in the *commission rebate/broker fee system* wherein –

- (1) the SM and broker agree on a share of the broker's commission that will be rebated to the SM and
- (2) the broker and SM agree on a fee for the broker to when the broker's retained commission after SM rebate does not cover the broker's cost of services.

These two attributes of the current system give rise to questions of conflict of interest because the SM acts as an agent of the OC and also in many cases as agent of the broker. The broker also acts as an agent of the OC.

There is a fundamental problem with this *commission rebate/broker fee system* and it is best explained by reference to the **principal-agent problem**.

To consider this topic, it is necessary to digress and explore the concept of conflicts of interest which is an outworking of the principal-agent problem, also known as simply the *agency problem*, that is familiar to economists.

The principal-agent problem and conflicts of interest

The principal-agent problem occurs when one person or entity (the "agent") is able to make decisions and/or take actions on behalf of, or that impact, another person or entity (the "principal").

There are often benefits to these relationships, usually because the agent has some expertise or resources that the principal does not have. However, this type of relationship also causes some problems for the principal. Since there is *asymmetric information*, where the principal is not necessarily aware of what the agent is doing, *moral hazard* can exist: the agent can act in such a way that the agent's own interests are met, rather than those of the principal.

An agency problem is a conflict of interest inherent in any relationship where one party is expected to act in the best interest of another –

- Agency problems arise when incentives or motivations present themselves to an agent to act other than in the best interest of a principal.
- Through regulations or by incentivising an agent to act in accordance with the principal's best interests, agency problems can be reduced.

The agency problem arises due to an issue with incentives and the presence of discretion in task completion. An agent may be motivated to act in a manner that is not favourable to the principal if the agent is presented with an incentive to act in this way.

The agent is responsible for completing tasks given by the principal so long as the principal provides reasonable instruction. Additionally, the agent has an obligation to perform tasks that will not intentionally harm the principal.

A **duty of loyalty** is implied within a principal-agent relationship, which requires the agent to refrain from putting himself or herself in a position that creates or encourages conflict between the agent's interest and the interest of the principal.

A **conflict of interest** arises when what is in the agent's best interest is not in the best interest of the principal to which the agent owes loyalty and is in a position of trust. In these situations, the agent may become unreliable because of a clash between personal (or self-serving) interests and professional duties or responsibilities: the agent's vested interests raise a question of whether their actions, judgments and/or

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decision-making can be unbiased. Vested interests may be, for example, money, status, knowledge, relationships or reputation.

In a principal-agency relationship, conflict of interest can arise –

- if the agent is in a position to choose personal gain over the duties to the principal or exploits their position for personal gain in some way, or
- if the agent must answer to two different parties whose needs are at odds with each other. In this case, serving one party may injure the other.

Self-dealing is the most common type of conflict of interest in the business world. It can occur when an agent accepts a transaction from another entity that benefits the agent and may harm the principal.

... adapted from Investopedia, article by James Chen, last updated June 2022 and Fama, E. F., & Jensen, M. C (1983). "Separation of ownership and control"

How does the principal-agent problem manifest itself in strata insurance?

The principal-agent problem arises in all insurances where an intermediary (broker or agent) acts between the underwriter and the client. For most insurances, this is an accepted practice which, while creating some potential conflicts of interest, is not considered further in this paper. In my view it is secondary to the conflicts confronted by SMs and brokers in strata insurance.

Additional principal-agent situations occur in strata insurance because there are often two agent, (SM and broker. The principal is of course the owners' corporation.

As already noted, the two features of interest with the *commission rebate/broker fee system* are -

- (1) the SM and the broker agree on a share of the broker's commission that will be rebated to the SM

and

- (2) the broker and the SM agree on a fee for the broker when the broker's retained commission after SM rebate does not cover the broker's cost of services.

In the *composite commission & broker fee system* (see Part 4), the conflicts are exacerbated because the existence of the third party venture hides from sight the underlying commission and broker fee transactions.

The above box explaining the principal-agent problem demonstrates that these two features constitute conflicts of interest and are inherent in the *commission rebate/broker fee system*.

Some evidence of these conflicts is that –

- some brokers describe as "premium" an amount which is actually premium plus broker fee – see also Appendix B – and the SM will use this terminology in communicating with the SC and in preparing the OC's accounts
- the underwriter's invoice to the broker will usually make it clear whether the premium is gross or net of commission but brokers do not usually show the insurer's invoice to the SM or the OC and do not make it clear to the SM or the OC if commission is included.

The importance cannot be understated of all parties being clear and accurate on what is the premium, being an amount presented by the underwriter to the broker, and whether the premium is gross or net of commission -

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- The disclosure regime in the appendices is a step towards overcoming such inaccurate or incomplete use of terminology.
- Special attention is needed on both issues, being lack of clarity around the meaning of “premium” and whether the premium (properly stated) is gross or net of commissions.

Additional attention is required under the *composite commission & broker fee system* because correspondence from the broker or SM may suggest nil commission when in fact commission is paid, on a portfolio basis, shared between the SM and the broker via the third party venture.

These conflict situations are examined in the next part of this paper. They exist because most of the agreements involved are made between SM and broker with little or no involvement of the strata committee. That is why they warrant our attention.

PART 6: Expanding on the commission rebate/broker fee system

In the *commission rebate/broker fee system*, as already explained there are two primary conflicts –

(1) the SM and broker agree on a share of the broker's commission that will be rebated to the SM and

the broker and SM agree on a fee for the broker when the broker's retained commission after SM rebate does not cover the broker's cost of services.

The SM share of commissions is frequently 15% to 20% of base premium part of the broker's total commission of 20% (and sometimes more than 20%), leaving little or nothing to fund the broker's.

Broker fees are usually expressed as a percentage of premium and are commonly between 5% and 15% of base premium, sometimes higher at 20% or more.

Before considering how these two conflicts might be mitigated or resolved, an extension of the explanation in Part 3 is needed.

(1) *The SM and broker agree on a share of the broker's commission for the SM*

This conflict is manifested through the bargaining power of the SM because the SM controls the relationship with the client. The broker is reliant on the SM for broking appointments: what better way to be awarded an appointment than by matching or exceeding the rebate offered by competing brokers?

It should be evident to all involved, however, that the larger the SM's share of commission, the larger the broker fee is likely to be. The result is higher costs for the OC, i.e. the commission is not a free benefit but a cost built into the insurance charges (premium plus fees) paid by the client.

... this is the nub of the conflict.

The superficial outcome for the SM of a higher commission rebate is that total SM fees for agreed SM services are lower than if the SM had a smaller share of commission, giving the appearance to the OC of the SM being more competitive on price. This is illusory if the total OC fees are unchanged (i.e. if the broker fee is increased to adjust for the commission-subsidised SM fees).

Many SMs have observed during the course of this review that, if they had to accept a reduced commission share, their own revenue would reduce and they then ask how would they replace that revenue?

This proposition is misplaced. If the services provided by SM and broker are unchanged and the commission rebate is reduced, then to make corresponding adjustments to the SM's agreed services fee would not affect either the SM's revenue or the broker's revenue. Nor would it change the total OC levies.

While the bargaining position of the SM is a key aspect of the arrangement, the role of the broker should not be overlooked. The broker is a participant by ceding a major portion of commission to the SM. The broker will argue of course that his or her arm has been twisted by the SM and that is true up to a point. It is no surprise, however, that market levels of commission rebates have drifted up in recent years, from a typical level of 10% or less 10 years ago to an average today that is north of 15%. The average is probably 17% or 18% and there are brokers ceding 20% and in some cases more than 20%.

From this arrangement and how the market has evolved, we can also see that current levels of commission rebate are not based on an assessment of the value of the insurance services being offered by the SM. They are based on either what has gone before (market or client precedent) or what might now be negotiated.

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There could of course be an intervention by the SC to negotiate the SM fee, the commission rebate or the broker fee. If that were so and the total of the SM and broker remuneration were to reduce, in principle it would simply be the market working: the SC would be exerting its bargaining power and would thereby be nullifying the conflicts of interest. This situation is hypothetical, however, because the market does not operate this way and there is no obvious means by which SCs across the board could be induced or would even be knowledgeable enough to undertake this type of intervention.

Conclusion:

It is anomalous that, firstly, the SM arranges to receive a significant part of remuneration by agreement with the broker instead of with the OC as client and, secondly, the SM's remuneration is not assessed according to the 'value of the services principle'⁶.

(2) The broker and the SM agree on a broker fee that is additional to the commission

The aim of the broker fee is to fund the broker's cost of services when the broker's retained commission after SM rebate does not cover those costs.

The financial interest for the broker is in achieving total revenue that is a material share of the original commission and meets the broker's cost of services.

Brokers rarely see what is presented to the SC and so in many cases are not sensitised to the level of intermediary costs borne by the OC as client.

Faced with pressure from the SM to concede a major part of the commission to the SM, the broker is bound to seek a broker fee that delivers some level of recompense for the loss of commission. And as the market rate of SM commission rebates has risen in recent years, so broker fees have also drifted upwards.

Anecdotal market information suggests that most brokers need at least 7% to break even and perhaps up to 15% to make their broking business viable. In most cases these amounts are less than the commission retained by the broker after rebating commission to the SM.

It is evident therefore that the SM commission rebate requirement will put the broker into response mode regarding broker fees. The broker still has bargaining power, however, and that will be stronger if the broker is dealing only with the SM, as is usually the case, and not also with the SC.

Conclusion:

it is unsatisfactory that the broker gives away a significant part of commission and then enters into a second agreement for a broker fee that, in conjunction with any retained commission, funds the broker's cost of services.

⁶ The 'value of services principle' refers to a pricing approach where the price sought for the goods and services being provided is commensurate with the value of those goods and services.

The value of services to be provided can validly include a 'distribution charge' to recognise the investment needed by the SM to arrange broking services and the corresponding cost the broker of establishing and maintaining the SM relationship.

PART 7: Assessing the commission rebate/broker fee system

The current financial practices that include the *commission rebate/broker fee system* have emerged over two or three decades not by design but from an inherited pre-broker past practice. In today's environment, these practices are confusing and a 'reset' could be beneficial to all participants in the strata insurance supply chain..

Main potential benefits of maintaining current arrangements

The main propositions in favour of not disturbing the current system are –

- It operates effectively on the whole. It delivers efficiencies in the appointment of brokers and in the collaboration between SM and broker that deliver good insurance outcomes for OCs. Those outcomes are primarily timely and effective insurance cover and placement at renewal time and, when claims occur, effective action on the claim by both SM and broker including advocacy with the underwriter.
- Disturbing this system may have unexpected adverse consequences within the SM and broker markets, possibly including –
 - some competent SMs and brokers deserting the market and creating a capacity shortage
 - diminishing the benefits of the pooling effect or cross subsidisation or smoothing of intermediary charges across portfolios: commissions and fees are usually calculated as percentages of premium, perhaps with minimum charges where premiums are small, such that, when claims or other activities requiring extra services from SM or broker occur, there are no additional charges or fees payable by the OC.
- There is a certain market stability that has emerged in the existing remuneration structures across the industry. Any material change to these structures would lead to both SMs and brokers having to reorient their pricing frameworks in ways that are difficult to predict in detail at this stage. SMs and brokers may need to undertake an analysis of their costs and fees as part of this reorientation. The changes would cause a degree of inconvenience and cost that will likely become clear only during their planning.
- The forthcoming introduction of the Phase 1 disclosure regime, along with enhancements to NIBA's Code of Practice for brokers including written terms of engagement conveyed to OCs, can be expected to succeed in generating stronger management of conflicts of interest by SMs and brokers and improved understanding of the system by owners.
- The Phase 1 disclosure initiatives may limit the conflicts and they should be given time for their effectiveness to be assessed.

Main potential benefits of making some changes

The main propositions in favour of making some changes to the current system are –

- The system contains two primary conflicts of interest, as explained in Part s 4 and 5, which are –
 - the SM and the broker agree on a share of the broker's commission to be rebated to the SM and
 - the broker and the SM agree on a fee for the broker when the broker's retained commission after SM rebate does not cover the broker's cost of services.

These two conflicts of interest are inherent in the *commission rebate/broker fee system* and they exist because most of the agreements involved are made between SM and broker with little or no involvement of the strata committee.

- These two conflicts are significant and create a case for making changes that would minimise or eliminate these conflicts. They represent risk and temptation for SMs and brokers to put their own financial interests ahead of their OC clients and there is anecdotal evidence that that is occurring in some segments of the market.

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- With almost no exceptions, all lot owners and other consumer representatives that have offered submissions to this review (mostly during Phase 1) expressed dissatisfaction not only with poor disclosure (about to be rectified) but also with the convoluted nature of the current system. The optics of the system, irrespective of its merits, whereby brokers receive revenue from two sources (a commission from the underwriter and fee from the client), then remit a major part of the commission to the SM, are perplexing to say the least.
- The system's convoluted structure is a clear impediment to its comprehension by both lay people and insurance practitioners alike.
- The system distorts competition in the strata management market because commission rebates enable strata managers to present prices for their total services that are artificially reduced by subsidies from the insurance commission rebates
- Provided that suitable transition arrangements are put in place to introduce change, there is no obvious reason why some remuneration system changes that preserve fair compensation for SMs and brokers should interfere with the range and quality of services that they provide or with the 'ecosystem' where SMs and brokers collaborate to the benefit of their clients.

The composite commission & broker fee system

As noted earlier, this system is a variation of the *commission rebate/broker fee system*. Instead of crediting to the SM and broker their remuneration on a policy by policy basis, the system accumulates these payments and then pays them out periodically as dividends or similar.

It is difficult to escape the conclusion that this system, by operating on a portfolio basis, is being used as a device to conceal the policy by policy commissions and broker fees, thereby exacerbating or perhaps demonstrating the conflicts of interest inherent in the *commission rebate/broker fee system*.

Conclusions

I have considered all of the above propositions for and against change and examined them in some depth. My main conclusions are that –

1. It is relevant to acknowledge the strength of the propositions in favour of continuing with the current system and its positive attributes.

These propositions all point to a system in which many of the participants, in particular SCA representatives and specialist strata insurance brokers, are confident in the system and its efficacy. And there is no doubt that in many respects the system does function effectively.

Also the Phase 1 disclosure arrangements and NIBA's enhancements to its Code of Practice will undoubtedly improve matters when there is full implementation. The improvements could be substantial.

Nevertheless it is evident that none of the propositions responds directly to the conflicts of interest inherent in the *commission rebate/broker fee system*. They do not address any of the incentives that are the source of the conflicts, being the ability of SMs and brokers to agree on levels of remuneration between themselves with limited or no involvement of their OC clients.

2. It is important to recognise the significance of the two primary conflicts of interest

I draw attention here to the two conclusions I have arrived at in the previous Part 6, namely that agreements between SMs and brokers on SM share of commission are anomalous and the arrangement whereby broker fees additional to the commission are agreed is unsatisfactory.

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3. **While acknowledging the favourable attributes of current arrangements, I believe that these two conflicts of interest cannot be satisfactorily managed across the strata industry. Consequently steps should be taken to phase out the source of the two conflicts, which is the convolution of the *commission rebate/broker fee system*.**

This conclusion indicates the need for a **structural realignment** that would enable the *commission rebate/broker fee system* to be replaced by something different. This topic is explored in the next Part 8.

PART 8: Options for structural realignment of remuneration

Something different?

The steps needed to phase out the *commission rebate/broker fee system* would lead to its replacement with something different that minimises or eliminates the two conflicts. Replacement would require that, in general, **brokers be remunerated by commissions only (from the underwriter) or fees only (from the OC) but not both** and that **SMs be remunerated partially or wholly by fees**. More precisely –

- where the broker is receiving a commission from the underwriter -
 - the broker would be remunerated through commission only, other than in the exceptional cases where the commission (normally 20%) is inadequate and requires a supplementary fee (which may occur when the premium is small)
 - the SM would be remunerated through any remaining commission after the broker's charges are satisfied and otherwise through a fee payable by the OC
- where the broker is operating on a net premium basis with no commission -
 - both broker and SM would be remunerated by fees only from the OC
 - agreement would need to be reached among SC, SM and broker as to the total fees and how they are to be allocated between SM and broker.

The same steps would apply where the *composite commission & broker fee system* is in place. The ventures characterising this system may become superfluous but, if continued, would need to be reoriented.

The main outcome is intended to be greater accountability of SM and broker to the OC without any adverse effects on the scope and the nature of the services being provided.

To deliver such changes will require a **structural realignment** aimed at minimising the conflicts of interest while simultaneously –

- satisfying owners that they have some influence over SM and broker appointments and their terms of engagement and also are being well served at fair prices by their SMs and brokers for the insurance advice, placement, claims support and other services provided
- maintaining fair compensation for SMs and brokers for the services they each provide, and
- maintaining a constructive and collaborative relationship that many SMs and brokers have developed to service the interests of their OC clients.

What might something different look like?

The primary requirement is to resolve the convulsion of the *commission rebate/broker fee system*. To do so would not necessarily completely overcome the conflicts but it would create a quantum shift in their impact. It would mean finding one or more methods of arranging either for brokers to rely on commissions for their own remuneration instead of broker fees, with SMs relying on fees plus a modest share of commissions, or for broker and SM together to rely on fees only, with no commissions and a net premium offered by the underwriter.

The *composite commission & broker fee system* can be resolved the same way. For example, the third party venture should receive as revenue the broker commission only because there would be no broker fees. The SM may then receive a portion of the commissions, accumulated in the same way as present, but the absence of a broker fee would reduce the revenue, in some cases by 50% (if at present the broker fee and commission are both 20%). That would also imply an alteration to the sharing of the venture's revenues which today would

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likely favour the SM who would normally receive 60% or more of the revenues. On restructuring, the proportion is likely to be something between 20% and 50%.

Candidates for something different

Realistic possibilities seem to be what I will call a *“broker commission/SM hybrid model”* and a *“fees only model”*.

“Broker commission/SM hybrid model”

The broker to be remunerated exclusively by commission and may rebate part of the commission to the SM. The SM to invoice the OC for any remaining fees agreed upon with the SC to cover any SM insurance services not covered by commission rebate.

“Fees only model 1” or “Single fee model”

Brokers and SMs to operate on fees only, paying net premiums to underwriters with no commissions involved. The broker and SM to agree on an aggregate fee to be approved by the SC and an allocation of that fee between them.

“Fees only model 2” or “Dual fee model”

This model is similar to the single fee model but there are two separate fees, one for the SM and one for the broker.

Two other models considered but dismissed as unworkable are a *“broker commission/SM fee model”* and a *“capped remuneration model”*, both explained later in this Part.

Realistic models - descriptions

- *“Broker commission/SM hybrid model”*

The broker to be remunerated exclusively by commission and may rebate part of the commission to the SM. The SM invoices the OC for any remaining fees agreed upon with the SC to cover any SM insurance services not covered by the commission rebate.

The broker would receive payment of the full commission and then remit the agreed portion to the SM, as with the *commission rebate/broker fee system*. The difference is that there would be no broker fee (except perhaps for a modest handling fee as commonly charged by brokers, typically between \$100 and \$300) and the SM's remuneration would have two components, part commission rebate and part fee charged to the OC.

In this environment, the commission rebated to the SM would be smaller than under the *commission rebate/broker fee system*. A market norm should emerge and would likely be most frequently between 5% and 10% part of the 20% commission.

Brokers would therefore dispense with broker fees but retain sufficient commission for their own remuneration and would rebate a portion to the SM for referral and/or services rendered in support of the broker. The SMs' fees would incorporate their fees for insurance services in support of the OC as part of the SM's overall agreed services fees to the OC.

The distinction between SM insurance services in support of the broker and SM insurance services in support of the OC as insurance client could be determined as part of the 'scope of insurance services' agreement with the OC (see Appendix E). This agreement should also be consistent with the Terms of Engagement agreed by the broker with the SC under NIBA's new Code of Practice.

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- “Fees only model 1” or “Single fee model”

Brokers and SMs to operate on fees only, paying net premiums to underwriters with no commissions involved. The broker and SM agree on an aggregate fee to be approved by the SC and an allocation of that fee between them. The SM presents a single fee to the OC on behalf of the broker and the broker, on receipt of payment, remits the agreed portion of the fee to the SM.

This model is common practice in the market today for two market segments. One is at the upper and/or more complex end of the market, where premiums are typically \$50,000 or more. The other is that part of the middle market where broker, SM and SC all agree to use this method. Some brokers use it for much of their portfolio and the premiums are typically upwards of \$10,000 but this method can equally be used at lower premium levels.

- “Fees only model 2” or “Dual fee model”

This model is similar to the single fee model but there are two separate fees, one for the SM and one for the broker -

- the SM negotiates a fee directly with the OC, not with the broker
- the broker also negotiates its fee with the OC and not with the SM.

This model is rarely used in today’s market. Most fees only arrangements use the *single fee model*.

Net premiums

If a broker is involved, the underwriter will be prepared to offer the broker a net premium (no commission). In today’s market, that would be 80% of the insurer’s base premium gross (with commission).

Without a broker, underwriters will almost always charge gross premiums. It is then a matter for the underwriter’s agent (usually an SM who is acting without a broker) to decide either to retain the full commission or to rebate part of it to the OC.

It is unclear whether the brokers and SMs who currently operate on net premiums plus fees know the profitability of their portfolios by policy or by portfolio segment. The likelihood is that their assessment of the total fee and the sharing between them contains the vestiges of the commission rebate/broker fee system. That is because the total fee is usually decided by reference to the base premium and is set as a percentage of that base premium, much as if it were a commission.

Setting intermediary fees with net premiums (no commissions)

It is worth noting that setting remuneration by reference to premiums establishes a type of benchmark for intermediary remuneration. Brokers’ services, including claims services, do not readily lend themselves to a ‘cost plus’ approach or to time-based fees which are common in other professional and commercial endeavours

Part of the role played by commissions set across a portfolio or across the market is the ‘smoothing’ or averaging of the charges made to individual customers. Levels of advice, nature and frequency of claims and other factors lead, in a commission-based or premium-based fees system, to some inevitable cross subsidies among policyholders. It is a form of pooling of distribution and other service costs, including the management of claims, that is akin to the risk pooling that is a fundamental part of the overall insurance system.

Commissions tend to find a market level that works generally across the market for the parties involved (underwriter, broker and insured party). Hence the standard or typical level of market commissions assists brokers to establish a market price or reference price for their services.

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Government charges

There is a customer benefit to net premiums: as premiums attract stamp duty and in some cases of government charges that are based on premium. In strata insurance with its 20% commissions, these charges are 20% lower when net premiums are applied compared to gross premiums.

Some brokers and some consumer representatives have become advocates for net premiums partly to take advantage of this cost reduction. It is greater in NSW and Tasmania than elsewhere because of the applicable emergency services levies in those states.

Implications

The *“Broker commission/SM hybrid model”* and the two *“fees only models”* have the primary effect of eliminating the convolution of the *“commission rebate/broker fee model”* and are aimed at mitigating the two primary conflicts. To consider their respective advantages and disadvantages, we observe that -

- *“Broker commission/SM hybrid model”*
 - Would reduce the number of agreements causing conflict from two to one: SM and broker to agree on level of commission rebate, SM then needing to go directly to the SC for any additional charges
 - Assumes that the broker can be satisfied with a maximum of 20% of base premium (which generally is the case) and that the SM who currently receives say 15% to 20% of base premium as commission rebate can accept some reduction down to say 5% to 10%, then add the loss of rebate to the SM’s other fees for agreed services to the OC
 - It is fair in principle as long as there is a rearrangement of SM and broker remuneration and it need not cause any change in total remuneration to broker or SM
 - It risks the same negotiating problem over commission rebates as the current system, owing to the SM’s bargaining power over broker appointments: If the broker receives commission only and no broker fee but some sharing with the SM, the bargaining power may remain with the SM, as at present. That becomes a threat to the broker’s remuneration because of lack of opportunity to add a broker fee.
 - The remedy for this situation would lie in a combination of (1) transparent disclosure to the OC, and (2) recognition by the parties, confirmed in the broker’s Terms of Engagement with the OC, that a broker fee is inappropriate when the broker is remunerated by commission, as is the case for other classes of insurance.
- *“Fees only model 1” or “Single fee model”* –
 - Would reduce the number of negotiations causing conflict from two to a half! (see next two points): the SM and broker would agree on the sharing of the fee and then the SM would arrange with the OC the single total fee.
 - Conceptually this model can eliminate the second conflict (agreement between SM and broker on the fee allocation) by transparent disclosure and genuine dialogue with the SC on the fee levels. That would be a variation to the existing market practice because, as with the commission rebate/broker fee system, the SM share is agreed between the SM and the broker. Generally it is not based on the value of services provided. The residual question then is whether transparent disclosure to the SC combined with the broker’s Terms of Engagement with the OC would create

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accountability and limit the bargaining power of the SM, as is needed to limit and manage the SM's conflict.

- Current market practice is also that the total fee is usually calculated as for commissions, i.e. a starting point of 20% of premium (actually often 20% of gross premium and therefore 25% of net premium). It could be higher or lower, however, and the flexibility is valuable to enable all parties to recognise any specifics for the property and the OC that may warrant a fee that is different from 25% of net premium. It may be higher or lower and it need not be expressed as a percentage of premiums..
- Current market practice is for a sharing of the fee between SM and broker, usually in the range 60/40 to 50/50 with the higher share going to the SM. As with the *commission rebate/broker fee system*, this sharing in today's market may reflect more the bargaining power of the SM than the value of services provided by the SM, thereby subsidising other SM services to some extent.
- *"Fees only model 2" or "Dual fee model"* –
 - Because there are separate fees for SM and broker, there is no ambiguity as to what is paid to the SM and what is paid to the broker provided that there is no behind-the-scenes sharing.
 - The similarity with the *single fee model* is most pronounced if the comparison is with the *single fee model* under transparent disclosure and open discussion or agreement by SC, SM and broker on the fees.
 - It is different administratively from the *single fee model* because the SM insurance fee would become part of the total agreed services fee of the SM, in contrast to a separate SM insurance fee being built into the total fee paid to the broker with part rebated by the broker to the SM.

Under either of *the fee models*, if the sharing of fees is set at 50/50 or similar and is agreed between SM and broker without direct consultation with the SC, some conflict may remain.

Two models considered but dismissed as unworkable

"Broker commission/SM fee model": the broker retains the whole commission without any sharing with the SM. I have not considered this model as realistic because it implies either the broker always retaining commission of 20%, which market experience indicates would be excessive in many cases, or the broker receiving from the underwriter a commission of less than 20%, say somewhere between 5% and 15%. Such an approach would call for an intervention in the underwriting market (how and by whom?) and there is no obvious or even practical case for such an intervention.

"Capped remuneration model" : brokers and SMs operate to a cap on the total of fees and commissions. Because commissions are standard in today's market, this method would mean imposing a limit or cap on broker fees.

Some observers have suggested capping of this kind. The basis of the idea is that the primary problem to be overcome is excessive charges. The idea does not, however, recognise the conflicts of interest that have been identified in this paper as the primary problem. For this reason it is not pursued. Further, it would be complicated to design and would almost certainly require legislation, which would be very difficult to prosecute.

PART 9: Assessing the restructuring options

Which model or models should be supported?

Any of the three models could be adopted and all three have the potential to ameliorate greatly the two primary conflicts of interest. Which one or more models should be used to overcome the current convoluted *commission rebate/broker fee system*? And how might they be introduced?

There are some practical issues to be considered regarding implementation, risk and compliance. A critical element of each of the models is that the broker's revenue be derived solely from commissions or alternatively solely from fees.

For *fees only models*, we have two variants. The *single fee model* contains some risk of conflict of interest because the SM can still seek a high share of the total agreed fee but it has the advantage of containing all insurance related intermediary charges in one fee. It therefore compartmentalises insurance charges from other OC costs including other SM services.

The *dual fee model* is cleaner from a conflict of interest perspective, assuming that there are no payments by brokers to SMs.

Hence all three models carry some conflict risk and also some compliance risk relating to transparent disclosure. Nevertheless all three overcome convolution of the *commission rebate/broker fee system* and would achieve the primary goal of diminishing greatly the two primary conflicts.

The best defence against these potential conflicts is active engagement by the OC or its strata committee in the broker appointment process that should the remuneration arrangements for the SM and broker. Terms of engagement between broker and OC as client under NIBA's new Code of Practice should assist this process.

Conclusion

These three models (*broker commission/SM hybrid model* and two variants of the *fees only model*) for structural realignment have been carefully considered alongside other ideas for minimising the primary conflicts of interest inherent in the *commission rebate/broker fee system* that currently dominates strata insurance remuneration practices.

In the free market that exists today, it would remain open to OCs and their intermediaries to make their own choice of remuneration models, subject to professional practice requirements of brokers who are NIBA members and SMs who are SCA members. The efficacy of their choices from a consumer perspective will rely on two ingredients, *transparent disclosure* as recommended in Phase 1 and a transition from the convolution of the *commission rebate/broker fee system*.

Combined with an improved and transparent disclosure framework and active participation of the strata committee where possible, all three models present a simple and direct intermediary remuneration structure which is chosen and paid for by the OC as client and which thereby mitigates substantially the two primary conflicts.

Further comment

It is contended that each of these remuneration models could be applied without disturbing the current 'ecosystem' where many SMs and brokers have developed a constructive, collaborative and efficient working relationship to service the interests of their OC clients.

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A question that has arisen in relation to the prospect of change is whether, if changes are to be made to the current system to respond to potentially unfavourable consequences of the conflicts of interest, would the changes detract from or add to the current 'ecosystem'?

One can only speculate on the answer but the scale of the changes advocated is not radical. With the interests of OCs and lot owners as the primary measuring stick, it is difficult to identify any fundamental reason why there would be adverse consequences and there is no obvious reason why the SM and broker markets would not adapt to the changes.

Recommendation

On the basis of the above analysis and conclusion, I am recommending that SMs and brokers who are using the *commission rebate/broker fee system* prepare to make a transition to one or more of the *broker commission/SM hybrid model* and the two variants of the *fees only model*.

As immediate change is not essential, especially with the challenge of introducing the Phase 1 disclosure regime, a workable transition process for change will be needed. This topic is covered in Part 11.

PART 10: Remuneration with one intermediary

The majority of this paper concerns strata insurance arrangements where a SM and broker are both appointed. The situation is simpler when there is just one intermediary.

SM appointed but no broker

In cases where there is a SM but no broker, underwriters usually offer gross premiums only and so a conventional commission arrangement can continue to be used as at present. It then becomes a matter for the SM to disclose the commission to the OC and to reach agreement on whether there is to be any sharing of commission with the OC.

Broker appointed and no SM

In cases where there is a broker and no SM, the broker has a choice as to whether to use net premium with fee or gross premium with commission and, if the latter, whether there is to be any sharing of commission with the OC.

Conclusion

Neither of these arrangements involves the *commission rebate/broker fee system*. As a result, there is no need for any structural realignment and I am advocating no change to either of these existing arrangements.

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PART 11: Delivery of remuneration reforms

This Part sets out a recommended staged process for implementation of both the Phase 1 recommendations on transparent disclosure⁷ and the Phase 2 recommendations in this paper on remuneration reforms for strata managers and brokers.

The transition process for phasing out the *commission rebate/broker fee system* can be considered in three stages to allow for –

- (1) the introduction of *transparent disclosure* (2022-23),
- (2) preparation for the restructuring of remuneration (2023) and
- (3) Implementation of plans made in Stage 2 (2024).

This third stage represents a deferral of remuneration reforms and should enable the new transparent disclosure regime to become bedded down before reforms are introduced.

The recommended staged process is –

Stage 1:

- Bring the existing commission and fee arrangements into the open so that owners and their SCs can readily see and understand them, via the Phase 1 recommendations for **transparent disclosure** to the SC and **effective communication** between the SM and the SC and OC
 - *Phase 1 is aimed at delivering transparent disclosure and the tools for effective communication*
- The Phase 1 recommendations be adopted by all strata managers and brokers as soon as possible,
 - *The effectiveness of Phase 1 will not be known until a period of time after its implementation.*
 - *the influence of the new transparent disclosure regime should become evident during 2023.*

Stage 2: SMs and brokers consolidate the disclosure regime and prepare to restructure their remuneration (2023 to 2024)

- A review be carried out in late 2023 of the implementation and effectiveness of the disclosure regime
- SMs and brokers plan and prepare during 2023 to restructure their remuneration
 - *those SMs and brokers currently using the commission rebate/broker fee system prepare to make a transition to a broker commission/hybrid SM model or a fees only model*
 - *those SMs and brokers already operating on a fees only model realign their fees to correspond to the 'value of services principle'.*
- To preserve the self-regulatory nature of strata insurance operations, both SCA and NIBA prepare guidance notes or practice standards in support of the decisions they take on structural realignment

Stage 3: phasing out the system via structural realignment – the transition (from 2024)

- For each of their OC clients, SMs and brokers carry out the transition planned at Stage 2 so as to have it fully implemented through the 2024 and 2025 renewal cycles.

⁷ For reference, the main recommendations are stated in the Executive Summary and the full Phase 1 proposals are reproduced in Appendices A to F. Appendix A (Disclosure matrix) describes their application.

Disclosure Matrix – what, when and how

There are three components of disclosure –

1. Financial items
2. Scope of services
3. Business arrangements

The Disclosure Matrix draws together all the steps required to deliver these components. .

Matrix of disclosure responsibilities*	1. Financial items	2. Scope of services	3. Business arrangements
What to document	Eight items	Allocation of SM and broker services	Explain arrangements between SMs, brokers, underwriters
How to document	Template or full one page equivalent	Complete check list, add notes if needed	Complete questionnaire, and schedule
When to document	1. At time of quoting 2. At time of invoice	On appointment then annually with quotes	On appointment then annually on any changes
When to communicate	1. When quotes ready 2. When invoice ready	On appointment then annually with quotes	On appointment then annually on any changes
How to communicate	Ensure timely and concurrent communication from broker to SM and OC	As for financial items	As for financial items

*Business arrangements are the responsibility of the SM. Many of the other responsibilities lie with the broker but some lie with the SM and others need to be arranged jointly between broker and SM.

1. Financial items

There are three sub-topics and hence three appendices on financial disclosure -

App B: Financial disclosures: recommended practices *what is to be disclosed*

- covering the basis for templates and associated definitions

App C: Templates for financial disclosures *presenting the financial disclosures*

- specifying recommended templates, presenting and explaining them

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App D: Strata insurance renewals: recommended practice *communicating during renewal*

- nominating how the templates are designed to be used and the steps that brokers and SMs take during the renewal process, from commencement, typically 8 weeks before renewal, through to completion when the insurance policy is renewed and the premium paid.

The three appendices comprise a set of primary disclosures dealing with financial aspects of the SM and broker involvements in strata insurance for their OC clients.

2. Scope of services (Appendix E)

The aggregate scope of services associated with insurance when the SM and broker are both appointed is similar across the spectrum of strata properties but –

- The properties themselves vary greatly as to age, size, complexity, past history of insurance claims and other factors
- The division of functions, workload and responsibilities between SM and broker can vary greatly. In some cases the SM takes substantial responsibilities and in other cases the broker does so. A simple example is claims where in some cases the SM takes on a major role whereas in other cases the broker does so.
- It is incumbent on the SM to be able to make the distinction between insurance services undertaken for the broker and other insurance services undertaken for the OC.

The main purpose of this type of disclosure is to enable SCs and lot owners to understand the respective roles and responsibilities of SM and broker.

The technique proposed in Part 10 is to construct a guidance note to be put together and agreed by SM and broker to assist with this process for the benefit of the OC. It may also benefit the SM and broker by creating a clearer understanding by both as to their respective roles.

3. Business arrangements (Appendix F)

The OC appoints an SM and enters into a written agreement with the SM. The SM may then recommend a broker or may appoint the broker within delegated authority from the OC.

What is in question about business arrangements?

Questions are frequently asked as to whether relationships or connections observed in the market between some brokers and some strata managers are healthy and in the best interests of the OC or whether there are any conflicts of interest for broker or SM that may not be in the OC's best interests.

The technique proposed in Part 11 is essentially that the SM completes a brief statement and a schedule of the arrangements between SM and broker (see Appendix F). Its main purpose is to offer transparent disclosure that enables interested OCs or lot owners to understand potential synergies in the business models and operations of their intermediaries and also potential conflicts of interest.

Applying the Disclosure Matrix

The Disclosure Matrix is simply a reference table to assist SMs, brokers and lot owners to know what disclosure steps are to be undertaken during the course of the annual renewal process and also at the time of any changes in the arrangements with SM or broker.

Financial disclosures: items to be disclosed

Essential items to be disclosed, each to be specified as a dollar amount.

<i>Item</i>	<i>Origin</i>
1. <i>Base premium:</i>	determined by the underwriter
2. <i>Commission:</i>	determined by the underwriter
3. <i>Broker fee:</i>	determined by the broker
4. <i>ESL or FSL:</i>	levied by underwriter based on government regulation
5. <i>Stamp duty:</i>	levied by underwriter on government formula
6. <i>Other fees:</i>	a modest underwriter or insurer administration fee is common
7. <i>GST:</i>	calculated as 10% of all items except stamp duty.
8. <i>Allocation of intermediary charges:</i>	allocation to SM and broker of the total of commission plus broker fee

Nomenclature and definitions

The terms insurer, underwriting agency and underwriter are explained in Terminology and References at Appendix A.

Each of the eight financial disclosure items above warrants a definition or explanation so as to leave no room for ambiguity or misunderstanding. Below are concise definitions followed by some explanatory notes.

- **Base premium:** the premium quoted by the underwriter to the broker or strata manager. The base premium includes commission (if any) but does not include stamp duty, any other government charges, GST or any other fees that may ultimately form part of the total amount payable by the customer.

Base premium gross is a base premium that includes commission

Base premium net is a base premium that has no commission

- **Commission:** any and all amounts included within the base premium that are to be paid to or credited to the broker or SM (if no broker) by the underwriter
- **Broker fee:** an amount added by the broker to the invoice received from the underwriter and included in the broker's invoice
 - sometimes referred to in documentation as a service fee or admin fee

NB: Commission is part of the base premium, broker fee is not part of the premium and is additional to it.

- **Premium:** the base premium (including any commission) plus government charges (e.g. ESL) and stamp duty. It may include or exclude GST.
 - this definition is standard insurance industry usage. Usually the underwriter makes it clear on any quotes and invoices what is included **but the underwriter will never include a broker fee.**
 - the premium is shown on the underwriter's invoice and will nominate which charges are included.
 - may also be referred to as 'insurance premium' or 'total insurance premium'
 - this usage of the term premium is also consistent with accounting standards (specifically AASB 1023), stamp duty legislation and industry data collections such as are undertaken by APRA.

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- **SM's share of remuneration:** that portion of the total intermediary remuneration* that is credited to the SM
 - frequently referred to as the 'commission rebate' because it can be seen as the portion of the broker's commission that is paid by the broker to the SM.
- **Broker's share of remuneration:** that portion of the total intermediary remuneration⁸ that is credited to the broker
 - may also be referred to as broker fee plus retained portion of commission
- **ESL or FSL (Emergency Services Levy in NSW, also known as Fire Services Levy):** in NSW, the State Government charges insurers for emergency services and insurers collect contributions from each policyholder to fund these charges.
 - the levy rates differ across insurers and change from time to time whenever the Government reviews the charges
- **Stamp Duty:** charged in all jurisdictions except the ACT
 - The rate and the formula vary from State to State but are close to or in the range 10% to 12% of base premium
- **GST:** charged on all components of premium and other insurance charges but Stamp Duty is exempt

SM's share of remuneration and 'commission rebates':

Strictly speaking, the payment by the broker to the strata manager is a fee determined according to the terms of a separate agreement between the broker and strata manager. In other words, it is an expense of the broker.

The term 'commission rebate' is in common usage because the SM fee is almost always expressed as a percentage of the base premium (e.g 5% or 10% or 15%, sometimes more). It is usually not more than the broker's commission, which in today's strata insurance market, is almost always 20%. It could conceivably be higher, and in some instances it is, in which case the broker fee would need to be shared with the SM.

Cases where there is no broker or no SM (i.e. a single intermediary)

From an administrative point of view, there is no difference in principle between a situation where there are two intermediaries (broker and SM) and a situation where there is only one. The differences in practice, however, are that –

- where there is a SM and no broker, there will be no broker fee and the SM will receive the full commission directly from the underwriter
- where there is a broker and no SM (including cases where there is a SM who is not active in the insurance process and the broker deals directly with the OC); in these cases the broker will retain the full commission or alternatively, and commonly in larger cases, use a net premium and charge an agreed fee in lieu of commission.

The important consideration here is that, where there is no broker, the SM will be dealing directly with the underwriter. Accordingly, to maintain consistency with cases where there is a broker and, more significantly, to maintain the same level of disclosure to the OC, it will be necessary for the SM to use the same disclosure techniques as brokers.

⁸ Total intermediary remuneration is the sum of commission and broker fee

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APPENDIX C

Templates for financial disclosures

STANDARD TEMPLATE – QUOTATION VERSION

Quote presentation template - 3 underwriters*

Undewriting agency Insurer	Last year	----- Quotations -----		
	[Name]	[Name]	[Name]	[Name]
	[Name]	[Name]	[Name]	[Name]
SECTION 1 - ITEMISED INSURANCE COSTS				
<i>Insurance charges</i>				
Base premium gross (includes commission)	9,000	10,000	10,400	10,800
ESL or FSL	1,170	1,300	1,352	1,404
GST	1,017	1,130	1,175	1,220
Stamp duty	1,080	1,200	1,248	1,296
Underwriting agency fee	200	200	100	150
Underwriting agency fee - GST	20	20	10	15
Total insurance premium	12,487	13,850	14,285	14,885
Broker fee	1,000	1,000	1,040	1,080
Broker fee - GST	100	100	104	108
Total insurance costs	13,487	14,950	15,429	16,073
SECTION 2 - REARRANGEMENT OF SECTION 1:				
ITEMISED INTERMEDIARY REMUNERATION				
<i>Initial remuneration before GST</i>				
Commission - within the base premium	1,800	2,000	2,080	2,160
Broker fee - additional to the premium	900	1,000	1,040	1,080
Total intermediary remuneration	2,700	3,000	3,120	3,240
<i>Allocation of remuneration</i>				
Strata manager: share of remuneration	1,575	1,750	1,820	1,890
Broker: share of remuneration	1,125	1,250	1,300	1,350
Total intermediary remuneration	2,700	3,000	3,120	3,240
Base premium net of commission	7,200	8,000	8,320	8,640
All other charges before GST	2,450	2,700	2,700	2,850
Total insurance costs before GST	12,350	13,700	14,140	14,730
GST	1,137	1,250	1,289	1,343
Total insurance costs including GST	13,487	14,950	15,429	16,073



* add or subtract columns to cater for more or fewer quotes

Notes:

- A. Allocation of remuneration in Section 2 between Strata manager and Broker is by agreement between them.
- B. All other charges before GST (in Section 2) = ESL + Stamp duty + Underwriting agency fee (in Section 1)

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RECOMMENDED TEMPLATE – INVOICE VERSION

Invoice Template

	Last year	This year
Undewriting agency	[Name]	[Name]
Insurer	[Name]	[Name]
SECTION 1 - ITEMISED INSURANCE COSTS		
<i>Insurance charges</i>		
Base premium gross (includes commission)	9,000	10,000
ESL or FSL	1,170	1,300
GST	1,017	1,130
Stamp duty	1,080	1,200
Underwriting agency fee	200	200
Underwriting agency fee - GST	20	20
Total insurance premium	12,487	13,850
Broker fee	1,000	1,000
Broker fee - GST	100	100
Total insurance costs - amount payable	13,487	14,950
SECTION 2 - REARRANGEMENT OF SECTION 1: ITEMISED INTERMEDIARY REMUNERATION		
<i>Initial remuneration before GST</i>		
Commission - within the base premium	1,800	2,000
Broker fee - additional to the premium	900	1,000
Total intermediary remuneration	2,700	3,000
<i>Allocation of remuneration</i>		
Strata manager: share of remuneration	1,575	1,750
Broker: share of remuneration	1,125	1,250
Total intermediary remuneration	2,700	3,000
Base premium net of commission	7,200	8,000
All other charges before GST	2,450	2,700
Total insurance costs before GST	12,350	13,700
GST	1,137	1,250
Total insurance costs including GST	13,487	14,950



Notes:

- A. Allocation of remuneration in Section 2 between Strata manager and Broker is by agreement between them.
- B. All other charges before GST (in Section 2) = ESL + Stamp duty + Underwriting agency fee (in Section 1)

Strata insurance renewals: recommended standard practice

The starting point

The renewal process for strata insurance usually commences eight or more weeks before renewal date. It may be earlier if, for example, there are underwriting questions likely to affect the price or placement, or if a change of broker is under consideration.

There are five cases to consider –

Case 1: SM and broker already appointed

Case 2: SM already appointed and no broker to be appointed

Case 3: SM already appointed, change of broker under consideration

Case 4: SM already appointed and broker being appointed for the first time
– could be for an existing or new strata property

Case 5: OC engages directly with broker (because either no SM appointed or the SM is not involved in the insurance process).

- In Case 1, which is the most common, the annual renewal process normally begins with the broker sending a Pre-Renewal Declaration (PRD) request to the SM.
- In Cases 2 and 5, the process begins the same way but with different parties (in Case2, PRD from underwriter; in Case 5, PRD directly from broker to the OC)
- Cases 3 and 4 involve additional steps to deal with the appointments that need to be made before the renewal process can commence.

The execution steps

For the templates as recommended in Appendix C to deliver transparent disclosure will require three important execution steps to follow, which are:

- (1) the standard templates with definitions or their single page equivalents to be adopted by all brokers when preparing broker presentations and invoices
- (2) the presentations and invoices to find their way in a timely manner from the broker to the SM and also to the SC or the OC (noting that, in some cases where transmission does occur at present, it is not timely, i.e. It is conveyed after decisions have been taken).
- (3) the circle to be closed through an assured process for the broker to become aware that the SC has received the broker's documents.

The paragraphs below are aimed at giving effect to these requirements.

Case 1: SM and broker already appointed

Many of the 14 steps below describe current practice but **the words in bold are extensions to current practice**. Requirements (2) and (3) are designed to ensure that the broker is aware of the existence and timing of transmission of broker information to the SC office bearer(s) and of the period of time between the SM receiving the information and the SC receiving it. The broker information comprises firstly the presentation of quotations and recommendation and, at a later time, the invoice following placement of the insurance.

The value of this arrangement is twofold –

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- that the broker fulfils and has confirmation from the AR or the SC of fulfilment of the broker's obligation to know that the client (the OC) has received the information
- that there is a known delay, if any, between the SC office bearer(s) receiving the information from the broker or the SM and the broker being aware of the transmission.

The goal can be achieved in more than one way. Three suggested methods are -

Method 1

The broker sends firstly the presentation and, at a later stage, the invoice to the SM who forwards it by email or other electronic means to the relevant SC office bearers and includes the broker as a recipient of the email.

Method 2

The SM arranges with the SC for the AGM and insurance renewal dates to be coordinated, with the renewal due 2 to 4 weeks after the AGM. Either the renewal date or the AGM can be adjusted to achieve coordination. The SM includes the broker presentation in the agenda papers and copies the agenda paper to the broker when distributing it to the OC members.

Method 3

The broker sends firstly the presentation and, at a later stage, the invoice simultaneously by email or other electronic means to both the SM and one or more SC office bearers –

- to enable the broker to do this, the SM will need to have notified the broker beforehand of contact details for the relevant SC office bearers.

In cases where there is both a SM and broker already appointed by the OC, recommended future practice is -

1. The SM, when preparing agenda and minutes for the client OC's AGM, is to include the broker invoice document prepared at Step 10. At least 8 weeks before renewal date, the broker and the SM begin collaboration for the renewal, including if requested by the broker a Pre-Renewal Declaration (PRD) from the SM.
 - Such declarations are aimed at ensuring that the broker has information for renewal purposes that is updated from the previous year, such as risk management steps taken, maintenance works, new or repaired defects, any claims that occurred.
2. The SM collects relevant information on behalf of the OC and supplies a completed PRD or equivalent disclosure statement and sends it to the broker -

The SM may also send up to date contact details for SC office bearer(s) for the information of the broker.

3. The broker prepares a quotation slip, taking account of any relevant new information, for presentation to several underwriters, usually including the holding underwriter.
4. Each underwriter either prepares a proposal with quotation or declines to do so, with reasons, and conveys its position to the broker.
5. The broker assembles the proposals, prepares a draft or final renewal presentation with quotations and recommendations for consideration by the SM and the OC or SC. If draft, the SM refers any queries or adjustments to the broker.
6. When finalised, the broker initiates transmission of the presentation with quotations and recommendations to the SM and the SC -

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The method of transmission used, whether Method 1 or 2 or 3 described above or some other method, needs to assure timely and preferably concurrent confirmation for the broker of receipt of the presentation by SC office bearer(s) -

The format and content of the renewal presentation are to conform with the recommended template (or its full equivalent on one page), disclosing the remuneration details for each quote.

7. The SM engages in dialogue with the SC, perhaps with the broker participating, in order to assist the SC to make an insurance decision on which quotation to accept.
8. The SM conveys the SC's decision to the broker and the broker conveys the decision to the selected underwriter –

If the SC's decision is late, the SM may be able to use delegated authority to give instructions to the broker (noting that the broker cannot take a late decision without authority from the SM).

9. The underwriter issues its policy and invoice to the broker.
10. The broker prepares its own invoice document for the SM and the SC –

The broker's invoice will differ from the underwriter's invoice if there is a broker fee to be added. The underwriter's invoice will not usually be seen by the SM or the SC.

The format and content of the invoice are to conform with the recommended template (or its full equivalent on one page), disclosing the remuneration details corresponding to the invoice.

11. The broker initiates transmission of the invoice to the SM and the SC –

The method of transmission used, whether Method 1 or Method 3 described above or some other method, needs to assure timely and preferably concurrent confirmation for the broker of receipt of the invoice by SC office bearer(s).

12. The SM arranges payment of the 'total payable' to the broker, normally comprising the premium payable plus any broker fee.
13. On receipt of the premium and broker fee, the broker remits to the SM any commission rebate agreed in advance with the SM and remits to the underwriter the amount shown on the underwriter's invoice less any commission due to the broker. The broker therefore retains the broker fee and any share of commission not rebated to the SM.
14. The SM, when preparing agenda and minutes for the client OC's AGM, is to include the broker invoice document prepared at Step 10.

Within this sequence of events, there are two situations where information is conveyed from the broker to the SM, as has always happened in the past but now modified. They are steps 6 and 11 which, in short, are -

Step 6: broker presentation of underwriter quotations and recommendations sent simultaneously to the SM and the SC office bearer(s)

Step 11: invoice from broker (including any broker fee) sent simultaneously to the SM and the SC office bearer(s).

There are two important changes here from current practice because it requires that -

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- the SC office bearer(s) receive the broker presentation with quotations and recommendation at the same time as the SM receives it.
- both the SC office bearer(s) receive the broker's invoice at the same time that the SM receives it.

There is no discretion for the SM on timing of transmission to the SC or OC of either the broker presentation or the broker invoice.

The additional communication discipline in Steps 2, 6 and 11 represents a substantial practical and cultural change from existing practices. It is designed to create transparency for the SC and OC and clear accountability for the SM and broker whereby, as stated at the beginning of this Part, through timely receipt by the SC of broker presentations and invoices along with knowledge by the broker that this receipt has occurred.

Case 2: SM appointed, no broker appointment to be made

If the SM is operating without a broker, all of the above 14 steps will be needed with the broker's place being taken by the SM. Some of the steps place additional demands on the SM and others simplify the process -

- additional demands arise at steps 2, 3, 5 and 8
- some simplification occurs at Steps 8, 9, 10 and 13.

Omitting the broker from the process creates some simplification (one intermediary instead of two) but the workload imposed on and the expertise required of the SM when there is no broker is generally more demanding.

Case 3: SM already appointed, change of broker under consideration

In cases where there is a holding broker but the SC or the SM is contemplating a change of broker, there will be three additional tasks at the outset, i.e. more than 8 weeks before renewal date –

- the first is for the OC to give instructions to the SM to pursue a new broker appointment or for the SM, under delegated authority, to exercise discretion over the new broker appointment,
- the second is for the OC to sign a formal Letter of Appointment for the new broker and give instructions to the broker
- the third is for the SM to inform the holding broker of the change and to confirm through conveying a copy of the Letter of Appointment to the holding broker.

Thereafter the same steps follow as for Case 1.

Case 4: SM appointed but broker appointment being made for the first time

In cases where there is no holding broker or where the SC has decided that a broker appointment is to be made for the first time, there will be two additional tasks at the outset, i.e. more than 8 weeks before renewal date –

- the first is for the SM to assist the SC to identify broker options so that the SC and/or the SM can make decisions on which broking firm to appoint and how the appointment will be made
- the second is for the SM or the SC to arrange the broker appointment through a formal Letter of Appointment, in the manner agreed in the previous step.

Thereafter the same steps follow as for Case 1.

Case 5: OC engages directly with the broker (no SM involved)

If the OC is working directly with a broker, one or more of the office bearers of the OC will undertake the role of SM.

Scope of services: strata managers and brokers

Three tables

The three tables that follow describe the more common allocation of roles, responsibilities and activities between strata managers and brokers. The strata manager allocation is classified in two parts, one part being for matters where the SM is acting as agent for OC and the second part where the SM is acting as agent for the broker.

The three tables are -

Table 1: SCOPE OF INSURANCE SERVICES - POLICY RELATED

Table 2: SCOPE OF INSURANCE SERVICES - ADMINISTRATION AND RISK MANAGEMENT

Table 3: SCOPE OF INSURANCE SERVICES - CLAIMS RELATED

Qualification

The tables are not intended as a comprehensive or tightly worded description of the roles but rather as a check list and general indication of the roles. It is deliberately brief so as to enable interested parties to gain a general understanding of the roles and to enable those interested, particularly lot owners and their SCs, to pursue questions that they see as relevant to their own circumstances.

Using the tables

These tables are presented as a companion to the Financial Disclosure templates in Section 7. They are intended, however, as *guidance only* for strata committees, lot owners and other interested parties to become familiar with the roles and responsibilities of strata managers and brokers.

The tables are *guidance only* because there are many variations as to how individual SMs and brokers operate. The details in each case are ultimately a matter of agreement across SM, broker and SC. As guidance, there is no barrier to individual SMs and brokers modifying the tables for their own purposes but it is highly desirable that SM and broker work together to offer OCs a mutually agreed description of the services.

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**Table 1: SCOPE OF INSURANCE SERVICES - POLICY RELATED
(ANNUAL, SEQUENTIAL)**

Strata Manager acting as agent for the OC	Strata Manager acting as agent for the broker	Broker
1.	1.	1. Prepare pre renewal documentation request for SM (if required)
2. Prepare pre-renewal declaration for broker if required, including any additional disclosure information such as revised valuation, defects, cladding matters	2.	2. Review pre renewal declaration and any additional disclosure information from SM such as revised valuation, defects, cladding matters.
3.	3.	3. Prepare quotation slip or risk profile for presentation to underwriters
4. Respond to any broker queries	4.	4. Arrange quotations including negotiating coverage, premiums and excesses, with underwriters, follow up as required, review outcomes and form a recommendation
5. Receive presentation from broker	5. Ensure concurrent receipt of the presentation by the SM, receipt by the SC or OC and confirmation of receipt for the broker	5. Prepare presentation for SM and OC with coverage details, market information, quotations and recommendation, advice on insurance program
6. Arrange OC instructions and communicate to broker	6. Arrange and attend insurance meeting with SC or OC, include broker if required	6. Attend and explain renewal presentation at a meeting of SC or OC (if required) and answer any queries
7. Convey insurance decisions to broker	7.	7. Receive and assess insurance instructions from SM
8. Receive invoice and pay premium to broker on behalf of client	8. Ensure concurrent receipt of the invoice by the SM, receipt by the SC or OC and confirmation of receipt for the broker	8. Procure insurance cover and present invoice to SM and SC
9. Include renewal information in AGM agenda and minutes	9.	9. Receive payment and issue certificate of currency

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**Table 2: SCOPE OF INSURANCE SERVICES - ADMINISTRATION AND RISK MANAGEMENT
(AS REQUIRED – NOT SEQUENTIAL)**

Strata Manager acting as agent for the OC	Strata Manager acting as agent for the broker	Broker
<ul style="list-style-type: none"> Keep records of renewal correspondence, annual PRDs, building information, etc. 	<ul style="list-style-type: none"> 	<ul style="list-style-type: none"> Offer risk management advice and insurance market advice
<ul style="list-style-type: none"> Monitor continuity of cover and renewal timetable 		<ul style="list-style-type: none"> Process any endorsements that arise
<ul style="list-style-type: none"> Arrange and obtain insurance valuation (at intervals of 2 to 5 years) 		<ul style="list-style-type: none"> Provide market and coverage commentary
	<ul style="list-style-type: none"> Undertake training as AR or Distributor for the broker and undergo periodic broker audits 	<ul style="list-style-type: none"> Arrange SM training and periodic audits to support the SM as AR or Distributor
<ul style="list-style-type: none"> Respond to 'make safe' emergency incidents (burst pipes etc) to minimise losses pending exploring maintenance vs insurance issues 		

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**Table 3: SCOPE OF INSURANCE SERVICES - CLAIMS RELATED
(LARGELY SEQUENTIAL)**

Strata Manager acting as agent for the OC	Strata Manager acting as agent for the broker	Broker
1. Investigate incidents and potential claims, maintain associated records	1.	1. Advise SM on potential coverage matters relating to incidents and potential claims
2. Prepare claims information and lodge claim with the broker	2.	2. Lodge claim with underwriter
3. Represent OC throughout claims process. Communicate directly with SC where required.	3. Manage claim interaction with SC or lot owner(s) and with broker	3. Manage claim interaction with underwriter
4.	4.	4. Provide claims management advice to SM, including what to do and when
5. Facilitate assessor access and follow up progress	5.	5. Appoint or manage assessor involvement
6. Engage and instruct contractors for claims remediation	6.	6. Oversee claims remediation progress in consultation with SM
7. Facilitate stakeholder communication with SC, lot owner(s), broker, assessors, builders, contractors	7.	7. Advise and communicate as required to support the SM in interactions with SC, lot owner(s), assessors, builders, contractors
8. Review quality of claim settlement, owner satisfaction and potential for complaints and disputes	8.	8. Facilitate settlement negotiations including client (OC) advocacy when denials or disputes arise
9. Maintain records and log of claim activities for each claim	9.	9. Advocate for the client (the OC) with complaints and disputes with underwriter, internally in the first instance (IDR) and externally (AFCA) if appropriate

Strata insurance business arrangements

Record of strata insurance arrangements (to be prepared by Strata manager)

1. Reference details

Body corporate identifier:

Address of strata property:

.....

Name of strata manager – individual:

– firm:

Name of broker – individual:

– firm:

2. Business model characteristics – see schedule next page

Features of the arrangements not evident from the items in the schedule:

.....
.....

3. Why this business model?

.....
.....

4. What are the benefits of this model to the owners' corporation?

.....
.....
.....
.....

Prepared by:

Date:

Strata Manager

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Table of business model characteristics

Tick one box in each segment

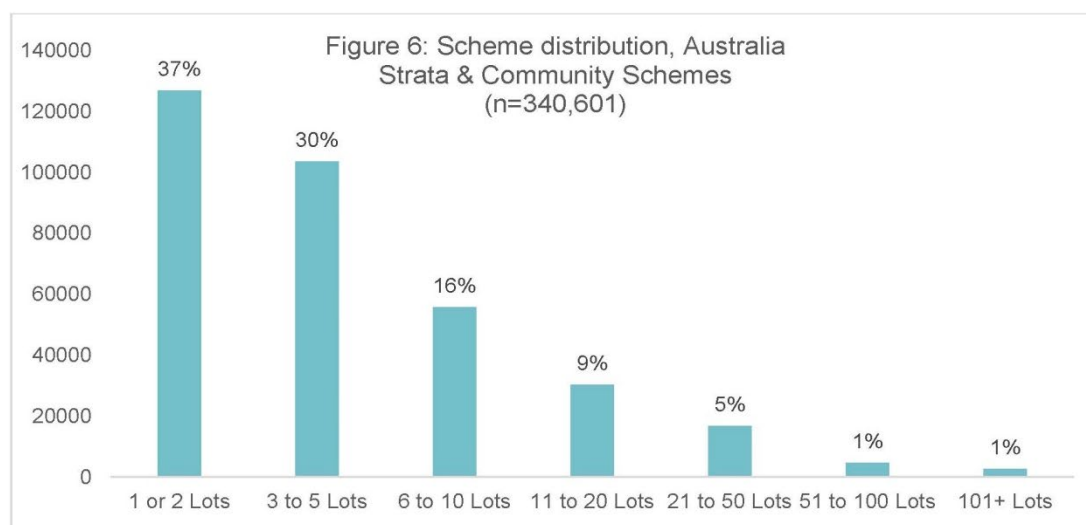
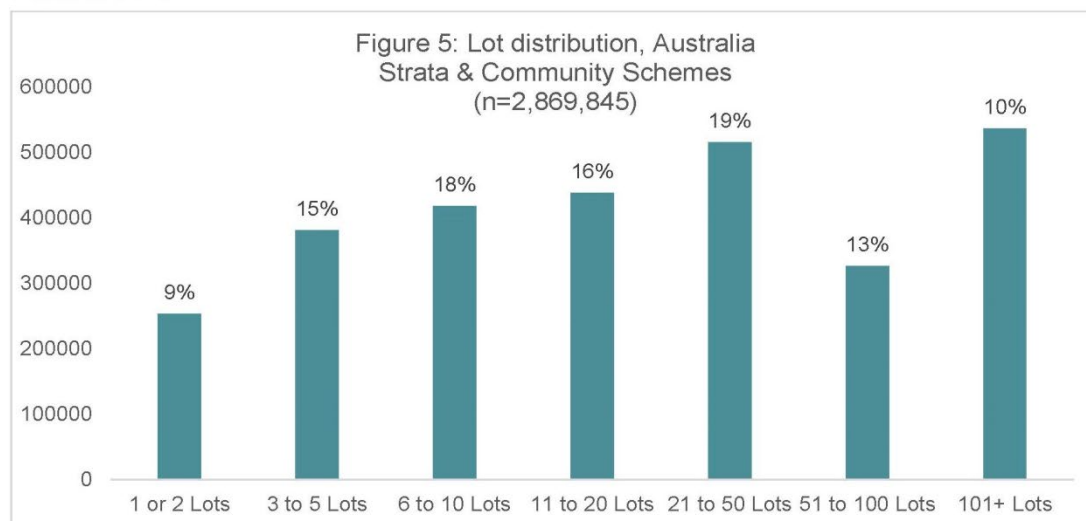
... some segments have some overlap with others

<p>A. Type of business model</p> <ul style="list-style-type: none"> • SM has appointed preferred broker but no tied or financial connection to broker <input type="checkbox"/> • SM operates with preferred broker(s), SM and broker have a direct shared interest in the combined commission and fee revenue <input type="checkbox"/> • SM has its own licensed broking firm <input type="checkbox"/> • SM is owned by the broking firm it appoints <input type="checkbox"/> • SM and broker have cross ownership <input type="checkbox"/> • SM and broker have a JV using a CAR and share the CAR's income <input type="checkbox"/> • SM receives full commission (no broker) <input type="checkbox"/> • Broker receives and retains full commission (no SM) <input type="checkbox"/> 			
<p>B. Third party entity between broker and strata manager</p> <ul style="list-style-type: none"> • None <input type="checkbox"/> • Corporate Authorised Representative (CAR)* <input type="checkbox"/> 			
<p>C. Remuneration structure</p> <ul style="list-style-type: none"> • SM and broker share commission and fees between them <input type="checkbox"/> • SM and broker share fees between them, no commission <input type="checkbox"/> • SM and broker share commission between them, no fees <input type="checkbox"/> 			
<p>D. Premium: gross or net?</p> <ul style="list-style-type: none"> • Gross: Commission in premium <input type="checkbox"/> • Net: Premium contains no commission <input type="checkbox"/> 			
<p>E. Remuneration approach</p> <ul style="list-style-type: none"> • Fees only, net premium <input type="checkbox"/> • Commission rebate and broker fee, gross premium <input type="checkbox"/> • Composite commission & broker fee, gross premium <input type="checkbox"/> • Commission only, some rebated to SM (no broker fee) <input type="checkbox"/> 			
<p>F. Broker category</p> <ul style="list-style-type: none"> • Specialist strata insurance broking firm, other business ancillary only <input type="checkbox"/> • Specialist strata insurance division within a wider insurance portfolio <input type="checkbox"/> • General broker with strata insurance as incidental part of a wider portfolio <input type="checkbox"/> • No broker appointed <input type="checkbox"/> 			
<p>G. Strata manager category</p> <ul style="list-style-type: none"> • AR - Authorised Representative of the broker <input type="checkbox"/> • Distributor for the broker or CAR <input type="checkbox"/> • Referrer for the broker or CAR <input type="checkbox"/> • No strata manager appointed <input type="checkbox"/> 			
<p>* If a CAR exists</p> <ul style="list-style-type: none"> • SM ownership 100% <input type="checkbox"/> • Broker ownership 100% <input type="checkbox"/> • Shared ownership SM and broker <input type="checkbox"/> 		<p>Income payable to SM and broker –</p> <ul style="list-style-type: none"> • Policy by policy <input type="checkbox"/> • Periodic profit share, dividends or similar <input type="checkbox"/> 	

Strata industry statistics

Appendix 3: Size of schemes by jurisdiction

Australia



While only 2% of schemes in Australia are larger than 50 lots, lots in such schemes account for nearly one quarter (23%) of all lots. The majority of schemes are five lots or fewer (67%); however, lots in such schemes account for just under one quarter (24%) of all lots. (Note: for 36 schemes, the number of lots is unknown.)

The size of strata schemes has increased in Australia between 2018-2020. Of particular note, the proportion of strata lots in large schemes (with 100 or more lots) has increased in New South Wales, Victoria, Queensland, West Australia and South Australia over this period.

Source: Easthope, H., Thompson, S. & Sisson, A. (2020) *Australasian Strata Insights 2020*, Sydney: City Futures Research Centre, <https://cityfutures.ad.a.unsw.edu.au/research/projects/2020-australasian-strata-insights/>

Terminology and references

Terminology

AFSL:	Australian Financial Services Licence
AR:	Authorised Representative of an AFSL holder
Broker fee, service fee or admin fee:	fee charged by broker that is additional to underwriter's premium
Commission rebate:	Component of the broker's commission that is passed to the SM <ul style="list-style-type: none">- strictly speaking it is a fee paid by the broker to the SM- see also elaboration in Appendix B
ESL, FSL	Emergency Services Levy, also known as Fire Services Levy (applicable in NSW and Tasmania only)
Insurer	The security or the bearer of the risk and therefore the ultimate responsible party when claims occur <ul style="list-style-type: none">- authorised by APRA to write insurance business in Australia.
Intermediary	Broker or SM connecting and servicing underwriter and OC
NIBA:	National Insurance Brokers Association
OC:	Owners Corporation (NSW, Vic, ACT), also known as Body Corporate (Qld, Tas, NT), Strata Company (WA), Community Corporation (SA)
PRD:	Pre-Renewal Declaration
Premium	Amount charged by an underwriter for an insurance policy <ul style="list-style-type: none">- see also elaboration in Appendix B
SC:	Strata Committee of the OC, also known as the Executive Committee
SCA:	Strata Community Association
SM:	Strata manager
Underwriter:	The entity accepting the insurance risk on behalf of the insurer <ul style="list-style-type: none">- It could be the insurer itself or an underwriting agency appointed by the insurer
Underwriting agency	An agency given underwriting, policy writing and claims authority by an insurer. <ul style="list-style-type: none">- allows the agency to price and issue insurance policies on behalf of the insurer.- <i>An underwriting agency is not an insurer.</i>
Underwriter vs insurer vs underwriting agency	<ul style="list-style-type: none">- For this paper, the distinction between underwriting agency and insurer is mostly unimportant and, when that is so, 'underwriter' will mean either underwriting agency or insurer- see also elaboration in Appendix B

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- SCA (NSW), July 2021: Code of Ethics
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