

INDEPENDENT REVIEW OF STRATA INSURANCE PRACTICES

Phase 1 – Disclosure: Findings and Recommendations



July 2022

INDEPENDENT REVIEW OF STRATA INSURANCE PRACTICES Phase 1 – Disclosure: Findings and Recommendations

About this paper

This paper is the result of Phase 1 of an independent review and investigation by the author into the functioning of the strata insurance market. The goal of this phase of the project is to identify disclosure limitations and to recommend ways forward aimed at achieving transparent disclosure for strata property owners and their strata committees.

There are several audiences for this paper across the strata property industry, the insurance industry, consumers including strata property owners, regulators and others.

As a reader, you are invited to consult the table below to decide which elements of the paper are of most interest to you. The full contents are listed on the next page.

This paper is in three sections –

Section	Target audience
Section I: Overview ... from p5 <ul style="list-style-type: none">• abbreviated summary of the remainder of the paper• list of all recommendations• templates recommended for future strata insurance quotations and invoices	All readers
Section II: Main disclosure topics ... from p15 <ul style="list-style-type: none">• introduction to the project• summary of investigations undertaken• summary of main outcomes• key issues and recommendations for financial disclosures to lot owners and their strata committees	<ul style="list-style-type: none">– Practising brokers– Practising strata managers– Lot owners and their strata committees
Section III: Related topics ... from p38 <ul style="list-style-type: none">• details of the regulatory landscape• recommended additional disclosures (scope of services and commercial relationships)• how and when all disclosures should be made	<ul style="list-style-type: none">– Executives and practitioners of broking firms and strata management firms– Interested lot owners and strata committee members

Independent Review of Strata Insurance Practices

Phase 1 - Disclosure: Findings and recommendations

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 sequel to a Phase 1 Consultation Paper released in March. Together these papers are the first step in a journey intended to carry the strata management and insurance industries through a review in three phases.

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

The paper sets out the author's findings and recommendations following submissions and discussions with interested parties arising from the Consultation Paper.

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
July 2022

Independent Review of Strata Insurance Practices

Phase 1 - Disclosure: Findings and recommendations

SECTION I - Overview

PART A: Abstract

Abbreviated summary

This paper is the result of Phase 1 of an independent review and investigation by the author into the functioning of the strata insurance market. It is the sequel to a Phase 1 Consultation Paper released on 30 March

The paper is the first step in a journey intended to carry the strata management and insurance industries through a review in three phases –

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

The goal of this phase is to identify disclosure limitations and to recommend ways forward aimed at achieving transparent disclosure for strata property owners and their strata committees. It sets out the author's findings and recommendations following submissions and discussions with interested parties arising from the Consultation Paper.

It should be noted that, in concentrating on disclosure, this paper offers explanations but no judgements or assessments about levels of remuneration or other aspects of strata insurance intermediary practices. Those questions will be considered in Phase 2.

The paper finds that, where strata manager and broker are both involved, the unorthodox structure of the strata insurance market is confusing -

- it is *convoluted* because, frequently part or all of the commission is paid to the SM and a separate broker fee is charged to remunerate the broker for the broker's services –
- 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 main recommendations in the paper 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 full explanation of commercial relationships between broker and strata manager (noting that some are beneficial to all parties, in the interests of the owners, and others raise questions).
- 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.

* SCA is the Strata Community Association

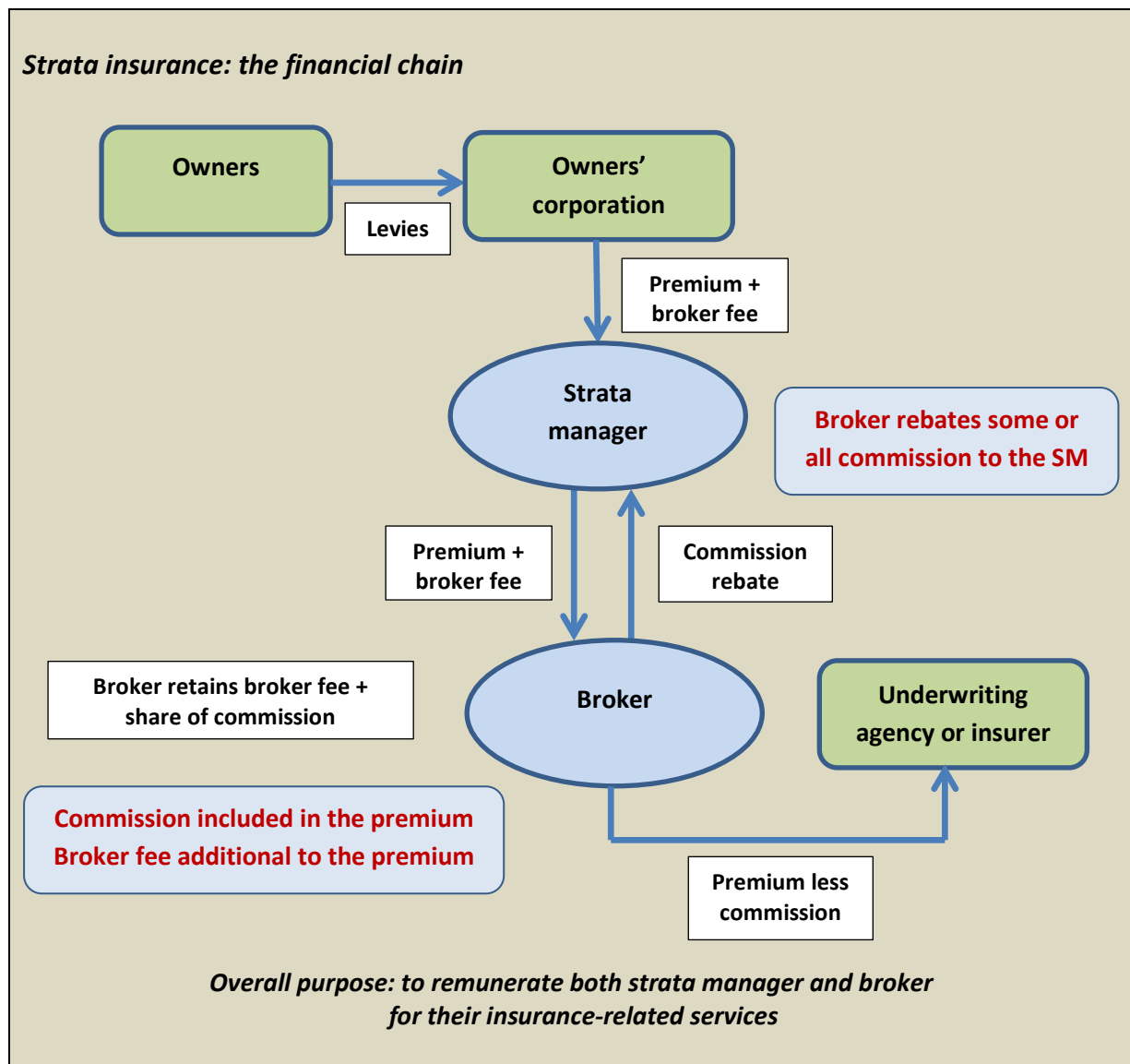
NIBA is the National Insurance Brokers Association

Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

Introducing the project

The strata insurance remuneration arrangements for intermediaries, being brokers and strata managers (SMs), are convoluted and poorly understood. They are illustrated in the *financial chain* below. This chain is of course simpler in those cases where there is only one intermediary (strata manager only or broker only with no strata manager).

Unravelling these arrangements in the interests of consumers, being the lot owners and their strata committees, is an important goal of this project. The owners stand to benefit through an improved understanding of the services being offered by their strata managers and brokers, creating the opportunity for them to evaluate the services and the insurance protections being offered and leading to greater trust and confidence in the insurance process.



Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

The goal of this phase of the project is *transparent disclosure*. My original expectation of the need was firstly a clear explanation of the system and secondly some form of template that would set out the financial items needed for transparent disclosure in digestible form. The submission process, however, has uncovered rather more. It has demonstrated that a transparent disclosure regime has five essential components -

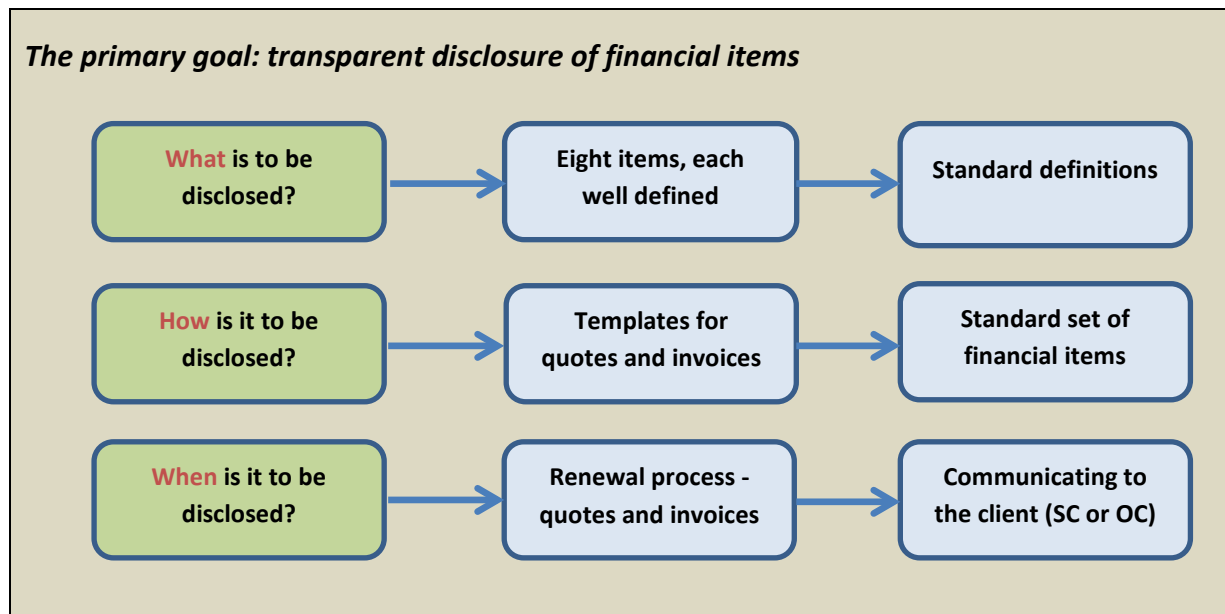
1. Financial items – offering customer understanding
2. Scope of services of SMs and brokers
3. Commercial relationships between SMs and brokers
4. Disclosure matrix – linking together 1, 2 and 3
5. Means of industry-wide implementation.

Questions have also arisen regarding the regulatory environment associated with strata insurance and that topic has been investigated for this review.

An outline of recommendations for each component is shown schematically below and the recommendations themselves are collated in Part C of this Overview

1. Financial items – offering customer understanding

Identifying the financial items to be disclosed is straightforward. The absence, however, of some form of standard arrangements for defining each one, presenting them together and conveying them to the client (the OC and its SC), needs more than just some definitions and a table or template. The full process can be summarised as below.

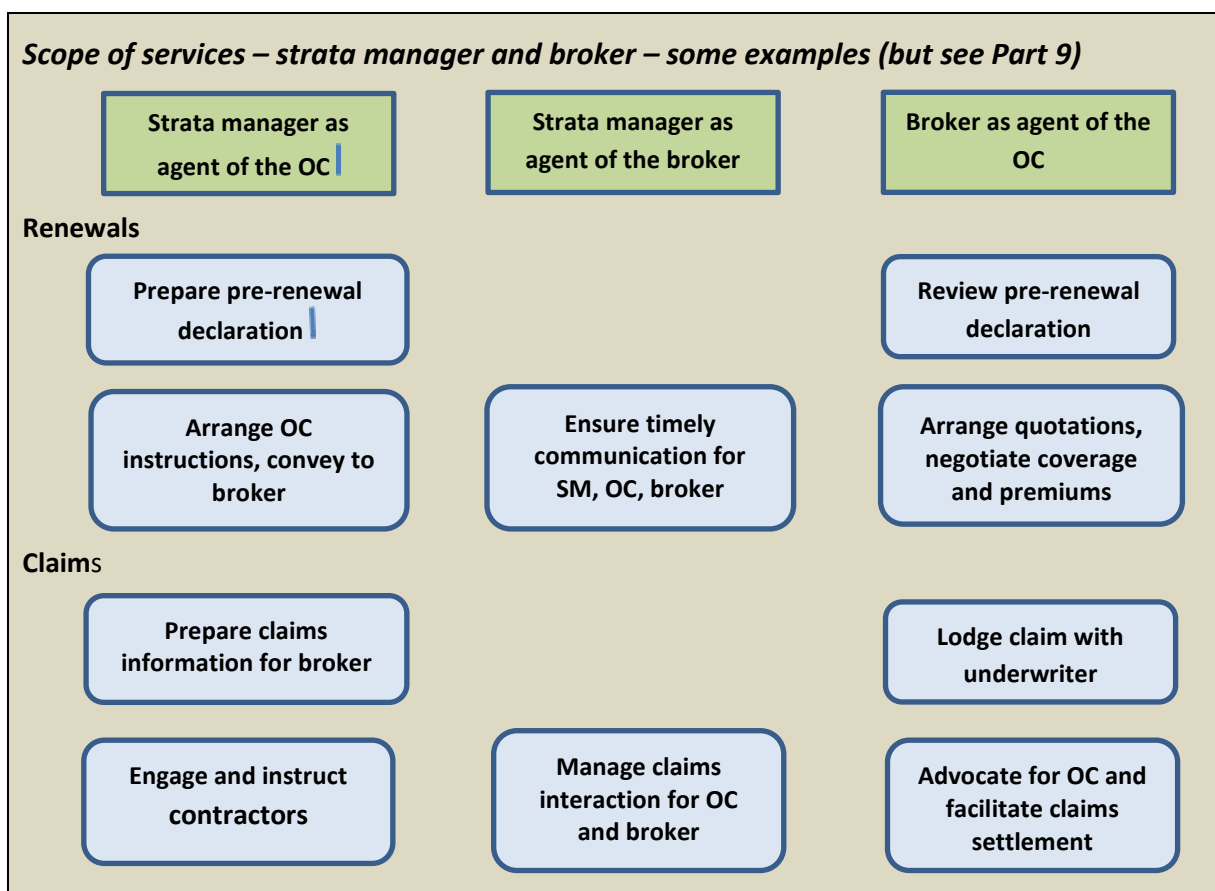


2. Scope of services of SMs and brokers

A number of submissions raised questions as to what strata managers do in relation to insurance and what brokers do. In practice there are many variations. It is apparent that many lot owners have a limited understanding of the respective roles and responsibilities.

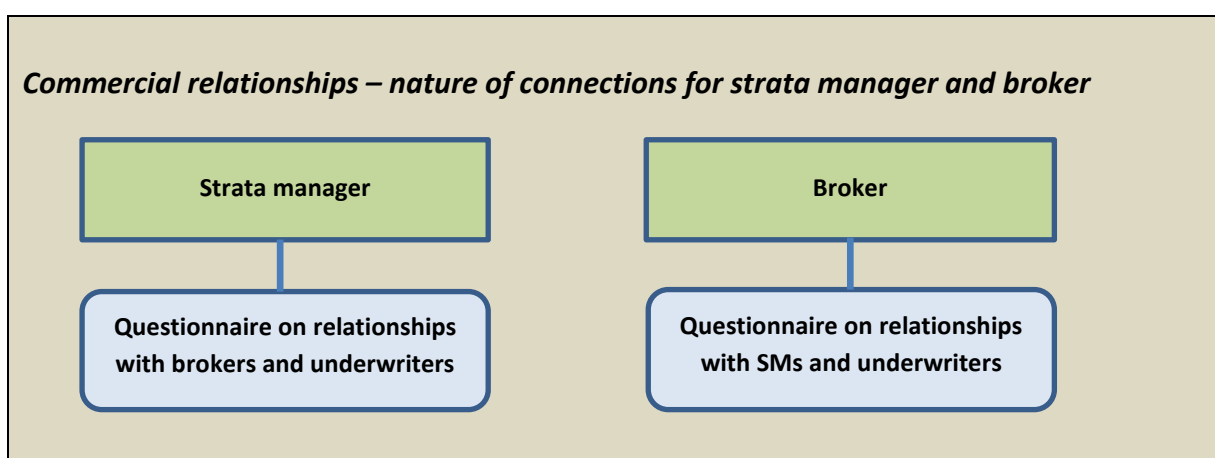
*... recommendations for these matters are guidance only
... details are a matter of agreement between strata manager and broker.*

**Independent Review of Strata Insurance Practices
Phase 1 - Disclosure: Findings and recommendations**



3. Commercial relationships between SMs and brokers

Questions are frequently asked, as indicated in numerous submissions, 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. The technique being recommended to respond to these questions is to require each SM and each broker to complete a short questionnaire.



It is uncertain how well these initial questionnaires will work. So it is recommended that they be adopted on a trial basis for 12 months and then reassessed.

**Independent Review of Strata Insurance Practices
Phase 1 - Disclosure: Findings and recommendations**

4. Disclosure Matrix – linking together 1, 2 and 3

The Disclosure Matrix draws together the steps associated with delivery of 1, 2 and 3 above.

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

*Many of these responsibilities lie with the broker but some lie with the SM and others need to be arranged jointly between broker and SM.

5. Means of industry-wide implementation

Despite the widespread support from strata managers and brokers for a transparent disclosure regime, there is a need for some form of regulatory initiative to give brokers and SMs clear guidance, confidence in any changes and an incentive or obligation to make the changes.

Both NIBA and the SCA have expressed support for a disclosure regime along the lines recommended in this paper and both associations are strongly supportive of a self-regulatory approach. Furthermore, both NIBA and SCA have indicated a desire to work with their members and with each other to establish a workable self-regulatory regime for strata insurance disclosure.

Additionally, NIBA's support is consistent with and exemplified by the disclosure provisions of its new Code of Practice coming into force on 1 November this year.

The above text, diagrams and tables are explained in later parts of this paper.

**Independent Review of Strata Insurance Practices
Phase 1 - Disclosure: Findings and recommendations**

SECTION I – Overview

PART B: Recommendations

It is recommended that –

- 3.1. The eight specified financial items as defined herein be included as a standard minimum set of financial items for all broker quotations and invoices
 - 3.2. The eight financial items be presented in a standard format in all broker quotations and invoices.
 - 3.3. The term *premium* be used exclusively for amounts determined by the underwriter and cease to be used by brokers and SMs to refer to premium plus broker fee, not only in quotations and invoices but also in OC accounts and other correspondence prepared by SMs.
 - 3.4. In cases where an underwriter deals directly with the SM and OC, no broker involved, the SM conform with the above three recommendations by substituting for the broker where relevant.
-
- 4.1. The pair of templates displayed in this Part be accepted by brokers and underwriters as the reference format for communicating quotations and invoices in all cases, whether there be broker and SM, SM only with no broker and broker only with SM participation in the insurance process.
 - 4.2. These templates or their single page equivalents be used by all brokers when preparing quotations and invoices for client OCs and their SMs.
 - 4.3. All SMs who have not engaged a broker use these templates or their single page equivalents when preparing quotations and invoices for their client OCs, perhaps simplified for the absence of a broker fee.
-

To enhance the existing renewal process -

- 5.1 The broker include all eight financial items in all strata insurance quotations and invoices using the recommended standard template or its full equivalent on a single page;
 - 5.2 The broker, in arranging transmission of the presentation with quotations and recommendation to the SM and the SC, does so in a manner that assures timely and preferably concurrent confirmation to the broker of receipt of the presentation by SC office bearer(s)
 - 5.3 The broker, in arranging transmission of the broker's invoice to the SM and the SC, does so in a manner that assures timely and preferably concurrent confirmation to the broker of receipt of the invoice by SC office bearer(s)
 - 5.4 The SM incorporate the broker's insurance documentation in the next AGM agenda and minutes.
-

Each of NIBA and SCA to –

- 6.1. establish a set of guidance notes or practice standards for brokers and strata managers respectively that give effect to decisions they take on the recommendations made in this paper for transparent disclosure of strata insurance matters.

Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

6.2. Include in their guidance notes or practice standards use of the recommended standard templates or their one page equivalents for strata insurance quotations and invoices.

6.3. engage if appropriate with the Commonwealth and State and Territory governments and their agencies to gain recognition and acceptance of the self-regulatory disclosure initiatives that they take following release of this paper.

9.1. The disclosure obligations of brokers under the new NIBA code in respect of strata insurance be supported by a guidance note or practice standard prepared by NIBA. Its purpose would be to codify or simplify the means by which brokers can give effect and be seen to be giving effect to their disclosure obligations.

9.2. All brokers arranging strata insurance for their OC clients acknowledge that they are offering general advice, unless personal advice is offered.

9.3. All strata policies offered to OCs for residential buildings be treated as retail policies with all their associated disclosure and other regulatory obligations and irrespective of their size, unless the strata complex concerned has more than 50% commercial usage.

9.4. All brokers and SMs review their current AR and Distributor arrangements to ensure they are consistent with Recommendations 9.2 and 9.3.

9.5. For the avoidance of doubt over the retail client status of OCs, NIBA modify Clause 6.1(a) of its Code of Practice on disclosing remuneration by adding explicit reference to OCs.

10.1. The three tables specified herein be used as guidance from SMs and brokers as to their respective roles for their client OCs and prepared by agreement between SM and broker.

10.2. If the tables are modified for individual OCs at any stage, the SM and broker involved sign off jointly on any variations.

10.3. The tables be supplied by the SM to the SC or OC whenever a new SM or broker appointment is made and then supplied annually at the same time as the broker's renewal presentation is received by the SM, either as part of the broker's presentation or supplied separately by the SM.

11.1. The set of nominated questions about commercial relationships between SMs and brokers be adopted as a trial questionnaire for SMs and brokers during the next 12 months with a view to testing them with OCs and considering their efficacy during that time.

11.2. The two disclosures (SM and broker) be made annually in conjunction with transmission of the broker's renewal presentation to the OC and, when any new broker appointment is being considered, be made by additional disclosures to the OC at that time.

11.3. Depending on the feedback during this 12 month trial period, either persevere with the process and refine it, or alternatively abandon it in favour of a superior regime if one can be agreed upon, designed and implemented.

12.1. SMs and brokers retain a copy of the Disclosure Matrix for their own reference purposes and that the SM supply a copy to each year's SC

**Independent Review of Strata Insurance Practices
Phase 1 - Disclosure: Findings and recommendations**


SECTION I – Overview

PART C: Recommended templates

RECOMMENDED 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

* add or subtract columns for more or fewer quotations

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)

**Independent Review of Strata Insurance Practices
Phase 1 - Disclosure: Findings and recommendations**

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)

SECTION I - Overview

PART D: 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 work undertaken for this project up to release of the Consultation Paper at the end of March was exploratory. It involved interviews, dialogue and supply of information enabling me to draw together a reasonably comprehensive picture of the intermediary market for strata insurance. Subsequently the work has involved further investigations following the receipt of submissions. 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 the SCA (Strata Communities Association) in supporting this project through cooperation and supplying information from members to facilitate this work. NIBA has also been very supportive as its members prepare for the introduction of NIBA's new Code of Practice later this year.

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, as noted above, are independent of the Steadfast Group and its commercial interests.

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.

Independent Review of Strata Insurance Practices

Phase 1 - Disclosure: Findings and recommendations

SECTION II – Main disclosure topics

PART 1: Introduction

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 are best dealt with sequentially rather than together, as explained below. Hence the decision to 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.

Phase 1, which is the subject of this paper, is aimed at generating an understanding of current practices and laying the groundwork for improved and more transparent disclosure in the future across the strata manager and broking communities.

Why Phase 1 and Phase 2?

Although remuneration is a pressing issue in the eyes of some market participants and observers, I have concluded that **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.

Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

Dealing with disclosure and possible reform sequentially not only enables the presentation at an early stage of findings and recommendations regarding disclosure but also illuminates existing intermediary practices separately from and in advance of remuneration questions. It will thereby contribute to a greater understanding by interested parties as to why there is a debate on remuneration practices and where the starting point is for the debate.

What is in Phase 1 and what is not in Phase 1

Phase 1 is aimed at generating an understanding of current practices, a critique of those practices and proposals for improved future practices.

It needs to be emphasised that nothing in this paper is intended to suggest that SMs or brokers should not be paid a fair price for their services. Questions do arise, however, as to what those services are because they are usually disclosed in an abbreviated form only and they are not uniform across the strata industry. In some cases SMs bear a material workload associated with insurance, in other cases they do little and the broker does more.

Remuneration disclosure questions considered in this paper are therefore related to what payments are made to each party. They are not concerned about whether the payments are fair and reasonable or otherwise. That question will be dealt with in Phase 2.

Thus, in concentrating on disclosure, this paper offers explanations but no judgements or assessments about levels of remuneration or other aspects of strata insurance intermediary practices. Hence It does **not** consider—

- *the appropriateness of current financial arrangements*
- *levels of remuneration for strata managers and brokers*
- *the range of business models of strata managers and brokers or their effectiveness*
- *possible conflicts of interest*
- *the range and value of services supplied by SMs and brokers*
- *claims, claims services and claims responsibilities*
- *levels of efficiency of different SM and broker business models.*

Although the paper concentrates principally on OC arrangements where both a SM and a broker have been appointed, there are also strata properties where there is a strata manager but no broker and others where there is a broker and no strata manager. These arrangements are also considered.

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.

In cases where there is a strata manager and a broker –

- 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 –

Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

- 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).
- where a fee is payable instead of a commission, the market practice that has developed 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 'broker fee' arrangement is poorly understood generally by SCs and OCs.
That is one of the stimuli for this project.**

Some exceptions

There are exceptions to the above arrangements, for example –

- 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
- 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
- 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 also the diagram of the *strata insurance financial chain* in the Overview and on the next page.

Disclosure practices are confusing

Current disclosure practices are confusing. They reflect in part the unusual and unorthodox nature of the insurance arrangement when a broker is involved –

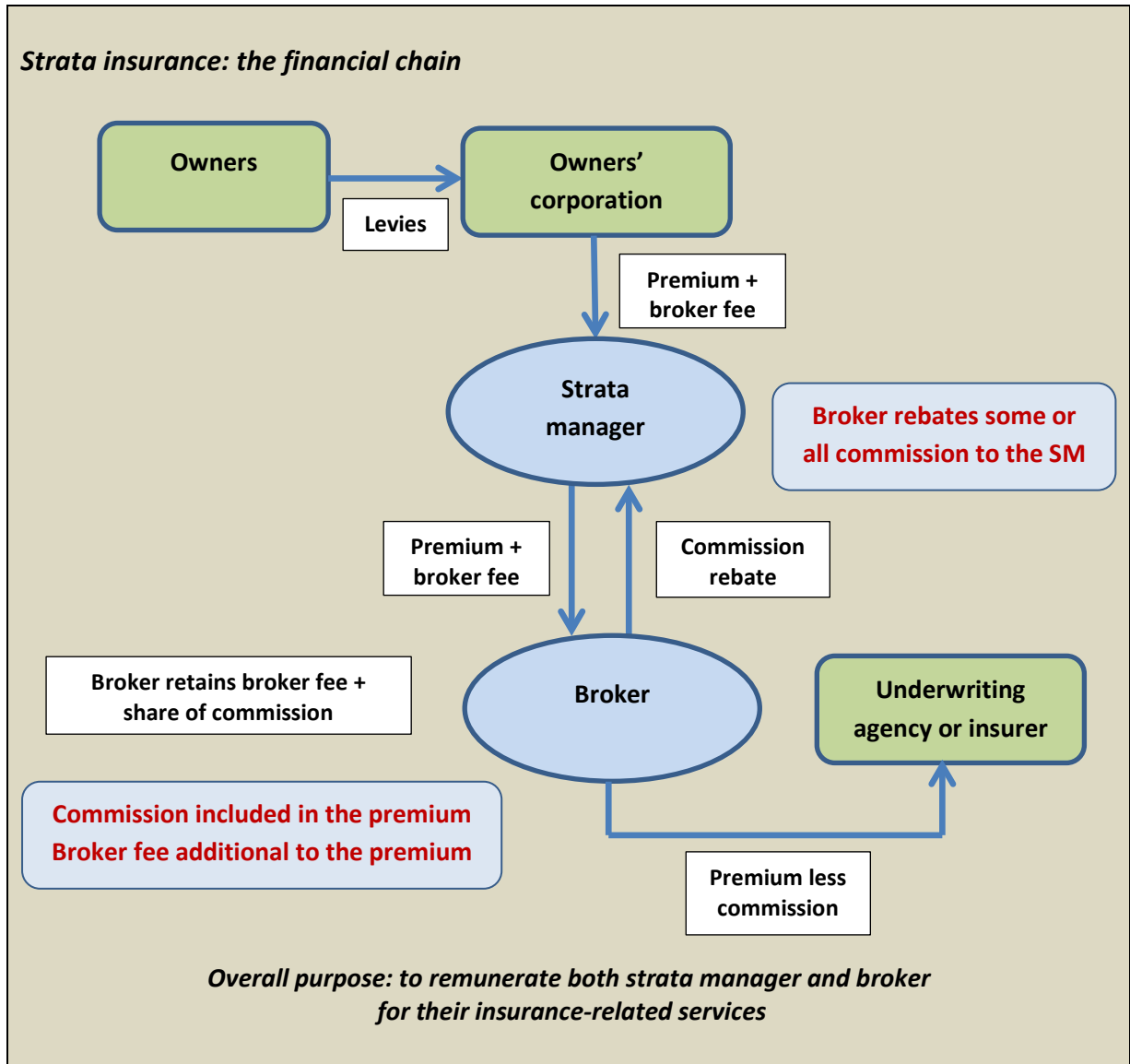
- Strata insurance is *convoluted* because, as already noted, frequently part or all of the commission is paid to the SM and a separate broker fee is charged to remunerate the broker for the broker's services –
 - we have two intermediaries (SM and broker) and a client (the OC) who is acting on behalf of multiple owners.
- It is *complicated* because frequently not all of the commission is rebated to the SM, the remainder being retained by the broker. In these cases, the broker will have two sources of revenue –
 - retained commission from the insurer after remunerating the SM, and
 - broker fee received from the OC through the SM.

In some instances the broker actually rebates the whole commission or more than the whole commission. The broker will then be reliant solely on the broker fee net of any rebate that exceeds the commission.

It is further complicated by the fact that some strata managers and some brokers do not disclose clearly and transparently to SCs and OCs the components of the insurance costs and associated financial arrangements including the allocation of intermediary remuneration between SM and broker.

This paper is intended to be a material step towards rectifying this transparency gap.

**Independent Review of Strata Insurance Practices
Phase 1 - Disclosure: Findings and recommendations**



With reference to the *strata insurance financial chain*, we can ask -

1. Why is the broker fee phenomenon poorly understood?
2. What evidence is there of this limited understanding?

In summary, the answers are -

1. The broker fee is frequently not transparent to the owners' corporation and, in contrast to commissions, is not included as part of the premium. These fees are therefore not visible in any data collections from insurers or in any insurance statistics.
2. The evidence of this limited understanding appears in two places –

Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

- When an OC or its SC is given a renewal presentation including insurance quotes by the SM, in some cases the quotes are sent by the broker to the SM without nominating that it includes the broker fee. In these cases, the total insurance cost may be referred to as the premium (which of course it is not).

Later, when the broker's invoice is sent to the SM, the broker fee will be visible in some form on the invoice, perhaps described as an 'advice fee' or 'service fee' rather than a broker fee. At that stage this fee is unlikely to be recognised as additional to the premium and may not even be passed on by the SM to the OC. This fee can then become buried in the OC accounts with the total amount payable again being referred to as the insurance premium instead of as, for example, insurance premium plus broker fee or total insurance costs including all fees and charges.

- Two comprehensive investigations into strata insurance including its financial arrangements are the ACCC reports into insurance in Northern Australia (three reports over three years to 2020) and a Deakin University investigation for the SCA published in June 2021. The investigation work behind both reports was extensive but neither report indicated an awareness of the scale and financial dynamics of broker fees and strata manager commission rebates.

This situation emphasises the relevance of this review.

SECTION II – Main disclosure topics

PART 2: Summary of outcomes

Analysis

The starting point for any reconsideration of current practices is an understanding and clarification of these practices. Seeking this understanding leads directly to the question of disclosure for the benefit of the clients, being the OCs and their SCs.

Disclosure practices in the industry vary considerably by broker, by SM and also by State. Some aspects are driven by government regulation of brokers and SMs, some by NIBA requirements and some SCA standards. Both SMs and brokers are diligent on the whole in meeting these requirements but there is quite some latitude in how they can be met. Many disclosures seem to be determined by individual SMs or SM groups and individual brokers or broker groups. Overall we find that, although many disclosures are technically complete, most disclosures are not transparent and do not give a lucid explanation of the financial arrangements

From the viewpoint of SCs and OCs, existing market practices range from the opaque, obscure and incomplete to full disclosure through the chain from underwriter, broker, SM and SC or OC.

At one extreme we see a presentation from a broker or SM to the SC that includes, for each quote, only a single number. In such cases the number is the total payable by the OC and it is the base premium plus broker fee plus any statutory charges. Sometimes it is described as that, sometimes it is described as the premium (which is a misnomer and misleading because the premium definition used by the insurer and the broker is the amount quoted by the insurer or underwriter which will exclude the broker fee). In such cases, if the SC approves the quote, the SC may subsequently see no more than the same single number with no additional disclosure.

In applying this single number approach for multiple quotes, there is no guarantee that the same amount or rate of broker fee is applied to each quote. There are cases where brokers apply different broker fees to different quotes, leading to price comparisons that may distort the underlying premium comparisons.

At the other extreme we see full disclosure from the broker to the SM and possible disclosure from the SM to the SC. Even in these cases, however, there is usually a lack of full visibility for one or more of three reasons –

- The numbers that constitute the various payments to SM, broker and underwriter are often not all in the same document and, even if they are, rarely are they all on the same page in a format that is readily comprehensible to the SC.
- There are instances of the SM not making available to the SC the invoice from the broker.
- There are instances of SCs showing no interest in the scope of disclosure, apparently satisfied with whatever information they are given, whether that be just a single number or more detail than that.

The position is further complicated by the differing practices across the market of both SMs and brokers.

To unravel the arrangement and make it clear to the SC and the owners, the first area to consider is financial arrangements (premiums, commissions, broker fees, other charges) but there is more, as has become clear from submissions.

The submission process

Following release of the Consultation Paper on 30 March 2022, numerous submissions have been received.

The submission process during April 2022 has been well supported and very constructive. It has yielded valuable information and ideas from across the spectrum of lot owners, SMs, brokers, underwriters and other interested parties.

Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

It is worth noting that there is considerable enthusiasm and passion within the strata industry, including its service providers, much of which spills over to insurance matters. This energetic interest has assisted materially in the submission process and the preparation of this paper.

Outcomes of submissions

A summary of the submissions received and associated discussions is in Part 8 of this paper.

There was unanimous support from owners, consumer groups, strata managers, brokers and underwriters for more transparent and comprehensible disclosure of strata insurance financial transactions for the benefit of the OCs as clients.

So the primary question that arises is not whether there should be better and more disclosure but rather what should be disclosed to OCs, when and how.

Regarding the 'what', there was also unanimous support disclosure of the eight financial items nominated in the Consultation Paper (see also Part 3 of this paper) with no submissions suggesting omitting any or adding any others.

Many submissions also went beyond financial disclosures. Overall, there were two further strong messages coming from several quarters as to what constitutes disclosure. They are –

- Clarity as to *scope of services* and roles undertaken by the SM and the broker
- Transparency of *commercial relationships* that may exist between SMs, brokers and underwriters.

There are also two further consequential topics –

- A 'Disclosure Matrix' to draw together all the actions arising from the above three disclosure topics and:
- Implementation: how can an enhanced disclosure regime be implemented?

Hence submissions have demonstrated that a transparent disclosure regime has five essential components –

1. Financial items
2. Scope of services of SMs and brokers
3. Commercial relationships that exist between SMs, brokers and underwriters
4. Disclosure matrix for business processes – linking together 1, 2 and 3
5. Means of industry-wide implementation.

The first, financial items, is the primary component of disclosure and is its bedrock. The fifth is about how to make it happen. The second and third are supplementary items but have been shown by submissions to be important to OCs, their SCs and lot owners for confidence in the transparency and integrity of the overall strata insurance process. The fourth represents a guide to assist SMs and brokers in the disclosure process and to assist OCs to know what to expect each year.

Conclusions and recommendations on each of these five topics are covered in Parts 3 to 5 and 10 to 12 of this paper.

Primary findings

The most significant findings are the two positive ones noted above, namely –

- unanimous support from more transparent disclosure, and
- agreement that the eight financial items proposed are the appropriate ones.

Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

These two findings respond to a range of shortcomings in and criticisms of existing practices.

Who is the broker's client? Is it the OC, the SM or both?

An unexpected and noteworthy finding is essentially a cultural one that is in contradiction to the factual and legal position: it should be evident to all that the insured, being the OC, is the client but there is a common misunderstanding otherwise:

To illustrate the level of misunderstanding, I was invited to participate in several live events around the country attended by a mixture of SMs and brokers. When asked this question, a surprisingly high proportion thought it was both OC and SM and a significant proportion said it was the SM (and altering the question from 'client' to 'customer' had no effect on the survey results).

The main disclosure limitations

Below is a concise summary of the main limitations of current disclosure practices derived from the examples the scene range of brokers and seems during investigations leading up to the Consultation Paper and subsequent submissions and discussions.

- A. Some brokers disclose only a single number in presenting quotations
- B. Many brokers do not disclose full information with quotes and many brokers do not disclose full information on invoicing documents
- C. I am not aware of SMs asking or influencing brokers to extend their financial disclosures.
- D. Many SMs, in passing limited information to their OCs, appear to rely on delegated authority from the OC to complete the insurance process. In some cases that results from apathy on the part of the OC.
- E. Those brokers who do disclose all relevant information to their SMs do not do so transparently and comprehensibly, as exemplified in the next point.
- F. I am not aware of any brokers disclosing in a single table or on one page the itemised total OC costs of insurance and allocation of fees and commissions between broker and SM.
- G. Different terminology is used by underwriters and many brokers and SMs for the term 'premium'
- H. Many brokers do not know how or when or even if the SM presents insurance quotations or broker invoices to the OC (because usually they do not ask and SMs do not usually tell them)
- I. Reconciliation of the broker invoice with the broker quotation can be difficult or even not possible.
- J. Most brokers and SMs do not explain their respective scope of services in a meaningful way to their OC clients and their disclosures on corporate relationships are mostly not very meaningful.

The main purpose of presenting these observations is to illustrate shortcomings in current disclosure practices. All of them relate to questions of transparent and timely disclosure of insurance transactions for SCs and OCs.

NB: These limitations are not intended to suggest that brokers or SMs are acting in a manner contrary to their understanding of their regulatory requirements. They reflect instead a limited customer orientation: there is a general tendency of many brokers and SMs to disclose only that which they believe regulators require them to disclose and current regulatory requirements do not oblige full and transparent disclosure.

In summary, my conclusions are that -

- each one of the ten observations A to J represents a shortcoming in the disclosure practices of many brokers and SMs
- and*
- all of them would be resolved in favour of full and transparent disclosure if all brokers and SMs were to follow the steps outlined in the Overview and elaborated upon with recommendations in later Parts of this paper.

SECTION II - the Report

PART 3: Financial disclosures: recommended practices

..... what is to be disclosed

There is a pressing need, in the interests of transparency and understanding for owners' corporations, to improve the scope, consistency and quality of insurance documents and agency agreements presented to them by SMs and brokers. This much is evident from previous parts of this paper, including the feedback from submissions described in Parts 2 and 8.

Also, as explained in Part 5, there is an approaching obligation on insurance brokers who are NIBA members to disclose commissions and other fees from 1 November 2023 for clients who are individuals or small businesses.

So how to resolve the financial disclosure challenge?

The matters to be considered regarding disclosure and transparency of financial items are –

1. *Essential items to be disclosed*
Eight items have been identified as the minimum set of financial items required for full disclosure of current market practices.
2. *Nomenclature and definitions*
Each of the eight items needs to have a clear and unambiguous definition or explanation.
3. *Templates for presenting items to be disclosed*
The disclosure items will become transparent if they are put together in a suitable *standard format*. For this purpose, a set of templates is being recommended.
4. *Usage of disclosure documents under a full disclosure regime*
Part 5 of this paper recommends improved practices relating to communication between broker, SM and OC during the insurance renewal process aimed at transparency of the recommended disclosure of financial items.

Topics 1 and 2 are covered below. The templates at 3 are in Part 4 of this paper and Topic 4, using the disclosure documents, is in Part 5.

1. Essential items to be disclosed

These items are dollar amounts for –

<i>Item</i>	<i>Origin</i>
(a) <i>Base premium:</i>	determined by the underwriter
(b) <i>Commission:</i>	determined by the underwriter
(c) <i>Broker fee:</i>	determined by the broker
(d) <i>ESL or FSL:</i>	levied by underwriter based on government regulation
(e) <i>Stamp duty:</i>	levied by underwriter on government formula
(f) <i>Other fees:</i>	a modest underwriter or insurer administration fee is common
(g) <i>GST:</i>	calculated as 10% of all items except stamp duty.
(h) <i>Allocation of intermediary charges:</i>	allocation to SM and broker of the total of commission plus broker fee

Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

Each of these items needs to be specified as a dollar amount. They can also be displayed as percentages if the broker or SM wishes to do so. Any percentages would usually be expressed relative to the base premium or alternatively to the total intermediary charges (being the sum of commission and 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

... this distinction needs to be clear.

- **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'
- **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 remuneration* 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.

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

Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

- the levy rates differ across insurers and change from time to time whenever the Government reviews the charges
- current levies are typically between 10% and 15% of base premium (residential) and 25% to 35% for commercial.
- **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 except Stamp Duty, which is Exempt.

Further commentary on some definitions

Premium:

As noted above, the definition which is standard insurance industry usage is base premium plus charges determined by the underwriter.

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.

Because this usage is standard practice among underwriters and brokers, customers can reasonably expect the same, i.e. premium is the base premium plus these taxes and charges. It excludes any broker fee.

Being so well established and well defined in all areas of insurance, it is recommended that SMs and brokers apply this same usage of 'premium' in their dealings with each other and with SCs and OCs.

This recommendation is made because -

- Some brokers and some SMs, in their correspondence with SCs and OCs, describe the premium plus broker fee as the premium.
 - this practice is misleading to owners because it is actually premium + fee.
- Some brokers and some SMs use as an alternative to 'premium' the description 'total insurance costs' or 'total payable for insurance'.
 - this description is incomplete in cases where there is a broker fee that is not separately disclosed to the owners and is therefore also misleading.
- Computer systems used by many SMs in preparing OC accounts show only a single line for insurance.
 - this arrangement is unsatisfactory from a disclosure perspective because it does not separate the premium charged by the underwriter from other insurance costs such as broker fees.

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). The term 'rebate' suggests that it is 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.

Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

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 of course 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 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.

Recommendations

It is recommended that –

- 3.1. The eight specified financial items as defined herein be included as a standard minimum set of financial items for all broker quotations and invoices**
- 3.2. The eight financial items be presented in a standard format in all broker quotations and invoices.**
- 3.3. The term *premium* be used exclusively for amounts determined by the underwriter and cease to be used by brokers and SMs to refer to premium plus broker fee, not only in quotations and invoices but also in OC accounts and other correspondence prepared by SMs.**
- 3.4. In cases where an underwriter deals directly with the SM and OC, no broker involved, the SM conform with the above three recommendations by substituting for the broker where relevant.**

SECTION II – Main disclosure topics

PART 4: Templates for financial disclosures

..... presenting the financial disclosures

In the previous Part 3, it is recommended that there be a standard set of eight financial items to be disclosed in broker quotations and invoices and that they be put together using templates that define a standard format. At present there are no standards or best practice principles or templates available to SMs or brokers for communicating with SCs and OCs.

How do we design a standard format? In principle the solution is simple, even if the execution may not be so simple:

- Identify all relevant items to be disclosed with an unambiguous definition of each
 - articulated in the previous Part
- arrange and present these items in as simple a format as possible, to facilitate clarity of the insurance transactions.

Although there are only eight items, because of the unorthodox arrangement (commission rebate and broker fee system) and the complications it causes, it is not entirely obvious as to what is the best way of presenting these items in a standard format that will be clear to all SCs and other interested parties.

The next two pages show two recommended standard templates, one for quotations and one for invoices. See RECOMMENDED TEMPLATE – QUOTATION VERSION and RECOMMENDED TEMPLATE – INVOICE VERSION. They are intended to be used across the value chain from OC to SM to broker. They are designed for their primary audience which is the clients, being OCs and their SCs and lot owners.

In practice the templates could be used precisely as is or could be modified by individual brokers or underwriters *provided that* the modified version contains all of the same information on a single page.

The templates are a pair and each can be used in all common situations, which are –

- Strata manager and broker, gross premium
- Strata manager and broker, net premium
- Strata manager but no broker, gross premium
- Broker but no strata manager, gross premium or net premium.

Both templates are the same but the quotation version caters for 3 quotations (and could be expanded to cater for more or contracted for fewer), showing a column for each, whereas the invoice version requires just a single column for the invoice items.

Both templates also include an initial column to show a comparison with the previous year's renewal. Utilising this column will bring quotations and invoices into line with the corresponding requirement of the General Insurance Code of Practice for other retail insurance products.

The template is set up in two sections –

Section 1: itemised insurance costs –

- shows all items leading to the total insurance costs payable by the OC
- commission is not shown because it is in the premium

Section 2: rearrangement of section 1: itemised intermediary remuneration -

- shows the commission, broker fee and their total
- also shows allocation of the total between SM and broker.

Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

Comparison with current presentation

Section 1 of the recommended template is essentially the same as in many existing broker invoices, although they are often presented across the page rather than down page. Some brokers also use this format with quotations. I have seen no examples, however, of Section 2 in consolidated form as in the template and no cases of the Section 2 items all being presented on the same page as the Section 1 details.

Why just one pair of templates?

Evidently the templates could be simplified in cases where the premium is net (no commission) and also in cases where there is only one intermediary (no broker and the SM deals directly with underwriters; or no SM, broker deals directly with OC). The alternative is to use the recommended template but simply to enter nil where relevant (e.g. commission zero or broker fee zero). It may be administratively simpler for brokers to operate with a single pair of templates only, even if they contain some nil entries in some circumstances, but there is no barrier to using a simplified version.

These templates show only dollar amounts and are now being recommended as the standard format for minimum levels of disclosure (see Recommendation 6.2). It would be straightforward to add a second column to each which displays percentage rates for each item. Such a second column is not essential as the percentages are of course a simple arithmetic operation but each of the dollar items displayed is considered essential to full disclosure.

Recommendations

It is recommended that –


- 4.1. The pair of templates displayed in this Part be accepted by brokers and underwriters as the reference format for communicating quotations and invoices in all cases, whether there be broker and SM, SM only with no broker and broker only with SM participation in the insurance process.**
- 4.2. These templates or their single page equivalents be used by all brokers when preparing quotations and invoices for client OCs and their SMs.**
- 4.3. All SMs who have not engaged a broker use these templates or their single page equivalents when preparing quotations and invoices for their client OCs, perhaps simplified for the absence of a broker fee.**

**Independent Review of Strata Insurance Practices
Phase 1 - Disclosure: Findings and recommendations**

RECOMMENDED 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

* add or subtract columns for more or fewer quotations

Notes:

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

**Independent Review of Strata Insurance Practices
Phase 1 - Disclosure: Findings and recommendations**

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)

SECTION II – Main disclosure topics

PART 5: Strata insurance renewals: recommended practice *communicating during renewal*

For the templates as recommended in the previous Part 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.

These steps are aimed at meeting transparent disclosure criteria including the provisions of the new NIBA Code requirements of full disclosure to the client, being the OC. Importantly, the disclosure of commissions and fees as well as the obligation to transmit the disclosed material to the OC as a small business client are being introduced for the first time in the new NIBA code. The broker is obliged not only to disclose commissions and fees but also to ensure that the client (the OC) receives the information. Clause 6.1(c) of the new Code states that "This information will be provided at the same time and by the same means as our advice to our client".

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

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 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.

Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

Case 1: SM and broker already appointed

A description of current practice is set out in normal black font below under steps 1 to 14. **The words in bold red are extensions to current practice.** These extensions are intended to give effect to the three requirements above. The 2nd and 3rd (timely receipt by the SC of broker presentations and invoices along with knowledge by the broker that this receipt has occurred) are the primary communication changes being recommended.

Steps 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 –

- 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 -

Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

- a. 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 -
 - a. 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) -**
 - b. The format and content of the renewal presentation are to conform with the recommended template (or its full equivalent on one page)**
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 –
 - a. 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 –
 - a. 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.
 - b. The format and content of the invoice are to conform with the recommended template (or its full equivalent on one page)**
11. The broker initiates transmission of the invoice to the SM and the SC –
 - a. 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

Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

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. 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, however, two important changes from current practice because –

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

There is therefore 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.

At present, it is often the case that one or both of these two communication steps do not occur and indeed the second (Invoice transmission) occurs only rarely.

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.

In other words, 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.

Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

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 –

- additional demands on the OC arise at Steps 2, 8 and 12
- simplification occurs at Steps 6, 7 and 13.

Recommendations

To enhance the existing renewal process, it is recommended that –

- 5.1 The broker include all eight financial items in all strata insurance quotations and invoices using the recommended standard template or its full equivalent on a single page;**
- 5.2 The broker, in arranging transmission of the presentation with quotations and recommendation to the SM and the SC, does so in a manner that assures timely and preferably concurrent confirmation for the broker of receipt of the presentation by SC office bearer(s)**
- 5.3 The broker, in arranging transmission of the broker's invoice to the SM and the SC, does so in a manner that assures timely and preferably concurrent confirmation for the broker of receipt of the invoice by SC office bearer(s)**
- 5.4 The SM incorporate the broker's insurance documentation in the next AGM agenda and minutes.**

SECTION II - the Report

Part 6: Means of industry wide implementation a self-regulatory solution?

A need for regulation?

There has been a high level of interest by brokers, SMs and consumer groups in transparent disclosure for owners' corporations and their strata committees, as signified in part by unanimous support for change during the consultation process for this paper. Despite this widespread support, however, there is a need for some form of regulatory initiative to give brokers and SMs clear guidance, confidence in any changes and an incentive or obligation to make the changes.

If there is to be regulation, it can occur through the two industry associations, NIBA and SCA, or by government legislation.

Along with the undoubted complications and delays inherent in legislative solutions that would need to be sought across as many as nine jurisdictions, **there is an overwhelming desire by both SCA and NIBA at this time for self-regulation** to the extent that regulation is desirable or necessary to bring about agreed changes. For example, SCA has noted in response to a question about incomplete or misleading disclosures that -

“A standardised disclosure framework clearly outlining all aspects to be disclosed by the Broker and Strata Managing Agency may address this issue in a better capacity. *An approach to this effect on a national scale would remove state-based variation, which impacts standardisation and consistency of disclosure in different jurisdictions.*” (my italics)

Furthermore, both NIBA and SCA are eager to promote change and have indicated a desire to work with their members and with each other to establish a workable self-regulatory regime for strata insurance disclosure.

What would a self-regulatory regime look like?

To be effective, self-regulation will generally need to comprise –

- (1) a professional or industry association that has a written guidance note or practice standard of some kind that is well constructed and specifies minimum standards or requirements to be met by members
- (2) a membership base within its practice domain that is dominant enough in its market to render it effective if members comply with its standards
- (3) a membership base that will, on the whole, respect the guidance note or practice standard and encourage compliance with it among the membership
- (4) infrastructure to facilitate development and implementation of professional standards including training support and, importantly, a disciplinary system to stand behind those standards.

Also, in this special case where there are two professional associations, NIBA and SCA, whose interests are complementary and whose efforts need to be co-ordinated, there are two further conditions –

- (5) both associations meet the above for conditions, and
- (6) they cooperate with the aim of ensuring that the standards are indeed complementary and consistent with each other (while obviously each serving the different needs of their respective members).

It becomes a matter for each of NIBA and SCA to set up a regulatory regime for their members. The most that can be done through this paper is that they use its recommendations as the foundation for these regimes.

Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

My involvement during the course of this project with NIBA, SCA and a range of their individual members indicates to me that both associations have sufficient market presence and influence to be likely to be able to meet all of these conditions in relation to strata insurance transparency and disclosure.

Timing

Timing is also an important consideration. Commencement of the new NIBA Code of Practice from 1 November 2022, with a transition of Disclosure Requirements to 1 November 2023 (see also Part 9), is relevant, by which time some of the broker disclosures recommended in this paper will become mandatory for NIBA members. This date may provide a basis for NIBA and SCA planning although both associations could plan for an earlier introduction if they choose. Earlier introduction would need to give adequate time for each association to develop a guidance note or practice standard and also for members to prepare systems, documentation and other business processes needed for any changes.

Status of self-regulation

The standing of self-regulatory initiatives with governments will matter. Acceptance and recognition by government or government agencies may have a bearing on the effectiveness of the professional standards and the disclosure regime as a whole.

We cannot readily anticipate at this stage how governments, government agencies and their regulators may react to self-regulation of strata insurance. It would be valuable to brokers, strata managers and owners corporations, however, if the authorities were satisfied to recognise guidance notes or practice standards promulgated by NIBA and SCA.

Both NIBA and the SCA have expressed support for a disclosure regime along the lines recommended in this paper and both associations are strongly supportive of a self-regulatory approach. Furthermore, as noted above, both NIBA and SCA have indicated a desire to work with their members and with each other to establish a workable self-regulatory regime for strata insurance disclosure.

Additionally, NIBA's support is consistent with and exemplified by the disclosure provisions of its new Code of Practice coming into force on 1 November this year.

Recommendations

It is recommended that each of NIBA and SCA –

- 6.1. establish a set of guidance notes or practice standards for brokers and strata managers respectively that give effect to decisions they take on the recommendations made in this paper for transparent disclosure of strata insurance matters.**
- 6.2. Include in their guidance notes or practice standards use of the recommended standard templates or their one page equivalents for strata insurance quotations and invoices.**
- 6.3. engage if appropriate with the Commonwealth and State and Territory governments and their agencies to gain recognition and acceptance of the self-regulatory disclosure initiatives that they take following release of this paper.**

SECTION III – Related topics

PART 7: Market history and evolution

The current practices 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
- Commissions paid to strata managers were initially just 5% but they increased over time to 10% then 15% and settled some years ago at today’s market rate of 20%. Reasons appear to have been a combination of demands being made on strata managers, creating cost pressures, and emerging competition by CHU and others in due course to retain the support of their strata managers with whom they had agency agreements
- Brokers began to enter the market in the 1990s, some began to specialise and that trend has grown in the last decade. Initially brokers saw themselves as direct competitors to underwriters in strata insurance
- 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
- As SMs began to engage brokers instead of dealing directly with underwriters, , there was subsequent jostling for market position among brokers. They began to compete amongst themselves for portfolios of strata manager business. This exacerbated the commission issue as brokers were winning SM business based on which party would be willing to pay the strata manager more commission. This saw the commission rebate to strata managers move towards a full 20% and in some cases to 22½%, with brokers thereby rebating more than their original commission to the strata manager to win their business
- There are no specific regulations regarding broker fees and no restrictions on commission rebates to SMs, hence no framework to discourage poor remuneration practices, leading to questions over –
 - Possible conflicts of interest for SMs and brokers
 - Possible over-charging of owners’ corporations
 - Lack of transparency, visibility and understanding of broker fees and rebates of broker commissions.

Size of the market

Statistics for strata insurance are not readily available because they are not collected regularly and separately from other classes of insurance. Estimates of total premiums are made and the Deakin report notes an estimated \$1.08bn in 2020 including all government taxes and charges. If that is accurate, we can reasonably

Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

assume that the market today is of the order of \$1.2bn to \$1.3bn of gross written premiums and government charges. This figure also includes commissions that probably approach \$200m but is before broker fees that are likely to be in the order of \$80m to \$100m.

These premiums relate to a strata property industry that was estimated in the UNSW – Australasian Strata Insights 2020 paper to comprise 870,000 strata lots and 341,000 strata schemes, qv table in Appendix B. This table also shows the distributions of lots by lot scheme size and numbers of schemes by lot size. We see, for example, that –

- schemes with 1 to 2 lots number 37% of all schemes but just 9% of lots
- schemes with more than 50 lots number less than 2% of all schemes but contain 23% of all lots.

Emergence of the broker/strata manager ‘entanglement’

When brokers were first involved, they handled the insurance relationship for the strata manager and shared commission with the strata manager, typically by paying the strata manager an amount equal to 15% of the 20% commission and retaining 5% for themselves. As the market grew, however, and the three quote requirement 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 deal with all the insurance technicalities, obtain three quotes and deal effectively with underwriters.

In the majority of cases the SM’s total strata management fee is negotiated by the SM with the client (the OC) on the understanding that an insurance commission will be received. The commission becomes a subsidy towards the management fee and therefore forms part of the SM’s total remuneration.

SMs have therefore become increasingly willing to use brokers but have also resisted any attempts by brokers to reduce the SMs’ share of commissions. At the same time brokers have wanted to become better remunerated for their own services.

This market dynamic, whereby SMs expect brokers to continue to remunerate them using some or all of the broker commissions and brokers wish to supply and be remunerated for their services, appears to have led to the introduction and the growth in scale of commission rebates and broker fees in strata insurance.

Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

SECTION III – Related topics

PART 8: Submissions and associated discussions

As noted in Part 2, the submission process following release of the consultation paper on 30 March has been well supported and very constructive.

Written submissions were received from a total of 32 different parties, some of them offering more than one document or discussion following enquiries that I made or additional material submitted after discussion.

It is notable that many of the submissions strayed into Phase 2, i.e. the commentary extended beyond disclosure into other matters such as views on the appropriateness of various practices observed in the market. . These submissions will be revisited and considered during Phase 2.

In addition to the submissions, I received on request from several brokers and strata managers documentation, primarily broker presentations with quotations and invoices, to assist my understanding of precisely what kinds of disclosures are being made about premiums, commissions, broker fees and other matters.

I also received verbal input from numerous interested parties, mostly in response to questions that I asked. These parties included –

- 5 of the 6 most active underwriters in the strata insurance market
- numerous brokers, SMs and lot owners when I followed up on written submissions
- a range of other brokers and SMs who did not make submissions but whose input I was interested in receiving
- SCA and SCANSIT (SCA’s National Strata Insurance Task Force)
- NIBA.

Most of the written submissions were confidential, prepared by associations, broking firms and strata firms, also individuals from within broking firms, SM firms and lot owners. In some cases they wanted to bring to my attention topics or experiences as participants in the strata insurance process. Some drew attention to alleged rights and wrongs of the strata insurance practices of some brokers and SMs

A notable non-confidential submission from interested groups was from the Queensland Consumers Association with written endorsement from the Consumer Federation of Australia

This and the other non-confidential submissions can be found on the website johnthrowbridge.com.au.

Quotes of some of the main points relating to disclosure from the QCA submission are

“General

We support the Paper’s advocacy for greater transparency in disclosure since this will **facilitate informed consumer choice and enhance competition**.

“Specific

1. We strongly agree with the following statement at the start of Part 6 of the Discussion Paper:

....there is a pressing need, in the interests of transparency and visibility to owners’ corporations, for improving the scope, standard and quality of disclosures made to OCs by some SMs and brokers.

2. We support a full disclosure regime.

3. We consider that:

Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

- all of the eight transaction items (base premium, commission, broker fee, any government charges, stamp duty, any other fees, GST, and commission rebate and resulting allocation of intermediary charges between SM and broker) should be disclosed.”

The full context for these extracts can be seen in the submission on the website.

Also received was some written input from OCN (Owners Corporation Network) and SCA –

- From OCN –

“ ... if a compelling case is made for a transition period, then OCN supports the Discussion Paper’s advocacy for greater transparency in disclosure since this will facilitate informed consumer choice and enhance competition.

“OCN strongly agrees with the statement in Part 6 of the Discussion Paper that *‘there is a pressing need, in the interests of transparency and visibility to owners corporations, for improving the scope, standard and quality of disclosures made to OCs by some SMs and brokers’.*”

“OCN supports the proposed eight essential items to be disclosed. To increase clarity, the dollar amount should be provided for all items quoted. And disclosure must be rigorously audited and enforced by the Regulator for it to provide real consumer protection.

“OCN supports a requirement for standard definitions to remove ambiguity or misunderstanding.”

- From SCA

(1) “SCA has championed disclosure and transparency in the insurance space for many years, stepping up the intensity of its work in 2020 in particular by establishing the Strata Community Association National Strata Insurance Taskforce (SCANSIT).”

(2) In reference to the 2021 Deakin report,

“... the report held three valuable recommendations in relation to improving strata insurance practices, which the strata industry take very seriously and are working hard to improve:

- To improve the distinctions between what services are undertaken by the manager and what insurance services are, or should be, undertaken by the insurance broker.
- To improve the description of the insurance-related services provided by managers in their management agreements.
- Communicate in a much more transparent manner with clients.”

(3) A standardised disclosure framework clearly outlining all aspects to be disclosed by the Broker and Strata Managing Agency may address this issue in a better capacity. An approach to this effect on a national scale would remove state-based variation, which impacts standardisation and consistency of disclosure in different jurisdictions.

This material underlines the primary findings of the consultation process, as explained in Part 2, in particular the strength and unanimity of support for transparent disclosure in the interests of lot owners and their strata committees.

There are also numerous references in confidential submissions to the other two topics emerging in submissions, namely the *scope of services* of SMs and brokers and the nature and level of interest in *corporate relationships* among brokers and strata managers.

Overall, there has been a consistent set of themes, as outlined above and in Part 2 of this Paper, running through both written submissions and discussions that I have held with a range of interested parties, both before and since publication on 30 March 2022 of the Consultation Paper.

SECTION III – Related topics

PART 9: Strata insurance – the regulatory landscape *... for supplying insurance to OCs*

Regulation associated with strata insurance has two dimensions –

1. **Disclosure obligations** on brokers and strata managers arising from their regulatory responsibilities
These disclosure obligations are underpinned by legislative obligations but are supplemented by industry based professional standards
and
2. **Legislative framework** for underwriters, brokers and SMs in supplying insurance services to OCs
The legislative framework is driven predominantly by Commonwealth legislation but there is also a State and Territory legislative element.

In this Part we look firstly at the *disclosure obligations* on brokers and SMs and then at the *legislative framework*.

1. Disclosure obligations on brokers and SMs

There are two regulatory regimes that apply to insurance brokers who are NIBA members and as many as four that apply to SMs who are SCA members -

- Brokers are regulated under the Corporations Act and need to hold an AFS Licence issued by ASIC.

Brokers who are NIBA members need to comply with the NIBA Code of Practice.

- SMs are required to support their clients (OCs) to comply with State or Territory laws for, among other things, maintaining insurances required by law. In some jurisdictions they are also required to be licensed or registered themselves.

SMs who are SCA members need to meet professional standards or guidelines of the SCA national body and any additional requirements of the SCA state body.

Regarding insurance, many SMs are appointed as Authorised Representatives (ARs) or Distributors by one or more brokers. In this capacity they are acting under the broker's AFS Licence and the broker needs to train, monitor, supervise and audit them as required by the broker's AFS Licence.

Many of the SMs who do not use brokers are ARs or Distributors of an underwriting agency.

Both NIBA and some sections of the SCA have been working on their professional codes and guidelines in recent years. As a result, the obligations on both groups are undergoing some change.

Brokers - legislative requirements

A broker holding an AFS Licence is required to do all things necessary to ensure that its services are provided efficiently, honestly and fairly; and that its ARs and Distributors are adequately trained and are competent. The relevance for this paper is that most SMs are appointed as ARs or Distributors for brokers or underwriting agencies and as such are subject to the Corporations Act responsibilities validly delegated to them by their brokers or agencies as AFS Licensees.

Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

Brokers – Code of Practice

NIBA has recently finalised and released its new Code of Practice for member brokers. For the first time, the Code will oblige brokers (referred to in the code as 'Code Subscribers') to disclose to their clients who are individuals or small businesses the dollar amounts of commissions and any other fees to be paid by their clients. This new Code will come into force on 1 November 2022, with a transition of Disclosure Requirements in Clause 6.1 extending to 1 November 2023.

Provisions of the Code that are relevant to disclosure of remuneration are –

“2.3 What the Code applies to

- (a) The Code applies to all services and activities a Code Subscriber engages in when arranging or advising on general insurance products or alternative risk transfer solutions on behalf of a client. This includes services and advice relating to claims handling, premium funding and risk management (Covered Services).”

“6.0 DISCLOSING WHAT WE EARN

6.1 Disclosing remuneration

- (a) If the client is an individual or a small business and we are acting on their behalf, we will provide them with information about any remuneration (including commissions) or other benefits we will or expect to receive as a result of providing Covered Services. See Section 2 for more information on Covered Services.
- (b) This information must include:
- (i) the dollar amount of commission we will or expect to receive in providing Covered Services;
 - (ii) any non-monetary remunerations we receive from insurers as a result of providing Covered Services;
 - (iii) any fees payable by the client in relation to our services to them; and
 - (iv) whether we intend to keep any portion of the commission or service fee if the policy is cancelled before it is due to expire.
- (c) This information will be provided at the same time and by the same means as our advice to our client.”

Strata Managers

The quotations below from SCA documents nominate general requirements of SMs. For the most part they are additional to their responsibilities as ARs or Distributors for brokers or underwriting agencies as explained above. They are underpinned in most jurisdictions by legislative requirements on disclosure.

Excerpts from the SCA (NSW) Code of Ethics –

This Code of Ethics is pursuant to the commencement of a Professional Standards Scheme in NSW (effective from July 2021), which at its core is a risk management and consumer protection instrument that is intended to increase confidence and trust in the professional conduct of strata managers. There is consideration being given to extending the scheme to all States and Territories.

“Duties of all Members

All Members must always:

- Act ethically.
- Act honestly, be straightforward and sincere.

Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

- Not provide false, misleading, or deceptive information to anyone.
- Be objective, fair, and not allow prejudice or bias to override that objectivity.
- Be and appear to be free of any interest, which might be regarded as incompatible with Integrity and objectivity.
- Disclose and deal with Conflict of Interest issues in an open and fair manner, and not pay or accept secret commissions, either directly or indirectly.”

Excerpts from the SCA national Strata Management Practice Standard (SMPS), Implementation Guideline

“3. Strata Community Management

3.1. Strata Management Agreement

The Business must complete in writing a Strata Management Agreement when a strata community wishes to engage a strata management business.

3.2. Agreement Terms

The Strata Management Agreement must clearly set out all of the contract terms.

3.2.3. Disclosures

The Strata Management Agreement must clearly set out all commissions or remuneration payable for insurance policies or other contract services, and any other conflicts of interest.”

Commentary

Brokers

Important requirements relevant to brokers regarding strata insurance that are being introduced for the first time in the new Code are –

- Under 6.1 (a), the broker will be obliged to provide remuneration information to the client and that means ensuring that the SC and/or the OC (perhaps depending on the jurisdiction) receives this information.
- Under 6.1 (b), (i) and (iii), the broker will be obliged to disclose commission, broker fee and sharing of broker fee between SM and broker.

At present it is not necessary for the broker to disclose to the SM the commission, broker fee and the sharing of commission, although many do so. As a general rule, however, brokers have not seen themselves as having an obligation to ensure that these payments and related correspondence are notified to the OC. Some argue that they do have that obligation already under their AFS Licence but the new broker Code removes any doubt and also introduces disciplinary arrangements that can be called on if the practice is not followed.

Strata managers

The requirements for strata managers are not, on their own, as specific or demanding as the NIBA code. Nevertheless those who are appointed as ARs or Distributors of a broker will be subject to the NIBA code. In both cases, it seems evident that the quoted SCA excerpts reinforce for SMs both the regulatory requirements on brokers and the consequential expectation or requirement that SMs will assist brokers to meet their obligations.

Further, these SCA obligations are additional to legislation in each state that governs OCs. The laws are not all identical but they do have some prescriptive obligations for disclosure of commissions and, in some cases, other insurance-related fees.

In general, SMs who are appointed as ARs are able to arrange, endorse, alter, cancel, complete applications, lodge claims and pay premiums on behalf of their OCs. SMs are not technically acting for the OC in these

Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

situations but acting on the broker's behalf to provide services to the OC in accordance with their AR agreement.

SMs appointed as Distributors are usually limited to receiving the broker's invoice, collecting the premium and notifying claims to the broker.

SMs who do not use brokers, and therefore need to be ARs or Distributors for one or more underwriters, will not be obliged to follow the NIBA code. Nevertheless they still need to observe all AFSL requirements of the underwriters and also to fulfil their fiduciary duty to their OC clients including acting in the best interests of the client.

Disclosure implications

The new NIBA Code will not only require better disclosure for clients (OCs) from brokers and SMs who are ARs. Clause 6.1 (c) also requires that "This information will be provided at the same time and by the same means as our advice to our client".

This obligation is significant because it will require the broker to know that the proper communications have been given to the SC or the OC and at the appropriate times during the insurance renewal process. It is an important innovation because at present brokers generally do not see the communication that goes from the SM to the SC and are therefore unaware of the disclosures made.

Implementing this disclosure requirement "at the same time and by the same means as our advice to our client" is considered in Part 8.

2. Legislative framework

Commonwealth legislation and State legislation

Each State and Territory has its own strata insurance legislation and the Commonwealth Corporations Act 2001 (the Act) regulates many aspects of financial services nationally.

Several questions arise from this dichotomy of legislative arrangements. Taking the Corporations Act first, we can ask –

- A. Separately from any effects of State or Territory legislation, what are the relevant pieces of the Act that influence the licensing and advice framework within which brokers and SMs operate when arranging strata insurance for their OC clients

Then, on State and Territory legislation, we can ask –

- B. What influence, if any, does State or Territory legislation have on Corporations Act requirements and obligations of brokers and SMs?

These two questions have arisen because, among the submissions received for this consultation paper, two industry participants have drawn attention to certain provisions of State and Territory legislation that operate to exclude OCs from the operation of the Act ("**excluded matter provision**").

The relevant strata legislation in each State and Territory except the ACT includes an excluded matter provision that references section 5F of the Act in relation to the OCs. Section 5F of the Act states that –

"Corporations legislation does not apply to matters declared by State or Territory law to be an excluded matter."

In other words, OCs are of a different nature from corporations that are registered under the Act and thereby subject to all of the corporate provisions of the Act. These provisions do not apply to OCs.

Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

Hence the question arises as to whether any of the requirements of the Corporations Act are relevant to strata insurance. The responses to enquiries that I have made reveal differing perspectives on this issue. Some suggest that the excluded matter provision operates such that the Act does not regulate the OCs as clients and some that the Act does not apply to or regulate the OCs as corporations. However, we know that participants in the strata insurance market operate on the whole as if the Corporations Act is their legislative underpinning.

I have examined this situation far enough to be satisfied there is no benefit at this time in delving further into this question. Instead, I have elected to explore the requirements of the Act as they apply to brokers and SMs conducting strata insurance business, while accepting that the requirements of the Act do not apply to financial services provided to OCs as clients.

In exploring Questions A and B above, there are two client situations to consider, which are (1) where an SM and broker are both involved and (2) where an SM is involved but no broker.

Situation 1 – Both broker and SM appointed

It is taken for granted that the broker holds an AFS Licence and that each SM that the broker deals with has been accredited by the broker as either an AR or a Distributor.

The relevant questions regarding strata insurance are -

- (1) Is a broker or SM who is arranging strata insurance for an OC providing a *financial service* as defined in the Act?
- (2) Is a strata insurance policy a *home building insurance product* as defined in the Regulations to the Act?
- (3) Is an OC an *individual or small business and therefore a retail client* as defined in the Act or is it a wholesale client?
- (4) Is an OC, as a consequence, a *retail client* or a *wholesale client* as defined in the Act?
- (5) In arranging strata insurance for a client OC, is a broker or SM giving *personal advice* or *general advice*?

Observations that can be made in response to these questions are -

Observation (1):

Both brokers and SMs are providing a financial service because they arrange the strata insurance for the OC and, in the case of ARs, provide financial product advice to their OC clients. Hence they fall within the ambit of the Act as providers of financial services. This is the case whether the OC is a retail or wholesale client.

Observation (2):

A *home building insurance product* is a retail product under Regulation 7.1.12 of the Act if it is “used, or intended to be used, principally and primarily as a place of residence”. As most strata units fall within this definition, it is appropriate to treat a strata insurance policy as a retail product provided at least 50% of the floor space of the strata complex is residential.

The 50% criterion is not referred to in the Act or Regulation but there are precedents including the definition in the new Cyclone Reinsurance Pool legislation that indicate that, with 50% or more residential usage, a multi-use property is generally treated as belonging to a retail client.

Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

Observation (3):

The OC is likely to be an individual person or a small business and therefore a retail client and as such is not a wholesale client (from the perspective of the Act, it must be one or the other).

To the extent that the Section 5F exemption could be seen to apply (i.e. an OC is seen to be neither a retail client nor a wholesale client), a practical approach to avoiding any doubt would be for NIBA's new Code of Practice to include a reference to OCs of strata properties alongside its reference to individuals and small businesses regarding disclosure of remuneration.

Observation (4):

As a corollary to (2) and (3), an OC is most likely a retail client for a residential strata policy because –

- the OC is most likely a *small business*;
- and
- a strata insurance policy is a *home building insurance product*.

It seems therefore that even if there is doubt regarding the client status, the status of the product leads to the proposition that the OC should be treated as a retail client.

Observation (5):

The distinction between personal advice and general advice is not entirely clear under the Act.

According to Section 766B (3) of the Act, personal advice is where “the provider of the advice has considered one or more of the client’s objectives, financial situation and needs” or “a reasonable person might expect the provider to have considered one or more of those matters.”

It is common, although not universal, practice in strata insurance that underwriting information given to the broker is based wholly or mainly on the characteristics of the property to be insured. If that is interpreted, as it usually is, as not considering the OC’s “objectives, financial situation and needs”, then it is considered to be general advice.

By contrast, personal advice is usually regarded as being given if the broker becomes involved in dialogue or communication about the risk characteristics of the building or other matters and offers opinions or advice on the client’s situation as to how to manage the OC’s risk and insurance arrangements.

Conclusions

The consequences of this analysis of the relevant aspects of the Corporations Act are that Observations (1) to (5) above hold notwithstanding the operation of any excluded matter provisions in State or Territory legislation.

As a result, I believe that we can regard the five Observations above as a clear version of the framework under which brokers can meet their AFS Licensee obligations and simultaneously give support to their OC clients of the kind generally believed to be intended by the Corporations Act.

The associated conclusions are –

1. All OCs are to be treated as retail clients unless the strata complex has more than 50% of its floor space devoted to commercial strata lots, in which case the OC could be regarded as a wholesale client. This retail classification applies irrespective of whether the strata property being insured comprises only 2 lots or 200 or 2,000.

Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

2. Strata insurance products are to be treated as *home building insurance products* for the purposes of the Act.
3. Advice given to OCs is usually general advice relating only to the characteristics of the policy and the strata property. If, however, more detailed advice is sought and given, including opinions or advice relating to the OC's own circumstances and needs, the advice may need to be treated as personal advice. In both cases, however, the broker and SM are bound by their fiduciary duty to the client and that includes acting in the best interests of the OC as client.
4. Brokers need to hold an AFS Licence appropriate to the financial services they provide as general insurance brokers and they also need to authorise all SMs with whom they work as either Authorised Representatives or as Distributors, according to ASIC requirements. Such ARs will not be authorised to give personal advice and Distributors will not be authorised to give any advice.

Situation 2 – SM appointed but no broker

In this situation, the SM needs to deal directly with an underwriter. To arrange insurance with an underwriter for a client OC, the SM would usually be an AR of the underwriting agency so as to be able to give general advice. Distributors cannot be authorised to provide any advice.

If we look at the five observations and four conclusions above for Situation 1 (broker and SM both appointed), we find that, where there is no broker –

- all five observations still hold
and
- conclusions 1 and 2 (retail client definition and 'home building insurance product') also hold
and
- conclusions 3 and 4, regarding licensing and the giving of advice, hold with respect to those SMs who are ARs (but they cannot give personal advice) and to Distributors who are engaged solely in placement (but cannot give any advice, general or personal).

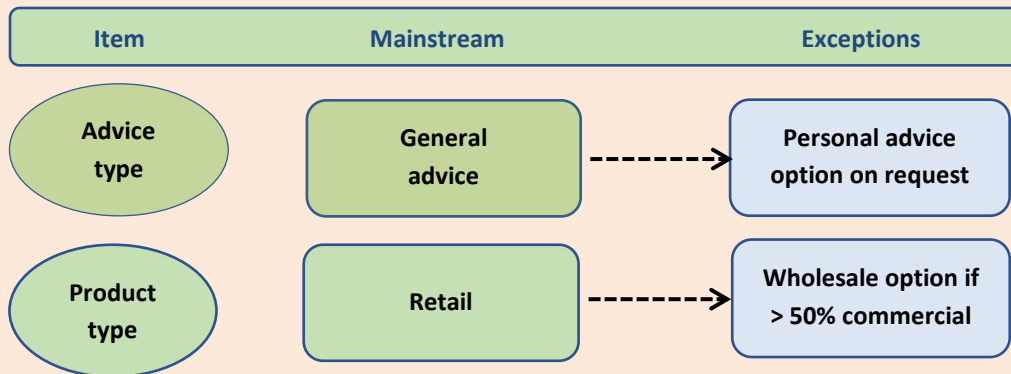
If these conclusions were applied across the strata insurance industry with particular regard to brokers and SMs, we could expect increased common understanding, uniformity and consistency of practice across the industry, along with a more level playing field from a competition viewpoint.

Summary of regulatory framework for strata insurance

There is some lack of clarity over Corporations Act responsibilities of brokers and their ARs because of State and Territory legislation but the approach indicated below is seen as safe, low risk for brokers and their ARs and, if adopted across the industry, would represent greater uniformity and consistency of practice.

Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

Regulatory framework for strata insurance – Corporations Act



Taking account of all of the above, I make the following recommendations.

Recommendations

It is recommended that –

- 9.1. The disclosure obligations of brokers under the new NIBA code in respect of strata insurance be supported by a guidance note or practice standard prepared by NIBA. Its purpose would be to codify or simplify the means by which brokers can give effect and be seen to be giving effect to their disclosure obligations.
- 9.2. All brokers arranging strata insurance for their OC clients acknowledge that they are offering general advice, unless personal advice is offered.
- 9.3. All strata policies offered to OCs for residential buildings be treated as retail policies with all their associated disclosure and other regulatory obligations and irrespective of their size, unless the strata complex concerned has more than 50% commercial usage.
- 9.4. All brokers and SMs review their current AR and Distributor arrangements to ensure they are consistent with Recommendations 9.2 and 9.3.
- 9.5. For the avoidance of doubt over the retail client status of OCs, NIBA modify Clause 6.1(a) of its Code of Practice on disclosing remuneration by adding explicit reference to OCs.

SECTION III - Related topics

PART 10: Scope of services: strata managers and brokers *..... describing their roles*

This section of the paper has been prepared to respond to several submissions whose authors appealed for more understanding of the respective roles of strata manager and broker.

Relationships among the parties

Active relationships within the strata insurance chain are –

on policies –

- SM with SC and OC
- SM with broker
- broker with SM, sometimes with SC or OC
- broker with underwriter

and on claims –

- as for policies but SM and/or broker sometimes involved with individual lot owners.

From the perspective of lot owners and the SC, the SM is at the centre of both the policy renewal process and the management of claims.

From the strata manager's perspective, the strata manager is the link between SC and the parts of the insurance process that are in the hands of the broker and the underwriter.

From the broker's perspective, the broker is at the centre of the policy renewal process and is a partner with the strata manager in the management of claims.

The strata manager is in an unusual position because he or she has a dual role, as agent for the client (OC) in some matters and agent for the broker in other matters -

- Some commentators regard this dual role as a conflict of interest simply because it is a dual role. It is possible, however, to distinguish between the two roles because in some matters the SM is acting as agent for the OC and in others as agent of the broker.
- Accordingly questions of conflict of interest may be more subtle than simply nominating the dual role. Equally, however, unless the SM, the OC and the broker all understand the full nature of the dual role, clarity around conflicts of interest will be difficult.
- This matter is not covered in this Phase 1 paper beyond the straightforward recognition of the existence of the dual role.

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

Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

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. It would be unproductive to attempt to prescribe the allocations in the tables or, worse, to establish rules about what each party can or cannot do. There are already substantial regulatory requirements on brokers, SMs who are ARs or Distributors of brokers and there does not appear to be any case for adding to these requirements for the purposes of the financial disclosures that are the main subject of this paper.

Further, 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.

Recommendations

It is recommended that –

- 10.1. The three tables specified herein be used as guidance from SMs and brokers as to their respective roles for their client OCs and prepared by agreement between SM and broker.**
- 10.2. If the tables are modified for individual OCs at any stage, the SM and broker involved sign off jointly on any variations.**
- 10.3. The tables be supplied by the SM to the SC or OC whenever a new SM or broker appointment is made and then supplied annually at the same time as the broker's renewal presentation is received by the SM, either as part of the broker's presentation or supplied separately by the SM.**

**Independent Review of Strata Insurance Practices
Phase 1 - Disclosure: Findings and recommendations**

**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

**Independent Review of Strata Insurance Practices
Phase 1 - Disclosure: Findings and recommendations**

**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 issue 		

**Independent Review of Strata Insurance Practices
Phase 1 - Disclosure: Findings and recommendations**

**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

SECTION II - the Report

PART 11: Commercial relationships: recommended practice

..... what is to be disclosed

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 commercial relationships?

Questions are frequently asked, as indicated in numerous submissions, 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 as client or whether there are any conflicts of interest for broker or SM that may not be in the OC's best interests.

There are two underlying questions that arise. The first is what kind of customer benefits arise from the arrangement, i.e. is the arrangement demonstrably in the interests of the OC? The second question is whether there are any benefits, monetary or otherwise, accruing to the SM or broker that are not in the best interests of the OC or are anti-competitive in some way.

How are these relationships structured?

Regarding brokers and SMs, some brokers specialise in strata insurance and operate exclusively in that field, some have specialised strata divisions with sizeable strata portfolios and others include strata insurance as one segment of a wider portfolio of insurance broking services.

Some SMs or SM groups have one or more preferred brokers. Their preferred brokers may have commercial relationships with the SM which involve, for example –

- (1) A sharing with the SM of commissions from the underwriter but no other commercial connection with the SM beyond the level of trust and confidence in the scope and quality of services of the broker.

The sharing of commissions will usually be on a pre-agreed basis across the insurance portfolio that the SM maintains with each of the preferred brokers.

- (2) An SM operating its own broker with AFS Licence, thereby operating a 'one stop shop' for strata management and insurance including insurance broking.
- (3) Financial arrangements between SM and broker that may not be a simple sharing of commissions because there are other ways that the two parties can operate together and be remunerated, for example –
 - (a) 'Deals' of different kinds done between a SM group and a broker. Such deals will usually constitute some form of partnership or agreement aimed at sustaining or improving the market position of one or both parties.
 - (b) A joint venture of some kind between SM and broker, which may involve some degree of cross ownership or other financial connection along with active collaboration between the two in a manner that they believe is favourable to the SM's clientele and also synergistic for the two parties. An ownership connection could be one where –
 - the SM has a partial or full ownership stake in the broker
 - the broker has a partial or full ownership stake in the SM.

From the OC's perspective, the total intermediary costs (commission plus broker fee) should be the main insurance expense item after the premium net of commission.

Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

In general, the best way to evaluate these different forms of joint involvement between SM and broker is likely to be by reference to the total intermediary costs (being the total costs to the OC of the insurance services beyond the net premium) and their assessment of the scope and quality of those services

There are also other business models and business model variations. Details can vary within each of the above and new variants continue to emerge as the strata property industry, the strata management industry and the strata insurance business grow. The distinctions between each of the business models referred to above may not be black and white.

What are the concerns?

The concerns held about these commercial relationships relate primarily to two questions –

1. Is there any elevated pricing of insurance services to support the financial interests of the SM or broker and/or the competitive interests of the SM or the broker ahead of the interests of the OC?
2. Are there any relationships which place the SM's or the broker's financial or other commercial interests above those of their OC clients, reflecting any conflicts of interest? Those client interests relate primarily to financial terms, contractual terms, professionalism and service quality.

Unless either of these two conditions is in play, there should be no constraints put on these relationships that might lessen commercial freedoms of business model and reduce competition.

There are other concerns expressed by some market participants that relate to practices regarding broker appointments, apparent 'deals' between some brokers and some SMs and other practices that 'raise eyebrows'. It is not readily apparent whether there are ethical, financial or other aspects of conduct that some consider questionable. The primary consideration, however, should be the interests of the OC and their interests are, as I see it, reflected in the two questions above.

A further question that can arise, which is of a different nature, is –

3. Are there any aspects of the relationship that have the effect of confounding the usual distinctions between commissions and broker fees?

For example, some submissions have drawn attention to so-called zero commission arrangements whereby the broker commission payments are credited to a separate corporate vehicle that transfers funds to the SM as a fee, bypassing the commission disclosure obligations of the SM.

Ultimately each OC's interests relate to cost, scope and quality of services provided by the combined efforts of SM and broker. It is a matter for each as a professional group to maintain standards that avoid or minimise conflicts of interest and support professionally the best interests of the OCs as customers.

How do these arrangements work?

There are two main kinds of market situation that have developed where SM groups and specialist brokers operate in concert in some way. They are –

- A SM group using one or more preferred brokers and directing all or most of its OC clients towards a preferred broker under an agency agreement which either side can terminate with limited notice, say three months
 - a change of broker in this way requires a letter of appointment for the new broker from each individual strata committee
 - usually most but perhaps not all OCs will agree to change brokers if the SM recommends it.

Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

- A SM group and broker having a commercial relationship, such as cross shareholdings or other financial 'deals' between each other, which ties the SM to the broker in a way that gives the SM an incentive to persuade all of its OC clients to use the same broker. Generally such arrangements are not readily unwound.

For experienced strata brokers, most of these arrangements are unlikely to affect adversely the support from underwriters in offering quotes and managing claims. It is unclear, however, the extent to which any of them affect service quality or costs to OCs of the total insurance services, being commissions plus broker fees. Some of these arrangements call for total intermediary remuneration of 20% or 25% (where commission rebates and broker fees are relatively low) while others call for total intermediary remuneration of 40% or more (20% commission plus broker fee of 20% or more).

As stated elsewhere in this paper, it is not the purpose here to pass judgment on or analyse these arrangements, only to see them disclosed in the future in a transparent way.

How to introduce disclosure?

This topic is not straightforward and any prescriptive or 'box ticking' form of disclosure is likely to be inadequate. For example, it may lead to efforts to 'game' the rules so as to nullify or water down their effect. It may also be adverse to some market participants and advantageous to others while not making clear the real effects of the relationship.

What can be done?

My conclusion is that there needs to be some form of principles-based disclosure regime that is built around concepts associated with the fiduciary obligations of the two parties.

The first consideration is the purpose of the arrangement –

- is it of sound intent or otherwise?
 - Sound intent would be typified by relationships that are genuinely aimed at improving the customer experience, while possibly also creating some benefit or competitive advantage for the broker or SM, by applying or searching for expertise, scale, efficiency, innovation, lower customer prices and the like
 - Unsound intent would be typified by arrangements designed to benefit the SM or broker or both with no clear benefit to the customer and possibly some detriment (in cost or service quality).

Competition can drive both these approaches. Success in the first case relies on maintaining competitiveness in a free market with informed customers (informed OCs). The second, however, relies on the appearance to the OC of favourable price or good service without the protagonists actually delivering these benefits.

How to distinguish between the two? This can be a difficult question to answer but, consistent with the goals of this phase 1, the first step in the process is to require disclosure that reveals the details of the arrangements.

It is possible to create a limited scope questionnaire for this purpose along the following lines -

For the SM –

- (a) Is your SM business an associated entity¹ under the *Corporations Act* of the broker or of any underwriter?

If so, describe the nature of the association and related corporate structures.

¹ Associated entity – see box on next page

Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

- (b) Is there any sharing with the broker of insurance-related OC levies other than as disclosed in Sections 1 and 2 of the standard premium disclosure (the recommended templates) that arises from your arrangements with the broker (e.g. dividends, bonuses, issues of shares or service fees, pooling of commission shares, other than commissions or broker fees shown in the standard disclosure)?

If so,

- *describe and quantify the arrangements*
- *describe the customer benefits arising from the arrangement*

- (c) Is there any contractual relationship between your SM business and the broker or in your management agreement with the OC that restricts the OC's choice of broker or the OC's ability to appoint a new broker in place of an existing broker?

If so,

- *specify the restrictions*
- *describe any fees, penalties or other conditions, financial or otherwise, that would be imposed on the OC if the OC elects to appoint a new broker*
- *describe the customer benefits arising from the arrangement*

- (d) Is there any financial or contractual relationship between your SM business and any underwriter (underwriting agency or insurer) that may influence you to favour that underwriter over one or more others when advising the OC on which underwriter to appoint?

If so, explain the relationship and your interests in that relationship

**Associated entity*

Section 50AAA of the *Corporations Act* states that an entity (the associate) is an associated entity of another entity (the principal) if any of the following are satisfied:

1. The associate is either a holding company, subsidiary or a subsidiary of a holding company of the principal;
2. The principal controls the associate;
3. The associate controls the principal and the operations, resources or affairs of the principal are important to the associate;
4. The associate has a qualifying investment in the principal, the associate has significant influence over the principal and that influence is important to the associate;
5. The principal has a qualifying investment in the associate, the principal has significant influence over the associate and that influence is important to the principal; **or**
6. A third company controls both the principal and associate and the operations, resources or affairs of the principal and associate are both important to the third company.

For the broker –

- (a) is your broking business an associated entity* under the *Corporations Act* of the SM or of any underwriter?

If so, describe the nature of the association and related corporate structures

- (b) Is there any sharing with the SM of insurance-related OC levies other than as disclosed in Sections 1 and 2 of the standard premium disclosure that arises from your arrangements with the SM (e.g. dividends, bonuses, issues of shares or service fees other than commissions or broker fees)?

Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

If so,

- *describe and quantify the arrangement*
- *describe the customer benefits arising from the arrangement*

(c) Is there any contractual relationship between your broking business and the SM that you as holding broker can impose on the OC or the SM if you are not reappointed for the next renewal?

If so,

- *specify the restrictions*
- *describe any fees, penalties or other conditions, financial or otherwise, that you could impose on the OC if the OC elects to appoint a new broker.*
- *describe the customer benefits arising from the arrangement*

(d) Is there any financial or contractual relationship between your broking business and any underwriter (underwriting agency or insurer) that may influence you to favour that underwriter over one or more others when preparing quotations or giving advice to the OC or the SM on the underwriting appointment?

NB This cannot happen if the broker is acting as agent of the OC but can happen if the broker is acting as an agent of the underwriter

If so,

- *specify clearly whether the broker is acting as broker for the OC or agent of the underwriter*
- *explain the relationship and your interests in that relationship.*

What is to be done?

While the relevance of this topic is not to be under-estimated, it is not entirely clear whether this Review can respond effectively to the questions involved without further consultation. At the same time it would not be appropriate either to ignore the topic or to magnify its significance and place it on the same level of importance as the financial disclosures recommended in previous parts of this Paper. Further, we should not allow it to delay progress towards implementation of those disclosures. Accordingly, I am inclined to make two experimental recommendations as below.

Regarding method of disclosure, the simplest approach would be for a holding broker to include answers to the nominated questions in a note appended to the broker's renewal presentation of quotations and recommendation. In the case of a new broker appointment, the disclosure would be needed at the time of appointment as well as with the annual renewal presentation.

Recommendations

It is recommended that –

- 11.1.** The set of nominated questions about commercial relationships between SMs and brokers be adopted as a trial questionnaire for SMs and brokers during the next 12 months with a view to testing them with OCs and considering their efficacy during that time.
- 11.2.** The two disclosures (SM and broker) be made annually in conjunction with transmission of the broker's renewal presentation to the OC and, when any new broker appointment is being considered, made by additional disclosures to the OC at that time.
- 11.3.** Depending on the feedback during this 12 month trial period, either persevere with the process and refine it, or alternatively abandon it in favour of a superior regime if one can be agreed upon, designed and implemented.

**Independent Review of Strata Insurance Practices
Phase 1 - Disclosure: Findings and recommendations**

SECTION III - Related topics

PART 12: Disclosure Matrix

.... linking the three components of disclosure

There are three components of disclosure –

1. Financial items
2. Scope of services
3. Commercial relationships

The Disclosure Matrix draws together all the steps required to deliver what is to be disclosed, how and when in 1, 2 and 3 above.

Matrix of disclosure responsibilities*	4. Financial items	5. Scope of services	6. Commercial relationships
What to document	Eight items	Allocation of SM and broker services	Explain relationships between SMs, brokers, underwriters
How to document	Template or full one page equivalent	Complete check list, add notes if needed	Complete questionnaire, add notes if needed
When to document	3. At time of quoting 4. At time of invoice	On appointment then annually with quotes	On appointment then annually with quotes
When to communicate	3. When quotes ready 4. When invoice ready	On appointment then annually with quotes	On appointment then annually with quotes
How to communicate	Ensure timely and concurrent communication from broker to SM and OC	On appointment then annually with quotes	On appointment then annually with quotes

*Many of these 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 Parts of the paper on financial disclosure -

PART 3: Financial disclosures: recommended practices *what is to be disclosed*

- covering the basis for templates and associated definitions

PART 4: Templates for financial disclosures *presenting the financial disclosures*

- specifying recommended templates, presenting and explaining them

Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

PART 5: 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.

These three Parts 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

See Part 10

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. Commercial relationships

See Part 11

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 commercial relationships?

Questions are frequently asked, as indicated in numerous submissions, 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 that SM and broker each complete a questionnaire of a few questions each, to describe and explain any commercial relationships that they have with each other or with other 'associated entities' (as defined in the Corporations Act). The aim is to nominate questions that will draw out such relationships in a manner that creates initial transparent disclosure and enables interested OCs or lot owners to understand both potential conflicts of interest and potential synergies in the business models and operations of their intermediaries.

Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

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 a new SM or broker appointment.

Recommendation

It is recommended that

- 12.1. SMs and brokers retain a copy of the Disclosure Matrix for their own reference purposes and that the SM supply a copy to each year's SC**

APPENDIX A: Terminology, references, acknowledgments

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 Part 6
ESL, FSL	Emergency Services Levy, also known as Fire Services Levy (applicable in NSW 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 Part 6
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 and policy writing 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 Part 6

Independent Review of Strata Insurance Practices Phase 1 - Disclosure: Findings and recommendations

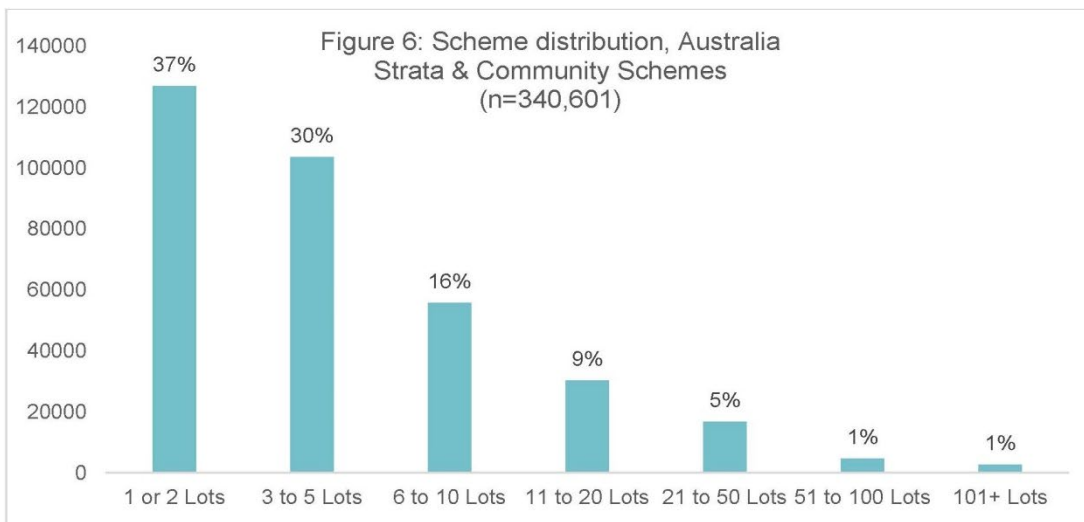
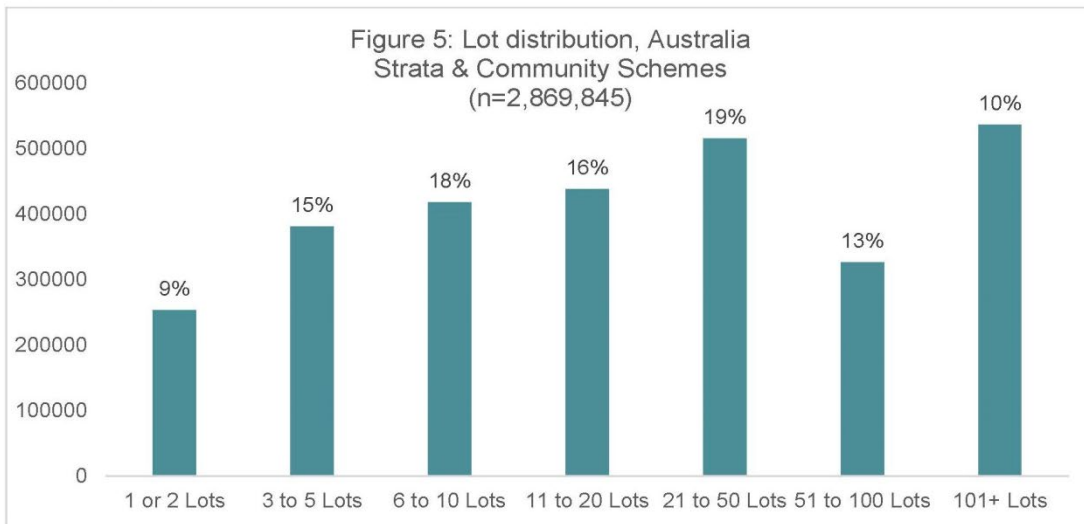
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- UNSW – Australasian Strata Insights 2020 (see also full attribution in Appendix B)

APPENDIX B: 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.adu.unsw.edu.au/research/projects/2020-australasian-strata-insights/>