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ACCC Northern Australia Insurance Inquiry
GPO Box 520
Melbourne VIC 3001
TO: insurance@acc.gov.au

11 April 2019

Dear **Sir/Madam**

Thank you to ACCC for the inviting submissions to the recent Northern Australia Insurance Inquiry – First Interim Report. SCA (Qld) has previously submitted their response to the ACCC Northern Australia Insurance Inquiry which closed in January 2018 and we have a strong interest in representing the strata sector.

SCA (Qld) is a non-profit, professional organisation for bodies corporate, body corporate managers and suppliers of services to the body corporate industry in Queensland. SCA (Qld), through its predecessor CTIQ, was established in 1984 and currently has more than 700 individual and 230 corporate members. SCA (Qld) members administer more than 65% (300,000) of all strata titled properties in Queensland and an estimated 90% of all managed properties. The strata sector comprises of 485,251 lots in 48,895 strata community schemes.

SCA (Qld) as the peak body for the strata industry is in the unique position to understand the sector from varying viewpoints. Our membership represents not only strata managers but also service providers, allowing us to take into consideration a diverse range of factors affecting strata communities.

SCA (Qld) is an independent membership body affiliated with Strata Community Association Ltd, a national body servicing state bodies such as ours. SCA Ltd has provided the enclosed submission which SCA (Qld) and its 970 strong membership (corporate and individual) fully support.

The First Interim Report is based on some common misconceptions about the strata industry, specifically the relationship between commissions and the strata manager, and what the commission is received for. Strata managers are highly skilled, trained professionals in a sector that does not require licensing or registration. Yet the skill set of a strata manager is comparable to any tertiary trained professional and requires around 2 years of on the job training and ongoing professional education to be able to keep up with the legislative compliance requirements that apply to strata communities.

Strata managers, or body corporate managers as they are referred to in Queensland, are undervalued and the ACCC's First Interim Report inadvertently misrepresents their role in strata and community title living and SCA (Qld) urges the ACCC to engage with SCA Ltd to clarify any elements in their submission as any legislation changes around commissions must be made with a full understanding of the benefits and risks.

SCA Ltd elaborates in their submission on *Recommendation 11* and *Draft Recommendation 9* that a loss of commissions is unlikely to result in any reduction in costs to consumers, as the party responsible to service the body corporate relating to their insurance would be a different one. Due to mandatory insurance requirements, the need for the service is undeniable and will



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always include administrative expenses that the consumer must carry one way or another. Strata Managers are better placed to understand strata communities and their unique needs, while also maintaining the relationships that enable communication with each individual owner; something strata insurers do not have the capacity or systems to do.

The strata management profession who we represent as their industry body for the past 35 years prides itself on upholding standards and servicing lot owners for a reasonable fee and excellent service.

We believe that there is clear scope to further improve transparency and accountability through the financial services licensing mechanism. Any reform that seeks to remove commissions should only occur in the context of a comprehensive program that provides transitional support to affected businesses.

Strata Community Association (Qld) supports SCA's submission to the ACCC *North Australian Insurance Inquiry's First Interim Report*.

Conclusion

If you would like to discuss this matter further from a Queensland perspective, please contact Katrin Watson SCA (Qld) Executive Officer, on (07) 3839 3011 or via email: katrin.watson@strata.ommunity

Yours faithfully,

A handwritten signature in black ink, appearing to read 'Simon Barnard'.

Simon Barnard,
President, SCA (Qld)

Enclosed:

- 2018 Copy of SCA (Qld) Submission to the ACCC Northern Australia Insurance Inquiry
- 2019 Copy of SCA Ltd Submission to the ACCC Northern Australia Insurance Inquiry First Interim Report



Northern Australia Insurance Inquiry – First Interim Report

Australian Competition and Consumer Commission

Strata Community Association Submission

April 2019

Executive Summary

- Strata insurance is a specialised product that is specifically tailored to the needs of Bodies Corporate;
- The efficiency and effectiveness of strata managers helps strata insurers keep the costs of insurance lower than it would be without their assistance;
- The income received by strata managers from insurers is compensation for the work performed, including obtaining quotes, liaising with insurers on behalf of the Bodies Corporate and assisting Bodies Corporate in the claims process;
- If strata managers did not receive this income, then the cost of those services would be borne by the Bodies Corporate in the form of additional service fees under the strata management agreement;
- The most likely net result would be an increase in the costs of insurance to the consumer as well as an increase in their strata management fees as it would result in less efficient and more complex insurance processes;
- A regulatory regime founded on a principle of full transparency and disclosure, rather than prohibition, would be a better and fairer approach as it would enable consumers to make an informed decision on the value of the service of the strata manager. Each Body Corporate could then elect for the strata manager to receive a commission from the insurer or pay higher body corporate management fees.
- This would underpin current best practice while minimising disruption to the market and provide a mechanism for dealing with conduct that is not in line with ethical business practices and consumer expectations.

Introduction

Strata Community Association (SCA) is the peak industry body for Body Corporate and Community Title Management (also referred to as Strata Management, Strata Title or Owners Corporation Management) in Australia and New Zealand.

Our 5,000 individual and corporate members include body corporate managers, support staff, owners' representatives and suppliers of products and services to the industry. SCA proudly fulfils the dual roles of a professional institute and consumer advocate.



The main purpose of this submission is to dispel some common misconceptions about the industry that were reflected in the First Interim Report, such as this comment:

“Strata managers were criticised heavily throughout our consultation. Strata property owners accused them of having no incentive to negotiate the best premium, again due to conflicted remuneration arrangements where they receive a share of insurance brokers’ commissions, which are based on a percentage of the premium.”

This submission will demonstrate that the above statement does not stand serious scrutiny and largely reflects a lack of knowledge of the strata manager’s role. We note that the only basis for this assertion appears to be the Queensland Legal Aid Commission submission, which relies on anecdote and conjecture, rather than serious analysis or empirical evidence, and offers no insight into the actual dynamics or operation of the industry.

We trust this submission will provide a basis for development of an informed and effective reform agenda to improve consumers’ confidence and trust in the strata services market, including strata insurance in Northern Australia.

Specifically, we expect that further and more informed consideration of

Recommendation 11: Extend the ban on conflicted remuneration to insurance brokers. The Corporations Regulations should be amended to remove the exemption for general insurance retail products from the conflicted remuneration provisions as they apply to insurance brokers.

and

Draft recommendation 9: Strata managers to be remunerated by body corporate only. State and territory legislation governing strata managers should be amended to prohibit strata managers from accepting payments in relation to arranging strata insurance other than those agreed to, and made by, their body corporate.

will ensure that any regulatory change does not result in unintended but potentially serious consequences for an emerging and dynamic growth sector.

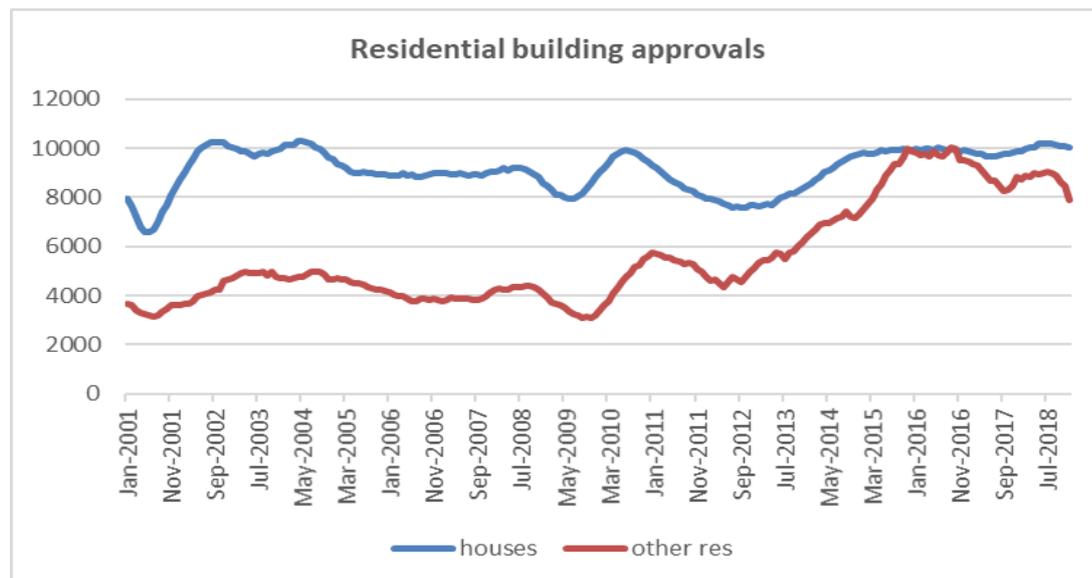
Strata Market

Based on the 2016 Census, more than 2.2 million people live in flats and apartments, the vast majority being strata titled. This figure does not include other forms of strata title such as townhouses and community titled developments. Nor does it include businesses operating in strata titled commercial buildings.

A 2018 survey of state and territory land title records¹ showed there were 316,227 strata schemes in Australia comprising 2,587,397 individual lots. Their combined replacement value exceeds \$1 trillion. The sector’s growth was illustrated by the fact that 42 per cent of these schemes had been registered since 2000.

¹ Australian National Strata Data 2018, UNSW City Futures Research Centre

Residential building approvals, which include a shift towards larger and more complex multi-use developments, reflect the global trend towards higher density particularly in major cities.² New apartment construction in recent years has caught up with detached housing and is likely to overtake it in the coming decade, based on most population projections, despite a recent downturn.



Strata Management Services

This relentless growth in the size of the market has generated an intensively competitive and rapidly evolving service sector. The governance and technical features of strata buildings increasingly require a high degree of specialist knowledge among all the many and varied trades and services that operate within the broader property services industry. The difference between common and private property, and the decision-making processes of body corporate committees, add a degree of complexity to trade and service delivery. Strata managers are the key link in this value chain.

Direct employment in specialist strata management companies is approaching 10,000 people. More significantly, they are pivotal in an estimated \$6.7 billion in annual economic activity³.

Strata managers are required to navigate through a maze of legislation and regulation ranging from actual strata specific legislation to Workplace Health and Safety, Building Codes (including cladding regulation), as well as measures applicable to the management of body corporate funds. A strata manager is expected to be knowledgeable on a range of issues relating to the management of a scheme and skilled to deal with interpersonal challenges. Many of the areas a strata manager advises on are specialised, detailed and complex.

One of these services a manager is expected to be knowledgeable in is strata insurance, including coverage, claims processing, valuations, and duty of disclosure requirements. To assist in the preparation of this submission, SCA sent a questionnaire to owners and

² Australian Bureau of Statistics building approvals January 2019 (12 month rolling average)

³ Australian National Strata Data 2018, UNSW City Futures Research Centre



operators of strata management businesses and received more than 40 detailed replies. This was further analysed in a workshop with senior strata managers from most states and territories.

It was clear from their feedback that intense competition and low barriers to entry are features of the strata services market.

Comments included:

“Current State of Management Services market - Turmoil. Price cutting to get business without thought to sustainability in Victorian Market. Level of Competition is huge, due to no barrier (minimum education requirement) any one person can open up at any time, best story I have heard is the Lingerie buyer for Coles Myer being made redundant Monday and opening up as a Strata Manager Wednesday.”

“Competition in strata is fierce with many practitioners and a variety of business models. There is downward pressure on pricing and upward pressure of wages costs.”

“It continues to be a 'race to the bottom' unfortunately.”

“Retaining business is generally not a challenge as clients will remain loyal where there are outcomes being achieved from their service provider. New business is generally what is price-driven.”

“Many companies are underquoting for business just to get clients in the door. This is resulting in an undervaluing of the vast array of services provided by our industry which for the most part is still largely misunderstood and undervalued and underappreciated.”

The sector is still largely unregulated in terms of professional qualifications with only one state, NSW, currently having a specialist licensing regime although both the ACT and NT require a real estate license. There is a severe shortage in strata managers due to the complexity of strata legislation and the long lead time in developing the required skillset.

Strata managers are mostly trained on the job and need on average more than two years to be able to work independently with committees. SCA has long identified the skills shortage as a key issue and has taken the lead in developing professional standards and accreditation models that are being well supported by member firms.

The SCA National Accreditation Pathway aligns accreditation levels with a formal education program and ongoing Continuing Professional Development requirement for Strata managers to complete and retain their Accreditation and Competency Level.

SCA and the Property Industry Reference Committee are developing formal and nationally recognized qualifications for Strata Managers.

- Certificate III in Strata Community Management (in progress)
- Certificate IV in Strata Community Management
- Diploma of Strata Community Management (in progress)

Each qualification corresponds to the SCA accreditation pathway.

As a further adjunct to the above, SCA has developed a national competency framework for Strata Managers to overlay into the existing framework.



In many states there are minimum qualification entry conditions as well as ongoing education requirements for members. This is to assure consumers that they work with qualified professionals who continuously update their knowledge by way of professional development.

The market, driven by owners' representatives on strata committees who are not often knowledgeable in strata professional standards, has been slow to embrace this. SCA membership has long been open to strata owners and specialised training is available in most jurisdictions. But the education of owners comes off a low base and it is hard to motivate owners to invest in their understanding of how strata works. Most are happy to rely on their strata managers.

While most legislation assumes self-management through representative committees as the default position, the reality is that most owners struggle to come to grips with all the legislation applying to the management of a scheme and its workers, volunteers and residents.

Strata managers are also at the coalface of dealing with a large and growing economic and social issue around the quality of construction of more recent developments in many parts of Australia. The recent Opal Tower controversy and the ongoing issues with flammable cladding and other building material issues are seen among our membership as canaries in the coalmine.

These are high profile examples of issues our members deal with daily, where systemic failures in certification and supervision have left a legacy of sub-standard construction that will take decades to resolve.

In our member's experience, the price of strata management services remains the primary competitive driver. Yet the quality of strata management services can have a major bearing on property values and rental returns, as well as the quality of life for owners.

Strata Insurance Market

The specific focus of this inquiry is on Northern Australia and the First Interim Report documents the market's current features well, both from a regional and national perspective. Consideration of the recommendations on commissions, however, would benefit from more granular analysis of both insurer and broker data to ascertain the actual premium taken at each level of the value chain, i.e. insurer, broker or other intermediary and strata manager. This would provide a better understanding of the cost and benefits of the current market dynamics and any alternative regulatory model.

Member survey responses, which covered most states/territories and included small to large firms, suggest a broad consensus that the strata insurance market overall is both competitive and well-serviced.

As the First Interim Report documents, this has not been the case in Far North Queensland. SCA first became involved in this issue when in 2011 most insurers dropped out of the market after suffering significant losses which the Australian Government Actuary found was correctly attributed to previous under-pricing. Our members reported soaring premiums were causing severe distress to their clients. It is worth revisiting this extract from our submission from January 2012 to the House of Representatives Standing Committee on Social Policy and Legal Affairs inquiry into residential strata insurance:



On November 14 and 15, 2011, SCA hosted community forums in Cairns, Townsville and Airlie Beach that were attended by about 400 unit owners and other stakeholders. SCA and an insurance industry representative outlined the factors behind the current situation and heard at times distressing feedback about the impact on local communities. Examples included:

- Pensioners and other retirees on fixed incomes struggling to cope with massive insurance-driven rises in body corporate fees, already their largest single expense;
- Investors facing almost negative returns before interest, caught in a perfect storm of soaring outgoings, a soft rental market and collapsing property prices;
- Real estate salespeople who said they could not ethically sell apartments as a viable investment;
- Builders and other tradespeople dealing with the impact of complete collapse of any new strata-type construction activity; and
- Building executive committees concerned about the long-term effects of slashed maintenance budgets, usually to help offset rising insurance costs, on the quality of life of residents and asset values.

There was discussion at the meetings about the role of government in insurance markets and the risks to competition inherent in a regulatory response. On a show of hands, all three meetings were unanimously of the view that the situation had reached the point where government intervention was justified.

It is also clear at the meetings that all three levels of government were seen to share some level of responsibility. At the first instance, local government has approved high-density development in vulnerable locations. More broadly, state-level policies and planning frameworks have encouraged or at least not discouraged these kinds of developments. Even today, the Western Australian Government is actively promoting and providing extensive financial support for major new high-density development through its Pilbara Cities program.

State Governments are also responsible for the legislative underpinnings of strata schemes, including compulsory insurance provisions. While demand is effectively mandated, there is currently no countervailing regulation of supply in strata insurance. The precedents here are well understood - compulsory motor vehicle third party, workers compensation, home owners' warranty, other professional indemnity schemes etc. All are either highly regulated or delivered through state monopolies. On the face of it, strata insurance would fall into the same category.

Direct government intervention in the strata insurance market is no longer such a live issue as capacity and competition have gradually returned to Far North Queensland. Affordability, though, remains a major issue and many property owners have not recovered from the impact of the market's collapse in 2012.

Against that background, it is therefore still worth considering why strata insurance remains unique among all forms of compulsory insurance. The supply side is almost entirely left to what is for the most part an efficient market and, despite the crisis in Northern Australia, one where there is still little support for government intervention.



Strata insurance is compulsory because of the moral hazard inherent in individual owners being asked to take responsibility for collective risk. It is poorly understood that individual members of a body corporate bear unlimited liability for anything that occurs on common property. This is not an academic question when it comes to, for example, serious or catastrophic personal injury with claims costs in the many millions. An obvious parallel is compulsory third-party motor insurance.

Anecdotally, non-compliance is common in small strata title complexes where the body corporate is inactive and individual owners take care of their own insurance.

“There is also the risk that members will choose to insure their units separately Some of the direct insurers do not cover bodies corporate or common property, so there is a huge risk of exposure.”

Compliance with compulsory insurance provisions is, however, not a significant issue across the wider market because both owners and strata managers see it as central to their role. If strata management services became uneconomic or unaffordable for the more marginal segments of the market, such as small schemes in regional areas, the level of non-compliance would almost certainly become an issue for governments.

Insurance Services Provided by Strata Managers

A strata manager’s role is to assist committees in fulfilling their legal obligations to obtain insurance to the full replacement value of the asset, as required by legislation. They must also arrange liability cover for common areas which can be difficult to define as well as a range of other covers that will be specific to each scheme or building.

Advocacy and administration tasks in quoting and servicing an insurance contract include:

- Undertake regular training on insurance
- Providing general advice
- Understanding legislative requirements for insurance and ensuring they are met
- Completion and lodgement of all documentation
- Sourcing of quotes
- Collection and payment of premiums
- Obtaining Certificate of Currencies for owners
- Co-ordination of repairs
- Processing of claims
- Arranging / updating insurance valuations.

To illustrate the volume of work generated by insurance claims, one member company provided the following statistics for a portfolio of 657 strata schemes over the 12 months to 31 March 2019:

- **759** claims received (many dealt with damage to multiple units within the single claim).
- **4,481** logged interactions (i.e. material enough to warrant making a note in the file)
- **840** claims closed (average elapsed period from opening to closure of 158 days).



In many cases, the strata manager has established a relationship with both the insurer and the body corporate, understanding what each party is prepared to accept when less complicated issues arise. The manager often has a pre-approved limit granted by the insurer for a specific scheme on expenditure for claimable repairs and based on the knowledge of committee attitudes, and the ability for direct contact with all members of a scheme (property managers, tenants, etc), strata managers can get claims processed and completed fairly efficiently. Brokers do not have this relationship or trust of the client.

“A manager knows their buildings and the risk appetite of Committees better than a broker and a manager has direct lines of communication with every member of a strata scheme. A broker does not have this depth of knowledge of a building, or of the committee and does not have the contact details of lot owners.”

Specialist strata insurers have, over time, developed considerable expertise in requirements of strata buildings. However, they still rely on strata managers for their specific knowledge of particular buildings. The insurer in turn will bring their portfolio wide experience to bear in problem-solving in what is essentially a collaborative relationship.

A key measure of the efficiency of this market is claims acceptance rates. That is, where a claim is submitted and settled in accordance with the terms of the policy and without disputation. Strata insurance, by any measure, is among the most complex and multifaceted of any of the insurance classes. And yet the Productivity Commission recently reported:

Across personal insurance products, 95.8% of claims were accepted in 2016-17 with the highest rates of acceptance in motor vehicle insurance (99.5%) and residential strata insurance (98.1%) and the lowest rates in consumer credit insurance (89.9%) and travel insurance (87.9%) (General Insurance Code Governance Committee 2018).⁴

Strata managers are critical to achieving this level of service and efficiency, not least through their ability to clearly distinguish between an insurance and a maintenance issue. As one member described it:

“We receive a high volume of claims calls and email ongoing of which we provide the consumer with general and factual advice pertaining to the insurance cover and claims. We assist the consumer in submitting the claim, as well as liaising with access and communication to other parties involved in the claim (multilevel complexes). We assist the assessor with matters that are complex. We assist the insurer and panel repairer in collecting the excesses and providing a report to the OC members when instructed. We collate the decision of the owners corporation/ body corporate members in relation to upcoming renewals and provide clear instructions to the insurer/broker on how the members wish to place the insurance.”

Commissions v Fee for Service

Insurance commissions have been a feature of most strata management business models from the industry’s earliest days. Strata title was first created as a property class in 1961 in Australia. Insurance for strata initially required multiple separate policies including Fire & Perils, Public Liability, and Personal Accident for Voluntary Workers which was inefficient and

⁴ Productivity Commission Inquiry Report 29th June 2018 - Competition in the Australian Financial System - Page 404



carried a high risk of non-compliance as coverage was not tailored to the strata legislation. In the late 1970's a more efficient and tailored single package policy was developed. Specialised strata managers, then also a new type of property professional, were soon identified as ideal intermediaries both due to their business acumen, knowledge of the risk, record keeping, especially in relation to past claims incidents and of course access to a larger potential customer base.

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

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

This portfolio aggregation by strata managers, we would suggest, has also led to more underwriting capacity entering the market due to the efficiency of the distribution model. Specifically, in terms of Far North Queensland, a leading specialist underwriting agency entered the market in 2015 post the general exit of others in 2011 in order to gain access to a strata manager's whole portfolio. This "making the market" by strata managers aggregate portfolios also has positive effects for other "hard to place" strata risks with undesirable construction materials, poor claims history etc.

The commission model also does not discriminate on location and risk quality and works to the benefit of the smaller and less attractive risks which might otherwise lack enough leverage on their own to achieve affordable insurance.

It is also well aligned to the concept of pooled risk that is central to the insurance value proposition. If strata managers were to charge a management fee for each claim, then this would add considerable uncertainty and risk to the body corporate and its members because a large or complex claim would usually also generate a large fee. By pooling the remuneration for those services across the strata managers' portfolio through commissions, this risk is effectively mitigated for the client.

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

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



The place of commissions in current business practices is well articulated in our member feedback.

“We act as the office for the Insurance Company. Without our office, the Insurance Company would need to need to establish offices and resources to process the claim.”

One member in Townsville drew on their experience in the catastrophic February 2019 floods:

“Our office was flooded. So was my house and car. We set up shop in a lounge room with a few laptops and set to work on all the insurance claims that were coming in.”

“We charge a \$100 fee for claims but doesn’t go anywhere near covering our time. We’ve been dealing with totally gutted places and a lot of really upset people coming in crying. We have to work with the brokers to organise the assessors and often go out to the site with them to get an outcome as soon as possible. Luckily, we’ve only had two claims denied because they aren’t covered for flood. Those are new clients and the policies were in place before we got them. There are a lot of other people with a lot more who aren’t covered. When the claim is knocked back, we’re the ones who have to deliver the bad news.”

“Our management fees haven’t changed since 1998 because clients won’t pay any more and it’s really competitive. We employ 11 people and we make up some of the difference with search fees and so on, but insurance commissions keep us going. We don’t just go with the policy that pays the best commissions and we go to different brokers to get several quotes. Sometimes when they really can’t afford it, we will go to Suncorp to try to get them a cheaper quote and they don’t pay commissions at all. But we just don’t get enough from our management fees and if we lost commissions, we’d probably have to close our doors.”

Some members do not accept commissions but charge additional fees for providing insurance related services. These are a relatively small minority, but they do provide consumers with a genuine choice. As noted earlier, the market is highly competitive and there are a wide range of managers with different business models and value propositions.

It is also noteworthy that our members advise commissions now paid in Far North Queensland have generally settled at levels in percentage terms that are much lower than in the rest of Australia at around 8-10 per cent. The effect has been to return a comparable dollar amount of income to the rest of Australia off the higher base premium. This has been a market outcome driven entirely by competition for the benefit of consumers.

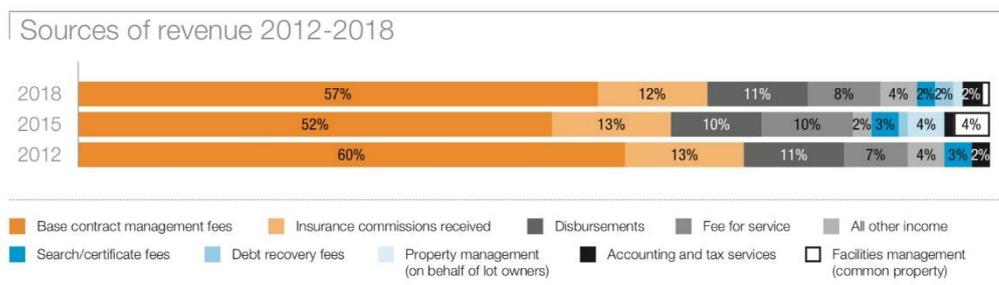
Are Strata Manager Commissions Conflicted Remuneration?

Whether insurance commissions satisfy the definition of conflicted remuneration is far from settled in strata management. At its most technical, conflicted remuneration is defined as where “the nature of the benefit or circumstance in which it is given could reasonably be expected to influence the choice of financial product recommended ... or financial product advice given to retail clients.”⁵

⁵ Corporations Act 2001 S963A

This requires consideration of the extent to which variations in a secondary source of income could reasonably be expected to influence a contractual fiduciary obligations to a long-term client. This is very subjective, and our members argue that it has no real influence at all.

Industry data suggests that commissions on average provide about 12 per cent of total strata management income, a figure which has remained relatively stable over recent years⁶.



Anecdotally, the proportion of total strata management income ranges from nil to 30 per cent depending on business size and operating model. There is debate about whether this income creates any genuine conflict of interest at all or whether it is simply a matter of perception.

“Most managers get 2 - 3 quotes and in some States, it is mandatory to get 2 - 3 quotes any way.”

“The perception is that maybe it does. We however don’t influence the broker as to which underwriters they should seek quotes from, and we encourage our Clients to adopt the policy recommended by the broker.”

“I would like to see it abolished and to see an end to the constant undermining of the agent’s professional integrity as a result. HOWEVER, I believe this would only be possible if the industry mandates the minimum professional fees to avoid agents under quoting management fees as a result of the change.”

Disclosure vs Prohibition

SCA can confidently assert that full and transparent disclosure of all commissions is considered best practice in the strata sector. While we cannot attest for every management contract in every jurisdiction, our members see it as fundamental to their client relationships.

“Yes, our business receives insurance commission, which as required is disclosed to clients, whom do not have an issue with it. Especially as clients are aware that whether the broker pays the managing agent a commission, it does not affect the cost of the insurance and if the brokers did not, the brokers would just simply retain this amount.”

“The amount of commission received is disclosed clearly to our clients. For this, our clients can be sure that the advice we are providing in relation to their insurance policies is given in accordance with the insurer's licence agreement and financial services guide.”

⁶ 2019 Strata Benchmarking Report, Macquarie Bank



That said, the industry has been grappling with the question of perceived conflicts of interest for some time. In 2013, the NSW Government proposed amendments to the Strata Schemes Management Act (SSMA) to ban strata managers from receiving commissions.

After extensive consultation with the industry and other stakeholders, a consensus emerged around a new, more stringent disclosure regime requiring a minimum three quotes that was enacted in 2015 as part of a wider reform package:

SSMA section	Provision
s60 - Disclosure of commissions	60.1a. Strata Manager must report at the AGM any commission that was received in the preceding 12 months.
	60.1b. Strata Manager must estimate the commission it is likely to receive in the following 12 months.
	60.2. Strata Manager must disclose any variation between estimate and actual commission received to the strata committee with an explanation.
s166 - Strata Manager to obtain quotations	166. Strata Manager must provide to the Owners Corporation not less than 3 quotations from different providers or provide written reasons to the owners corporation if less than 3 quotes provided.

These measures are now in place in NSW and appear to have been received well by consumers, although some insurers have observed that the mandatory requirement to obtain quotes in every case has increased overall transaction costs. That said, the issue is no longer controversial at the state level.

In late 2018, Western Australia enacted a new provision of the Strata Titles Act 1985:

S147 Disclosure of remuneration and other benefits

- 1) A strata manager of a strata company
 - a) must inform the strata company in writing of the amount or value of any remuneration or other benefit that the strata manager receives, or has a reasonable expectation of receiving (other than from the strata company) in connection with the performance of the strata manager's functions, and
 - b) must do so as soon as practicable after the strata manager becomes aware of the relevant facts
- 2) Subsection (1) does not apply to any remuneration or benefit that is less than an amount or value specified in or calculated in accordance with the regulations

These provisions will take effect later this year once regulations are promulgated. Both Victoria and Queensland have also reviewed the disclosure issue in recent years and not found prescriptive measures necessary, although Queensland does have a minimum requirement to obtain two quotes for all body corporate expenses above a threshold.



It is important to note that the disclosure requirements embedded in state-level legislative and regulatory regimes, as well as most standard management service contracts, do not extend to brokers. There is no corresponding obligation to disclose commissions or other broker remuneration such as volume incentives or profit shares that may be related to the transaction. Many brokers voluntarily disclose commissions and other payments in quotations and invoices, but it is not a consistent or mandatory practice.

In the ACCC's First Interim Report, the views of ASIC are noted:

Disclosure alone is not an effective means of overcoming consumer's misconception about the capacity in which an [intermediary] is acting and they recommend that conflicted remuneration in financial services should be prohibited or removed as a general policy.⁷

This comment arose specifically in relation to the mortgage broking industry where the incentive mix is fundamentally different to strata services. They generally involve a single service and transaction, not one element of a much broader ongoing service relationship.

ASIC's rationale for prohibition is also revealing:

In many cases, the most effective way to achieve regulatory simplicity would be to simply prohibit certain types of conflicts or conduct (e.g. the prohibition on selling financial products door to door), rather than to require burdensome disclosure and risk management rules that can be uncertain or very costly in their application.

Prohibition, while having the virtue of simplicity from a regulatory perspective, is also a blunt instrument. There are transitional costs and disruption to businesses and individuals from the removal of established income streams that also need to be considered.

SCA members, including members from the insurance sector, are very clear that the loss of commissions would not result in any reduction in costs to consumers, as the other types of intermediaries and insurers would have to deliver the customer and claims service currently performed by strata managers.

When the NSW Government considered banning commissions prior to the 2015 reforms, SCA NSW also made this point:

The likelihood of increased costs to smaller and regional/country owners corporations, which represent 97.6% of the NSW strata sector (LPI 2013), the likelihood being that strata managing agents will be forced to increase fees to reflect forgone commission income and that insurers will not reduce premiums for such clients⁸.

The quality of that service would suffer, at least in the short term, as insurers usually do not have the same level of in-house expertise as strata managers on the specific features and risks of buildings in their portfolio. Were strata managers to continue to play a role in insurance matters, they would have to increase fees commensurately to absorb the shortfall in income and ensure staff time is compensated.

⁷ ASIC submission to Financial Services Royal Commission Interim Report November 2018

⁸ SCA NSW 2014 submission on review of Strata Schemes Management Act 1996 Strata Schemes Management Regulation 2010 Property Stock & Business Agents Act 2002 Property Stock & Business Agents Regulation 2003 Strata & Community Title Law Reform | NSW Fair Trading Position Paper October 2013: Proposed ban on strata managing agents' receipt of insurance commissions



“If strata managers were barred from receiving commission, then this cost would pass onto the owners corporation and they would be charged a commercial rate for management for arranging insurance and managing claims. Despite a third party being involved, e.g. a broker, the strata manager is always involved with some aspect of the claim. Brokers do charge commissions as well, but don't always disclose this full amount.”

An underlying fear is that the transition could accelerate to the “race to the bottom” in service and price and undermine efforts to raise standards and professionalism in strata management services. Smaller businesses would be the most vulnerable. Should this result in the sale of their portfolios to the larger strata management groups, there would be a reduction in competition and specialisation.

This would be particularly the case in regional areas such as Northern Australia where smaller strata schemes may be uneconomic for the larger firms to service, resulting in an increase in self-management and the associated risks to owners including non-compliance with compulsory insurance requirements.

Conclusion

SCA is supportive of the general policy thrust towards improving trust in financial services. We also welcome the ACCC's contribution to finding a resolution to the insurance affordability issues in Northern Australia and particularly those recommendations to reduce taxes and improve mitigation for natural disasters.

But we are concerned that the First Interim Report highlights some misconceptions about the role of strata managers in insurance more broadly that, if unchallenged, could result in a poor policy outcome.

This inquiry will provide valuable input to the broader consideration of issues around conflicted remuneration as recommended by the Financial Services Royal Commission.

The words of the Royal Commissioner in his final report are worth repeating:

At their most basic, the underlying principles reflect the six norms of conduct I identified in the Interim Report:

- obey the law;
- do not mislead or deceive;
- act fairly;
- provide services that are fit for purpose;
- deliver services with reasonable care and skill; and
- when acting for another, act in the best interests of that other.

These norms of conduct are fundamental precepts. Each is well established, widely accepted, and easily understood.” (pp. 8-9)

Commissioner Hayne goes on to say that all these principles are reflected in current financial services regulation, but their application has been piecemeal. Among his recommendations:

As far as possible, legislation governing financial services entities should identify expressly what fundamental norms of behaviour are being pursued when particular and detailed rules are made about a particular subject matter.

(Recommendation 7.4)



We do not argue simply for the status quo. There is always scope to do more to support transparency and accountability in all regulatory frameworks touching on the strata sector, including the financial services regime. Our mission is to promote higher standards and professionalism and appropriate regulatory frameworks in line with the objectives articulated by the Royal Commission.

Draft Recommendation 9 recognises that payment of commissions to strata managers is ultimately a matter for state and territory law. Bodies corporate are excluded from the operations of the Corporations Law by Section 5F exemptions. To apply the financial services provisions directly to the sector, this carve-out would need to be revisited. This is a step with much wider policy and jurisdictional implications.

As it stands, the recommendation is largely moot as the four largest jurisdictions with more than 90 per cent of the market have all considered the question in recent years and either opted for improved disclosure and transparency or found current practices satisfactory.

With regards to **Recommendation 11** on broker remuneration, ASIC's conclusion on this matter is also worth referencing:

If there are evidence-based arguments that the removal of conflicted remuneration would generate costs associated with competition or consumer access that clearly outweigh the benefits of reduced consumer harms, then these particular cases could warrant limited exceptions to this rule. This should require ongoing public monitoring and gathering of data on the impacts of conflicts to test whether any exemption should be retained.

We agree with that note of caution. In the strata sector, broad brush reform risks unintended and damaging consequences for many small businesses and consumers. It is an emerging and evolving service industry that already plays an important role in Australia's economic and social fabric and one that will only become more important in the future.

This extends to the role of brokers, at least as far as they operate in the strata insurance market. The market is highly competitive and the growing interdependencies between strata managers and brokers serve the interests of efficiency, in terms of extracting synergies between the two services, at least as much as profitability. As noted earlier, more granular analysis of broker level data on premium income and commission payments would lead to a better understanding of these dynamics.

We respectfully submit that the application of the principles of full disclosure and complete transparency around commissions and similar payments to brokers and other intermediaries, at least as they apply to strata insurance, will reinforce the "fundamental norms of behaviour" identified by Commissioner Hayne.

Prohibition of commissions altogether carries greater risk and uncertainty. The market will inevitably seek to cover costs that must ultimately be borne by consumers in other ways, with other potentially adverse and unintended consequences.

Where this matter has been considered in depth at state level, the principles of disclosure and transparency have been settled on as the best means of encouraging ethical conduct and protecting consumers.

The Strata Community Association is available for a briefing on admin@strata.community or (02) 9492 8250.



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19 January 2018

ACCC Northern Australia Insurance Inquiry
 GPO Box 520
 Melbourne VIC 3001

VIA EMAIL: insurance@accg.gov.au

SUBMISSION: SCA (Qld) Feedback and Comments on ACCC Northern Australia Insurance Inquiry

Dear Sir / Madam

SCA (Qld) is a non-profit, professional organisation for bodies corporate, community managers and suppliers of services to the body corporate industry in Queensland. Our 640 Queensland members include businesses and individuals, which provide professional services and support to enable Queensland's 42,300 bodies corporate representing 390,000 lots to function efficiently and equitably. SCA (Qld), through its predecessor CTIQ, was established in 1984.

The core objectives of SCA (Qld) include

- representation on body corporate and community title issues to Government
- educating the general community on strata management and lifting the profile of the profession
- provision of on-going professional educational development to its members
- facilitating relationships between members, government, sponsors and suppliers of services; and
- the establishment and maintenance of professional standards of practice for SCA (Qld) members.

As there is no choice for strata title property owners with the legislation clearly stating the need to insure common property. It is a relief to see that the Government has listened to our and other stakeholder feedback to send positive signals and actively help.

SCA (QLD) surveyed its members to ascertain their views on the consumer questions set by the ACCC and some further clarifying questions which SCA(QLD) considered might be relevant.

We have summarised the responses from our members below.

Q1. How important is the premium in your clients' decision?

All of our member respondents stated that the premium amount is very important in their client's insurance decision.

Q2. How much choice of insurers do your clients have?

75% of our member respondents indicated that their clients had "very limited" choice of insurers, while the remaining 25% indicated that their clients' choice of insurer was "limited".

Q3. What are your clients covered for? Can you get the insurance they want?

Our member respondents that the majority of their clients could obtain the type of insurance coverage they wanted, however, the cost of the coverage was prohibitive or put a significant financial burden on the strata scheme.

Q4. How important is customer service and claims handling reputation?

25% of our member respondents stated that customer service and claims handling reputation was “very important”, 37.5% indicated it was “somewhat important” and the remaining 37.5% indicated that it was “not important”

Q.5 Have you seen an insurer behaving in way that you think is unfair or confusing?

50% of our member respondents indicated that they had seen unfair or confusing insurer behaviour, including:

- “price gouging”;
- refusing to renew insurance as a result of a current insurance claim; and
- refusing to offer new insurance coverage as a result of a current insurance claim with the previous insurer.

Q6. What information does your insurer give you and how useful is it?

All of our member respondents stated that they received all necessary documentation as required by law and that brokers were also good sources of information and comparisons of insurance options. Some members felt that some of the information was full of jargon and legalese, which was not easy to understand.

Q7. Where else do you see or look for information?

Our member respondents stated that their sources of information include:

- The PDS and Policy Documentation;
- Insurance Brokers;
- Online resources; and
- Information available at strata industry conferences.

Q8. Do you use an insurance broker?

75% of our member respondents stated that they always used a broker, while the remaining 25% indicated that the sometimes used a broker.

Q9. Is there information to meet the needs of all consumers?

Our member respondents indicated that there was a lot of information available, however, such information was not easily understandable due to jargon and legalese.

Q9. What special information do owners or managers of strata units need?

Our member respondents indicated that they needed better clarity around the factors affecting the setting of premiums and excesses and what impact (if any) cyclone ratings of buildings has on the setting of premiums and excesses.

Q10. Have you seen examples of tools, technology or information in other industries that should be used to make insurance easier to understand?

Our member respondents indicated that some building consultants use online building audit tools to allow for the more efficient capture, storage and transfer of important building information.

Q11. Have any of your clients considered renovating or altering their building(s), to reduce the risk of storm or cyclone damage? Did they go ahead?

Some of our member respondents had clients who had considered and proceeded with building renovations or alterations, however, others indicated that building owners found it difficult to fund such works, due to the increasing costs of insurance.

What are insurers doing to make it easier and could they do more?

Our member respondents didn't think that insurers were doing much to make things easier and considered that they could do much more in this regard.

Other Issues

Have your clients in North Queensland been able to obtain building insurance for their Scheme(s)?

87% of our member respondents said that they had experienced an inability to obtain insurance for one of their clients.

If your clients have been successful in securing insurance, do you consider their insurance policy affordable? What are they doing to manage the cost of insurance? In the event that you have clients that have been unable to secure insurance, please list the reasons why. Was the premium too high? Were none of the insurers willing to offer their product to the scheme(s)?

Our members' responses included:

- Insurance products have been offered but because they are in the cyclone belt the premiums are about 40% higher than South East QLD;
- The cost of insurance is extremely high for units with the average contribution per lot between the range of \$1,500 to \$3,000 which impacts greatly on the affordability of owning a unit, particularly as an investor;
- The insurance is not affordable. A lot of bodies corporate obtain premium funding;
- Clients are getting used to the insurance being high, they budget accordingly, which often means making concessions elsewhere in the budget;
- Some owners that can't afford levies have sold their units;
- Keeping a Maintenance register helps with getting Insurance every year; and
- Increasing excesses has helped to keep premiums more affordable

If you have clients that have been unable to afford/secure a Building Insurance Policy what action have they taken/what did they do next?

Many of our member respondents have clients that are utilising insurance premium funding.

Do you have schemes who have attempted or, have been successful in negotiating excess and owner improvement values in order to reduce the premium?

Many of our member respondents have clients that have negotiated better deals with insurers, however, report that more recently there is less tendency for insurers to negotiate.

Have the Schemes had an Insurance Valuation recently? Was the Insurance Valuation higher or lower than anticipated?



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25% of our member respondents said that insurance valuations were higher than expected, 25% said that insurance valuations were lower than expected, 37.5% said results were mixed and 12.5% had clients which had not recently completed an insurance valuation.

Do any of the Schemes you manage in North Queensland have any serious maintenance issues? If so, please list the issues.

Many of our member respondents have clients that have serious maintenance issues, including:

- Building cracking;
- Water ingress; and
- Repairs still being completed as a result of Tropical Cyclone Debbie

Do your clients in North Queensland have a current maintenance plan in place and an up-to-date Sinking Fund?

Most of our member respondents have clients that have clients with up to date sinking fund forecasts and maintenance plans, however, indicated that levying the required funds from owners was becoming difficult.

FURTHER INFORMATION

If you have any further questions please do not hesitate to contact me via admin.qld@strata.community or the office on 07 3839 30111.

CONCLUSION

SCA (Qld) appreciates the opportunity to provide this submission.

Sincerely

A handwritten signature in black ink, appearing to read 'Simon Barnard'.

Simon Barnard
 President