

Improving transparency, flexibility and choice

- 4.1 This chapter examines a range of issues relating to improving transparency in the factors impacting on strata title insurance premiums and options to increase flexibility in tailoring insurance cover.
- 4.2 The range of factors considered include:
- commissions,
 - claims history,
 - excess levels, and
 - full replacement cover and building codes.
- 4.3 The purpose in considering transparency and flexibility is to enable Body Corporates and unit owners to make more informed choices in their insurance arrangements. By examining the current constraints on the insurance market, the further aim is to attract greater choice back into the strata title insurance market in north Queensland.
- 4.4 While the Committee did not seek evidence on the capacity of insurers to offer bundling for strata insurance and the range of insurance products they offer, the Committee sees potential benefits for both insurers and their customers in offering discounts on multiple policies. The lack of bundled offers for strata insurance and other policies was raised during the Cairns public hearing.¹

¹ Dr Janice Crowley, *Committee Hansard*, Monday 30 January, Cairns, p. 26.

Box 4.1 Hidden, unreasonable kickbacks

'There is virtually no competition between insurance intermediaries as the gate keepers, being the Body Corporate managers, in most cases have insisted intermediaries kick back commission to win the insurance on the properties they control. The Body Corporate committees seem to be powerless if they challenge their Body Corporate manager on this matter' (Graham Koch, *submission 214*, p.1).

'My pet dislike (hate is a better word) is the 'hidden commissions' paid by the insurer to both brokers and Body Corporate managers, which do not appear on any tax invoice.' (Margaret Shaw, *submission 404*, p.1.)

'Not many people seem to realise (even though it is in their contract) that Body Corporate Service Companies are allowed to receive a commission of up to 20% on insurance products they procure for their clients. We find this to be unreasonable percentage...' (Geoff & Kathy Partridge, *submission 50*, p.1.)

'[the relationship between insurance brokers and Body Corporates] can be obscure, poorly disclosed, and not well known or understood by owners. The relationship between Body Corporate managers, brokers, insurers and their respective role in the market deserves further attention. Unlike house insurance, there are several levels between an owner and insurer.' (Mark Beath, *submission 298*, p.2.)

'I was surprised to learn about the extent of secret commissions being paid on Body Corporate insurance.' (Matthew Blackmore, *submission 377*, p.3.)

'There is a profit disincentive for Body Corporate managers to take measures towards facilitating an insurance market that would reduce our premiums [because they]...profit directly from increasing premiums through their percentage commissions. (Graham Janz, *submission 387*, p.8.)

'It is also known that there is a significant "kickback" (commissions) to the strata manager from the broker and or the insurance company IF the insurance policy recommended is taken out by the Body Corporate.' (Peter Brownscombe, *submission 98*, p.2.)

'With each increase in insurance cost, the commission to the broker increases proportionally, exacerbating the increases. One area for reform may be a set fee for commission for brokers.' (Mandy Sapper, *submission 111*, p.1.)

Commissions

- 4.5 Body Corporate managers may be unit owners who volunteer or are paid a fee to manage the business needs of their strata title complex, including sourcing insurance either directly through an insurance company or through an insurance broker. Alternatively a strata title complex may employ the services of a management company to act as their Body Corporate manager.
- 4.6 Under the BCCM Act in Queensland, a person is a Body Corporate manager for a strata scheme if:
- the person is engaged by the Body Corporate (other than as an employee of the Body Corporate) to supply administrative services to the Body Corporate, whether or not the person is also engaged to carry out the functions of a committee, and the executive members of a committee, for a Body Corporate.²
- 4.7 As policy premium costs have increased, so have the commission costs (such as Body Corporate manager or insurance broker fees) that are added to premiums and then passed on to individual unit owners. While commission costs are not drivers of premium increases, their commensurate dollar value rises as premium costs rise, and so they therefore contribute to overall price increases.
- 4.8 A number of issues were raised in relation to the fees and commissions charged, including:
- the independence and accountability of those accepting commissions,
 - the transparency of commissions charged, and
 - the value of the services.
- 4.9 The Committee took evidence from both unit owners who were the Body Corporate manager for their complex, and from representatives of Body Corporate management companies. The Committee also spoke to NIBA.

2 *Body Corporate and Community Management Act 1997 (QLD)*, p. 29.

Insurance brokers

4.10 The Committee heard evidence from a number of insurance brokers, including from NIBA. According to NIBA:

the traditional role of insurance brokers is to:

- Assist customers to assess and manage their risks, and provide advice on what insurance is appropriate for the customer's needs,
- assist customers to arrange and acquire insurance, and
- assist the customer in relation to any claim that may be made by them under the insurance.³

4.11 NIBA claims that brokers are skilled at offering tailored insurance packages and providing clients (Body Corporates) with detailed information on insurance options when selecting appropriate cover. They also offer assistance with submitting claims and suggest that they achieve 'a higher success rate with settlements (about 10 percent higher than claims made without a broker)'.⁴

4.12 In relation to the independence of advice offered, NIBA concede that in a small number of instances, the broker acts on behalf of the insurer rather than the Body Corporate. However, this is not the usual relationship and in such instances, full disclosure is required:

The NIBA make the qualification that, in limited cases, insurance brokers may act as agent of the insurer not the insured but where such a relationship exists the customer is clearly advised up front.⁵

4.13 During the public hearing in Canberra, the CEO of NIBA, Mr Dallas Booth, confirmed that unless particular brokers are acting as agents of insurance companies, and that relationship has been clearly explained to the customer, the fiduciary duty of brokers is always to their customers rather than insurers. This is dictated under financial services regulation.

4.14 Body Corporate managers are not bound by the same regulations and are not necessarily subject to the same fiduciary duty.

4.15 NIBA emphasises the difference between qualified insurance brokers and Body Corporate managers lies in market knowledge and independence. They assert that Body Corporate managers (a category that includes large companies) play a significant role in sourcing insurance due to their close relationship with the Body Corporates they manage.

3 National Insurance Brokers Association (NIBA), *submission 303*, p. 1.

4 NIBA, *submission 303*, p. 1.

5 NIBA, *submission 303*, p. 1.

4.16 However, NIBA doubts that Body Corporate managers are able to best serve the Body Corporate when it comes to sourcing or recommending the most appropriate and most competitive insurance option. Further, they suggest that the intervention of Body Corporate managers in negotiating insurance contracts may have contributed to the diminished involvement of other insurers in the market.

4.17 NIBA questions:

whether a lack of competition could to some degree be contributed to by the fact that strata managers act as a conduit in organising strata insurance. Such managers would typically have a relationship with one or a limited number of insurers. Unlike a traditional insurance broker they would not provide personal advice on the most appropriate strata insurance available for the strata Body Corporate.⁶

4.18 However, some witnesses questioned the accountability and independence of brokers, suggesting that initial premium prices may have been inflated in order to 'cover' the commission of the broker who then supposedly negotiated a reduction of the premium price.

4.19 Mrs Margaret Shaw, a unit owner and treasurer of her Body Corporate in Airlie Beach, suggested that the insurance offer provided by one company indicates them 'discounting the premium by the 20% [commission] loading' and goes on to add that:

the insurance companies actually add the commission onto the base premium, and then it is split between the brokers and Body Corporate managers according to their own agreement.⁷

Body Corporate managers

4.20 Body Corporate managers, whether individual unit owners or management companies, are paid a fee for services. In some instances this fee includes the task of sourcing insurance for the strata title complex. In other instances, managers charge a commission in addition to their usual fees to source the required insurance coverage.

4.21 Under the BCCM Act, Body Corporate managers have a legislated code of conduct, which includes requirements that they:

- have a sound knowledge of the Act, including the code of practice,

⁶ NIBA, *submission 303*, p. 7.

⁷ Mrs Margaret Shaw, *submission 404*, p. 2.

- undertake their engaged tasks with honesty, fairness, professionalism, skill, care and diligence,
 - act in the best interests of the Body Corporate,
 - keep the Body Corporate informed of any developments or issues,
 - ensure that employees comply with the Act and code,
 - supply goods and services at competitive prices,
 - keep Body Corporate records as required by the Act, and
 - not engage in fraudulent, misleading or unconscionable conduct.⁸
- 4.22 A further stipulation in the code relates to conflict of interest, though this is limited to any conflicts that might arise from the management of multiple strata schemes.
- 4.23 The response from the Western Australian Government to the 'Report into the Western Australian Strata Management Industry' in 2002, noted that while strata managers are responsible for ensuring they have complied with the state's strata laws, the evidence suggested that they can have little understanding of the relevant law.⁹
- 4.24 The Committee notes that Body Corporate managers in Queensland are similarly responsible for ensuring that strata schemes comply with relevant legislation. However, the Committee did not collect evidence on whether strata managers in Queensland had sufficient knowledge of the relevant Acts (as they are required to do under the legislated code of conduct). The Committee can therefore form no conclusions in this regard.
- 4.25 Neither the Act, nor the code specifically mentions or places clear legislated requirements on the payment or receipt of commissions.
- 4.26 When speaking to individual unit owners, some were unaware of the commissions paid to Body Corporate managers or had only become aware of the commissions since querying the premium increases and reading the fine print of the contracts. Several refer to these commissions, especially when there were cumulative commissions, as 'hidden' costs that add to the burden of strata insurance costs.¹⁰

8 *Body Corporate and Community Management Act 1997 (QLD)*, pp. 341-3.

9 Western Australian Government, 'Response to the Recommendations of the Legislative Assembly's Economics and Industry Standing Committee Report on the Western Australian Strata Management Industry', October 2003, p. 19.

10 See, for example, Mrs Margaret Shaw, *submission 404*, p. 1; Geoff and Kathy Partridge, *submission 50*, p. 1.

- 4.27 Mr Ian Campbell concedes that insurance brokers have a right 'to make a quid', however he objects to 'Body Corporate managers charging a commission on arranging that insurance. How many people have got their fingers in the till?'¹¹
- 4.28 Mr Campbell describes the situation as:
- just an absolute rort. We are paying these people a fee to manage our business and to then have to pay a commission on top of that. I think is absolutely disgraceful.¹²
- 4.29 Mrs Shaw comments on the size of some commissions paid to Body Corporate managers. She suggests there is a lack of transparency around these business dealings and how they might be recorded:
- when you consider the premiums for the larger complexes (replacement value >\$10M and >20 units) are now between \$77 000 - \$180 000, or more, a 20% loading (+GST and stamp duty) is a huge amount of money which is why the Body Corporate managers do not want it shown on the tax invoices.¹³
- 4.30 The UOAQ are also concerned about the additional commission cost and the scope for less than objective advice from Body Corporate managers:
- In addition to the premium increases there is also a practice where some Body Corporate Management Companies are receiving a commission for the insurance they recommend which is accepted and approved by Body Corporate management committees. These commissions are an additional cost which is paid for by unit/apartment owners and is in addition to the insurance premiums paid by unit and apartment owners.¹⁴
- 4.31 Mrs Shaw expresses concern about the accountability and independence of Body Corporate managers and brokers when it comes to insurance contracts. She suggests that both brokers and Body Corporate managers may have a greater allegiance to insurers as that is where they gain the commission.¹⁵
- 4.32 The lack of accountability and independence of advice was raised by Mr David Morgan as a key concern in relation to Body Corporate managers. He suggests that Body Corporate managers may lack independence and

11 Mr Ian Campbell, *Committee Hansard*, Monday 30 January 2012, Port Douglas, p. 18.

12 Mr Ian Campbell, *Committee Hansard*, Monday 30 January 2012, Port Douglas, p. 17.

13 Mrs Margaret Shaw, *submission 404*, p. 1.

14 UOAQ, *submission 328*, p. 10.

15 Mrs Margaret Shaw, *submission 404*, p. 1.

can wield too much power over the market for strata title insurance because of their close links with large insurers:

From my observations, the provision of Strata Insurance Policies in Australia is controlled by a very small group of Large Insurers, who derive a large percentage of their business through a system of appointing Strata Managers as their Distributors or Authorised Representatives. Strata Managers traditionally source the Insurance on behalf of Body Corporates and in doing so, will in turn, as a Distributor or Authorised Representative, receive a commission from the Insurer.

- 4.33 Mr Morgan also suggests that some commissions charged were particularly high and that current business arrangements were not necessarily benefitting Body Corporates. He adds that this lack of independence could be negatively impacting on market competitiveness:

Whilst not opposed to the payment of commissions for business provided, the levels of commissions can range from zero to 20% with the latter figure appearing to be the norm. Additionally some Insurance Companies act under 'Binders' for other Insurers, which in fact means they are acting for the other Insurance Company and not the Body Corporate seeking Insurance. Commissions in these instances can approach 30%.

At these levels of commission it is extremely difficult for smaller Insurers to compete in providing Strata Insurance as they would in most cases be unable to generate sufficient policies to allow such percentage payments to Distributors.¹⁶

- 4.34 From the evidence received it is apparent that there is a great variation in commissions charged by Body Corporate managers. However the Committee also heard of one instance where an insurance broker agreed to waive his fee to ameliorate the dramatic increases in premium prices.¹⁷
- 4.35 No doubt, as in any industry, there are a range of operators and business practices amongst those negotiating strata title insurance. The Committee commends those who act with integrity and transparency in the negotiation of insurance on behalf of Body Corporates, particularly those who have generously waived some fees.

16 Mr David Morgan, *submission 4*, p. 1.

17 Mr Anthony O'Rourke, *Committee Hansard*, Wednesday 1 February 2012, Mackay videoconference, p. 10.

- 4.36 Allegations of lack of transparency, accountability and independence are concerning, particularly at a time when many unit owners are under such financial stress. From these accounts there is obviously a need for Body Corporates to ensure that Body Corporate managers and/or insurance brokers provide a full disclosure of fees, duties expected and additional commissions.
- 4.37 At the conclusion of this chapter the Committee makes further comment about addressing transparency and accountability of commissions, and equipping Body Corporates with greater knowledge to oversee their business affairs.

Excess levels

- 4.38 The Committee notes some contradictory evidence was received in relation to how excess levels reduce premium prices.
- 4.39 On one hand, the Committee heard evidence from the ICA that raising excess levels would help reduce premiums. On the other, the Committee heard that recent increases in premium prices were accompanied by elevated or new excesses, particularly 'catastrophe' or 'named cyclone' excesses, and that these were becoming a standard condition in strata policies.¹⁸ These 'one-off' excesses are discussed in the following section.
- 4.40 In terms of the degree of flexibility enjoyed by Body Corporates in the balance of premiums versus excesses, the ICA suggests that part of the fault lies with strata managers, who:
- do not always lower premiums with excess or deductible settings. The setting of appropriate excess payments or retention levels is a mechanism widely used in insurance markets to reduce upfront premium costs to a client, by nominating an excess payment to be made at the time of a claim.¹⁹
- 4.41 The ICA argues that, in contrast to the residential housing market, the practice of agreeing to a higher excess in order to secure lower ongoing premiums is not the norm for strata title complexes:
- In the residential strata market there has been a long term trend by some strata managers to set excess payments as low as \$200 for

18 See, for example, Mr Andrew Hayes, *Committee Hansard*, Monday 30 January 2012, Cairns, p. 2.

19 ICA, *submission 380*, p. 2.

some aspects of cover, leaving premiums payable by their strata unit holders at very high levels.²⁰

4.42 It was reiterated to the Committee from insurance industry representatives that small excesses that were payable by individual lot owners led to a higher number of small or frivolous claims that, in turn, made insuring strata schemes more costly.

4.43 Zurich suggests that low excess levels are having a feedback effect on claims history, leading to increased premiums. Mr Shaun Feely from Zurich says that ‘we have a frequency issue that is quite high and that links to the excesses that are paid, and they are charged at an individual level.’²¹

4.44 Mr Whelan from the ICA emphasises that ‘there are flexibilities about being able to provide a dial down premium for an increased excess.’ He adds that:

the excess that would be paid on a claim – we are also talking about claims which do not happen every year – by a unit holder is reasonably light, it is not a particularly large impost on people if you have a dialled up excess. So yes it does prevent people putting in small claims which would build the constant claim profile, which drives the business into loss. Increased excess will reduce the premium but it also reduces the claims which continue to feed back into premiums.²²

Figure 3 A selection of various excess payments and their impact on typical strata premiums

	No Excess	\$200 Excess	\$500 Excess	\$1000 Excess	\$2000 Excess	\$5000 Excess	\$10,000 Excess
Annual Premium Payable	\$18,000	\$17,820	\$16,920	\$16,380	\$15,840	\$14,940	\$13,320
Annual Premium Payable per strata unit	\$1,125	\$1,113	\$1,057	\$1,021	-\$990	\$933	\$832
Premium Reduction due to excess payment	0%	-1%	-6%	-9%	-12%	-17%	-26%
Excess payment payable by each strata unit holder upon claim.	\$0	\$12.5	\$31.25	\$62.5	\$125	\$312.5	\$625

Example impact on annual premium of selecting excess payments – Varies depending on risk location and underwriting parameters
\$5,000,000 Sum Insured, 16 units, Residential Strata Property in Cairns – These levels of discount are not achievable by every insurer, it will vary depending on the underwriting model used.

Source ICA, submission 380, p. 6.

4.45 Figure 3, taken from the ICA’s submission, gives an indication of how various levels of excess payments impact upon typical strata premiums.

20 ICA, submission 380, p. 2.

21 Mr Shaun Feely, Committee Hansard, Monday 30 January 2012, Cairns, p. 9.

22 Mr Robert Whelan, ICA, Committee Hansard, Monday 30 January 2012, Cairns, p. 13.

- 4.46 The ICA further state that 'the average excess selected by individual home homeowners is \$500. In some instances strata unit owners have an average excess per unit of \$10.'²³
- 4.47 The Committee notes the need for Body Corporates to ensure that the managers or brokers whom they employ on their behalf are investigating all options to reduce premiums and provide a tailored insurance package with appropriate excess levels.
- 4.48 While increased excess levels may ameliorate some of the dramatic premium increases being experienced, they are not the sole driver or the sole solution to strata title insurance affordability.
- 4.49 The Committee also notes that in some instances, high excess levels are being set by the insurer for 'one-off' catastrophic events, such as named tropical cyclones.

Cyclone excesses

- 4.50 While insurers are encouraging Body Corporates to set higher excess levels in order to reduce the frequency of claims and rates of pay-outs, there was also evidence of extraordinarily high excesses being mandatorily set by insurers in some circumstances.
- 4.51 Many witnesses referred to the recent addition of large excesses being charged on policies in the event of 'named cyclones'.²⁴
- 4.52 Ms Linda Tuck, a realtor and investor in strata properties states that the introduction of these large excesses is significant. While technically complying with the law by having strata title insurance, the effect of such large excesses for named cyclone events is that individual unit owners feel exposed to large losses - which is contrary to the purpose of seeking insurance cover. Ms Tuck explains that:

If a cyclone does hit, many of the complexes now have ridiculously high excesses for named cyclones. The highest we have is \$25 000, which went up from \$100 plus premium. If we do have a claim, this will essentially take away half our sinking fund. The knock-on effect would be that either the work does not get done or owners have to pay a special levy.²⁵

23 ICA, *exhibit 1*, p. 1.

24 See, for example, Mr Ian Cruickshank, *submission 130*, p. 1; Ms Kim Hughes, *submission 305*, p.1; Ms Linda Tuck, *Committee Hansard*, Monday 30 January 2012, Cairns, p. 27; Ms Judy Hayden, *submission 100*, p. 1.

25 Ms Linda Tuck, *Committee Hansard*, Monday 30 January 2012, Cairns, p. 27.

4.53 Ms Tuck goes on to say that in her experience working with several Body Corporates to negotiate insurance policies, there is no option to negotiate on these special excesses. She notes that the level of cyclone excess set is:

mandatory. They still have a \$100 excess or a \$500 excess for other claims but for a named cyclone event the least they have is at \$10 000 and the most they have is at \$25 000.²⁶

4.54 Ms Kim Hughes is worried that her strata insurance policy included a \$15 000 'named cyclone' excess, which excludes cover for storm surge. Ms Hughes finds it 'very concerning, given the fact that storm surge is the biggest threat facing this building complex, yet we are unable to obtain cover for such an event'.²⁷

Claims history

4.55 The previous chapter discussed the contribution of claims history as a cost component to the insurance premium stack. In particular, the ICA suggests that Queensland experiences a higher number of claims than other parts of the country, and further that strata title policy holders have a higher frequency of claims than other types of residential housing. The combination of these factors adversely impacts the risk profile of strata title complexes in north Queensland.

4.56 While some witnesses dispute that Queensland has a higher claims frequency than other parts of the country, or that strata title complexes have a higher claims frequency than residential standalone households, the Committee must trust the data collated and published by insurers themselves.

4.57 The previous chapter includes data provided by the ICA showing that Queensland contributed to 25 percent of all national insurance claims, despite contributing only 15 percent to the national premium pool.²⁸

4.58 Further, the ICA reports that some insurers are experiencing claim frequencies of 30 percent for their strata portfolios, in comparison to an average of 10 percent for their residential home portfolios.²⁹

26 Ms Linda Tuck, *Committee Hansard*, Monday 30 January 2012, Cairns, p. 27.

27 Ms Kim Hughes, *submission 305*, p.1.

28 ICA, *submission 380*, p. 4.

29 ICA, *submission 380*, p. 2.

- 4.59 Mr Feely from Zurich notes that, in the north Queensland strata insurance market, his company is experiencing claim frequencies in the order of 30 to 40 percent, which is far higher than for general insurance.³⁰
- 4.60 Notwithstanding these figures, the lack of transparency provided to customers by insurers about how their strata complex's history of claims is factored into the pricing of premiums is a common cause of frustration expressed during the inquiry. Many submissions the Committee received from owners in strata schemes express their concerns that their insurance premiums have increased despite low claim histories.³¹
- 4.61 At the Townsville public hearing, Mr Pavey says that insurance brokers provide insurers with claims history 'verbatim', however, he says that companies 'do not discount for a good claims history. They knock you back if you have a bad one. That is essentially the way they deal with it.'³²
- 4.62 Many witnesses express concerns that the quality of their buildings under various building codes are not taken into account in the calculation of their premiums. In particular some witnesses who were unit owners claim that premiums have unfairly gone up when the buildings have not suffered any damage during recent weather events.³³
- 4.63 The Committee notes that with further questioning, some witnesses concede that the Body Corporate have made claims during those weather events for damage to trees or fences.³⁴
- 4.64 It is not unreasonable to expect that the claims history for strata title complex will impact on premium levels for future years – regardless of whether claims are for damage to garden areas or to buildings. For the insurer, the risk remains of similar damage in the future following a similar weather event.
- 4.65 However, the issue of claims history is a vexed one and reveals issues about the provision of information by insurers to Body Corporates, and from Body Corporates to unit holders.

30 Mr Shaun Feely, *Committee Hansard*, Monday 30 January 2012, Cairns, p. 9.

31 See, for example, Mr Matthew Blackmore, *submission 377*, p. 2; Sea Temple Palm Cove Body Corporate, *submission 126*, p. 1; The Committee of Josephine Palms, *submission 361*, p. 1; Mr Warren Pitt, *submission 397*, p. 1.

32 Mr Raymond Pavey, *Committee Hansard*, Wednesday 1 February 2012, Townsville, p. 25.

33 See, for example, Mr Don Cunningham, *submission 121*, p. 1; Dr Janice Crowley, *submission 389*, p. 1; Mr David Wah Day and Mrs Audrey Wah Day, *submission 424*, p. 1.

34 See, for example, Dr Janice Crowley, *Committee Hansard*, Monday 30 January 2012, Cairns, p. 25; Witness B, *Committee Hansard*, Wednesday 1 February 2012, Townsville, p. 36.

- 4.66 It was revealed that in many instances a Body Corporate may make a claim on its insurance without the knowledge of all individual lot owners. It was also reported that in some instances a unit holder may make a claim without the full knowledge of the Body Corporate.
- 4.67 This lack of collective responsibility and knowledge is concerning in light of the consequences for the collective. It is obvious that such a set of circumstances could encourage a culture of claiming amongst some, with many unit holders unaware of the claims being made but forced to then bear the costs of increased premiums.
- 4.68 Again, there is a need for greater transparency in how insurers determine a claims history based on both locality and the actual building complex. The Committee notes the recommendations made earlier in this report in regard to examining the methodologies insurers utilise to assess and price risk.
- 4.69 Additionally there is a need for Body Corporates and Body Corporate managers to retain greater oversight over their business affairs, including claims made on strata title insurance. This would enable them to better negotiate based on a low claims history, and to make more informed choices about when it is prudent to make an insurance claim.
- 4.70 The Committee makes further comment on these issues at the conclusion of this chapter.

Building codes

- 4.71 Another major concern is the lack of transparency in the manner in which building valuations, and the quality of particular buildings in relation to building codes and cyclone ratings, are taken into account in the calculation of premiums.
- 4.72 Throughout the inquiry many witnesses referred to their buildings being built to improved (and more expensive) cyclone ratings standards and commented that those buildings emerged relatively unscathed from recent disaster events, while nearby stand-alone homes suffered substantial, or total losses.
- 4.73 Mr Steven Malcolm, the Managing Director of a building consultancy and property development company in northern Queensland, directed the

Committee's attention towards a report produced by the James Cook University's Cyclone Testing Station.³⁵

- 4.74 Mr Malcolm's assessment of the report, 'Tropical Cyclone Yasi Structural Damage to Buildings dated April 2011', leads him to assert that:

there should be a consideration by the insurance companies of the performance of different types of buildings, constructed of different types of materials, and particularly the year of construction i.e. whether the building was constructed pre-or post 1980 as more than adequately discussed in the above-mentioned report.³⁶

- 4.75 Mr Malcolm notes the changes to building codes implemented in the 1980s, and the need to discriminate between buildings of different eras.

From 1980 there was a significant change in the structural construction requirements of the codes that were then legislated at that time. Therefore the structural damage that was sustained by houses and other buildings during cyclone Yasi constructed post 1980 was significantly less than those constructed pre-1980.

The point being that the owners of buildings constructed post 1980 should not have to bear the same cost of insurance premiums as that of older buildings. Whether the roof is of concrete tiles or steel sheeting appears to be another important consideration.³⁷

- 4.76 The author of the report, Dr John Ginger, confirms that recent studies have shown that:

houses built to current engineering regulations that were introduced in the early 1980s – have significantly better structural performance compared to houses built prior to the introduction of these standards.³⁸

- 4.77 The rigour of building codes in north Queensland ensures many buildings can withstand extreme weather events. However, it is also noted that these codes imposed additional costs should a building require repair.

- 4.78 Additionally, for any building constructed prior to the current building codes, reconstruction or repair work must comply with current codes and

35 Mr Steven Malcolm, *submission 147*, p. 1.

36 Mr Steven Malcolm, *submission 147*, p. 1.

37 Mr Steven Malcolm, *submission 147*, p. 1.

38 Dr John Ginger, *Committee Hansard*, Wednesday 1 February 2012, Townsville, p. 2.

consequently the costs may be extensive. Compliance with building codes, while protecting against damage also incurs the risk of costly repairs.

- 4.79 From the evidence received it is unclear the extent to which strata title insurance policies are being tailored to specific complexes and taking into account cyclone ratings and compliance with current building codes. Equally it is unclear the extent to which these same codes impose the risk of additional costs should a claim for repair be made.
- 4.80 Once more the Committee concludes that it falls primarily to insurers to improve their communication with clients, including notifying how construction style, assets covered, claims history and other factors may positively or adversely impact on a complex's risk profile.
- 4.81 However, the Committee considers that Body Corporates must accept a degree of responsibility to ensure that all relevant details, including adherence to current building codes and a claim-free history, are duly taken into account by the insurer.
- 4.82 The Committee acknowledges that in the current market of limited competition, policy holders have limited choices and hence limited negotiation power. The suite of recommendations set out in this report is intended to redress the perceived risk profile of strata title schemes and so attract further competition back into the north Queensland strata title market. This will assist in restoring the balance of power and provide Body Corporates with a greater range of options in seeking appropriate cover.

Full replacement cover

- 4.83 While all states and territories require strata title complexes to be insured for full replacement value, concerns were raised about the lack of flexibility this allowed Body Corporates in their insurance arrangements.³⁹
- 4.84 Evidence received by the Committee to this inquiry is focussed on the Queensland jurisdiction. Consequently the following sections refer to the legislative requirement for full replacement cover for strata title complexes and the possible impact of this requirement for strata title insurance premiums in Queensland.

39 See, for example, Mr Ian Campbell, *submission 281*, p. 2; Mr Garry Masters, *submission 95*, p. 3; Mr Terry Balson, *submission 68*, p. 2.

4.85 Mrs Pauline Stirgess suggests that the legal requirement for full replacement value leads to over-insurance of buildings that are capable of withstanding the majority of extreme weather events. She states:

the law requires that all Body Corporates are insured for the full replacement value of any building. This means that we are very much over-insuring in the majority of buildings. Modern buildings are now built to strict council requirements to withstand cyclones and they would, even in the event of a Category 5 cyclone, will withstand most of the damage and perhaps in the worst case scenarios will only lose the roof or have partial damage to some apartments from storm damage.⁴⁰

4.86 Mr Ian Campell, a unit owner from Port Douglas, believes that current legislative requirements for insuring strata schemes for full replacement value are discriminatory and contributes to an anticompetitive market. Mr Campbell says that:

Other than 3rd party motor vehicle insurance, there is to my knowledge, no other mandatory insurance under QLD legislation (except maybe in financial contracts). If any entity wish[e]s to insure anything of value, they are not legally enforced to do so. They can select their own opinion of Insurable value & negotiate with their insurer a mutually satisfactory premium. Or they can elect not to insure at all.⁴¹

4.87 Mr Garry Masters asserts that strata schemes should not have to insure for full replacement value, but rather for the current market value (i.e. sale price) of the property. Mr Masters says that 'insuring for total replacement value has provided the insurers with a total replacement value on which to base premiums which is more often as not, up to 100% higher than market value'.⁴²

4.88 In listing the following factors, Mr Masters suggests that many of them had an inflationary effect on the replacement value of a strata complex:

- Demolition of remaining parts of the building
- Cost to reclaim the site and prepare same for rebuilding
- Headworks and local council fees
- All other fees relating to services to be provided to the new building
- Cost of the materials and labor to rebuild, and

40 Mrs Pauline Stirgess, *submission 185*, p. 3.

41 Mr Ian Campbell, *submission 281*, p. 2

42 Mr Garry Masters, *submission 95A*, p. 1.

- Cost of landscaping and roadworks on site and gaining access to site.⁴³

- 4.89 Mr Colin Archer from SCA draws the Committee's attention to the practical implications and legal constraints around insuring for less than full replacement value, particularly for buildings nearing the end of their habitable life. He notes that, regardless of how old a building was, 'if someone gets hurt, you have to maintain it and you have got to insure it as though it were a new building. There aren't really any options.' Mr Archer adds that 'if it is habitable, you have to insure it for its full replacement value because you cannot take a lesser value under the Act.'⁴⁴
- 4.90 Certainly the requirement to insure for full replacement value provides added protection for unit holders in the event of a disaster, but also adds to premium costs which must be sufficient to cover reconstruction and replacement of all amenities and assets. Considering the rigour of building codes in north Queensland, it is more likely that a post-1980 building will withstand an extreme weather event relatively unscathed, while other infrastructure and assets in the complex may be significantly damaged.
- 4.91 Currently all aspects of a strata title complex must be insured for full replacement value. In most instances this puts the replacement valuation considerably higher than the market value of a complex.
- 4.92 Given that certain elements of shared property might be deemed non-essential to replace (for example, plants and garden sheds), and that consensus could be achieved within a Body Corporate on what is necessary to replace, there is merit in reviewing the legislative requirement across jurisdictions with the view to introducing greater flexibility in the minimum insurance cover required. This may provide some scope to reduce premium levels.

Valuations

- 4.93 In Queensland, as in other states, Body Corporates are required to have their strata scheme assessed to obtain a full replacement value every five years.
- 4.94 Assessing replacement value is a more complex task than determining current market value. The Committee notes that many unit owners do not appear to understand that the valuation required for strata title insurance purposes refers to full replacement value, rather than market value.

43 Mr Garry Masters, *submission 95*, p. 2.

44 Mr Colin Archer, *Committee Hansard*, Monday 30 January 2012, Port Douglas, p. 7.

- 4.95 In addition, the Committee heard of significant variations between full replacement valuations for the same complex. Such differences can substantially impact on premium prices. For example, one building was assessed for \$25 million, only to be valued by a different assessor for \$19 million the same year.⁴⁵
- 4.96 Concerns were also raised about additional cost factors that contributed to elevated valuations. In his submission, Mr Warren Pitt says that he had been given a valuation on his strata scheme and then had an additional 39 percent added on to account for 'Cost Escalations, Fees & Charges and Removal of Debris'. According to Mr Pitt:
- The final paragraph from the Valuer's report states that 'following the occurrence of possible catastrophic circumstances the sum insured for should further be increased' and the recommendation was a staggering 79% increase in the 'Replacement Building Cost'.⁴⁶
- 4.97 The Committee understands the logic for including such components in the assessment of full replacement value, yet it has concerns about the accuracy of the methodologies used to arrive at such inflated values. No evidence was presented to the Committee during this inquiry that unpacked or explained these processes.
- 4.98 The Committee would expect an insurance broker and many Body Corporate management companies to have some expertise in verifying the validity of a valuation. Similarly the Committee encourages Body Corporates to take an active role in understanding how a valuation for full replacement cover has been assessed and the components contributing to that cost.
- 4.99 Further comment on flexibility in strata title insurance arrangements is made at the conclusion of the chapter.

45 Mr Anthony Sharp, *submission 283*, p. 1.

46 Mr Warren Pitt, *submission 397*, p. 3.

Box 4.2 Townsville and Mackay: ‘The massive increases in insurance have the ability to smash people's dreams.’

“As more and more insurance companies have pulled out of the strata building industry, we have really arrived at a monopoly situation...We are captives because legally we have to insure our strata buildings. We cannot refuse to insure, so we are all helpless — absolutely helpless. This again has led to rorting on a grand scale — in my words, tantamount to theft...There will be more forced sales at reduced values, bank foreclosures, fear, distress and anger, with no end in sight.’ (Mr Lester Riley, *Committee Hansard*, Townsville, 1 February, p.13.)

‘I feel that I am in a movie which is a cross between *The Castle* and *Erin Brockovich*. It would be funny if it were not so tragic. We are hurting and it is only getting worse. It is not right and it is not fair.’ (Margaret Shaw, *Committee Hansard*, Townsville, 1 February, pp.14, 15.)

‘If the Body Corporate[s] are legally required to purchase the product that the insurers are selling at the price that the insurers nominate, what protection is there for us against rapacious insurance companies?...Extortion is demanding money with menace. The insurers are demanding my money...It is a disgraceful situation and it is bringing many pensioners to their knees...it is a catch-22 position. We cannot afford to pay the premiums; we cannot afford any more increases. Our investments are going down. We cannot even sell them. If we did have a claim, we cannot afford the excess.’ (Nanette Grace, *Committee Hansard*, Townsville, 1 February, pp.17, 19.)

‘When I spoke to our broker down south, he basically said, ‘Look, if you're in this part of the world, the insurers don't want to know you anymore; it's just the problem.’ If they are also flagging future increases, where do we turn to from here? There is only so much we can absorb in terms of insurance increases.’ (Anthony O'Rourke, *Committee Hansard*, Mackay, 1 February, p.10.)

‘The massive increases in insurance have the ability to smash people's dreams.’ (William Moffat, *Committee Hansard*, Mackay, 1 February, p.6.)

Committee Comment

- 4.100 The Committee is concerned about the apparent lack of disclosure in the commissions and apparent hidden discounts negotiated by intermediaries in their dealings with insurers on behalf of Body Corporates. The Committee sees the need for honest and transparent disclosure of every component that comprises strata insurance premiums.
- 4.101 In particular the Committee notes suggestions of a lack of transparency, accountability and independence from some Body Corporate managers

and insurance brokers. This evidence is anecdotal and in the scope of this inquiry the Committee did not have the capacity to investigate these allegations.

- 4.102 The Committee is aware of the difference between the roles of Body Corporate managers and qualified insurance brokers. Insurance brokers are bound to provide a full disclosure of any relationship that may exist with an insurer, although it is rare for such a relationship to exist. The broker must disclose all fees and commissions received from all sources.
- 4.103 The Committee considers that it is incumbent on Body Corporates or the Body Corporate manager who may be liaising with an insurance broker to ensure full and obvious disclosure of all information as part of establishing a contract with the broker.
- 4.104 Where a Body Corporate manager or management company negotiates directly with an insurer, there are not necessarily the same regulatory obligations placed on them for disclosure of relationship or commissions. The Committee considers this a severe deficiency in current requirements.
- 4.105 The Committee considers that Body Corporate managers should be similarly accountable to their clients, particularly when they act as intermediaries in negotiating strata title insurance matters.
- 4.106 However, once again an onus must rest with the Body Corporates to oversee their business affairs and dictate the terms and conditions under which a Body Corporate manager or management company is engaged to operate on their behalf.
- 4.107 The Committee draws no conclusions from the limited evidence received regarding improper practices on the part of Body Corporate managers or insurance brokers. However, the issue is sufficiently serious to warrant further investigation than the Committee was able to undertake.
- 4.108 Consequently, the Committee recommends that the ACCC undertake a preliminary investigation of the use of intermediaries to negotiate strata title insurance, with a particular focus on the north Queensland market. The ACCC should consider whether there is evidence of improper or anticompetitive behaviour taking place between intermediaries and insurers, and determine whether a full investigation is required.

Recommendation 6

4.109 **The Committee recommends that the Australian Competition and Consumer Commission undertake an investigation into the use of intermediaries to negotiate strata title insurance cover, in order to determine whether there is evidence of improper or anticompetitive behaviours taking place.**

The investigation should focus on the Queensland market and indicate whether there is evidence to suggest a more thorough investigation is required. The report of the preliminary investigation should be made public by 1 October 2012.

4.110 The Committee is firmly of the view that a number of factors are combining to excessively increase strata title insurance premiums in north Queensland. Many of these factors are beyond the control of Body Corporates and individual lot owners. The purpose of this inquiry is to mobilise urgent action across a number of fronts to investigate the market failure in this sector, and bring attention to bear on how insurers are pricing the risk of strata title complexes in north Queensland.

4.111 The Committee anticipates the recommendations made in the previous chapter will lead to a greater market involvement and a more robust methodology for pricing risk.

4.112 That said, the Committee also sees scope for Body Corporates to be better equipped around their rights and responsibilities when it comes to managing their affairs. In a tight insurance market with steep premium increases, there are a number of measures that can be taken to ensure that the most appropriate and competitive premium price and coverage is achieved.

4.113 The Committee also recognises that there are a number of Body Corporates who are well informed and who have actively pursued all available options already. However, this does not apply to all Body Corporates and unit holders. Furthermore, the Committee is aware that the premium for one strata title complex is influenced by the behaviour of other strata title complexes in the locality.

4.114 The Committee has received data which indicates that, overall, strata title complexes in the north Queensland region have lower excess levels and higher claim frequency than standalone residences.

- 4.115 Body Corporate structures are complex, and the Committee acknowledges that individual unit owners will often have had no prior experience in many of the matters which a Body Corporate must oversee, negotiate, make decisions on and forecast. In essence, each unit owner when purchasing into a strata title complex becomes part of a complex business management structure, usually without training or knowledge of how to access resources to assist them in these duties.
- 4.116 Often unit owners outsource their research into a Body Corporate prior to purchase to a solicitor acting on their behalf in the purchase. Thus, while the information may be obtained, it is not necessarily known by the purchaser.
- 4.117 The complexity of Body Corporate arrangements is the reason many Body Corporates employ a manager or management company to direct their affairs. However even this delegation requires a contractual arrangement and necessitates the Body Corporate overseeing the performance of the Body Corporate manager.
- 4.118 The Committee considers that Australian Consumer Law (ACL) could assist in the provision of plain English assistance to Body Corporates regarding contract responsibilities.
- 4.119 The ACL is a cooperative reform of the Australian Government and the States and Territories, through the Ministerial Council on Consumer Affairs (MCCA). The ACL framework replaces 20 existing State, Territory and Australian Government laws with a single consumer law. The ACL provides consumers with a law that is easier to understand and is better enforced.
- 4.120 Given that the issues raised in this inquiry appear specific to the Queensland market, the Committee sees a clear role for the Queensland Commissioner for Body Corporate and Community Management (the Commissioner) to assist in better equipping individual unit holders and Body Corporates to competitively manage their affairs.
- 4.121 The role of the Commissioner is to assist people who live, work or invest in Queensland strata schemes in accordance with the powers conferred on it by the BCCM Act. The Commissioner's office provides a range of valuable information and tools, including an online training course for Body Corporate members, committees and industry groups.⁴⁷

47 Queensland Commissioner for Body Corporate and Community Management, <<http://www.justice.qld.gov.au/justice-services/body-corporate-and-community-management>>, viewed 7 March 2012.

- 4.122 Similar online resources are offered by Strata Community Australia in New South Wales.⁴⁸
- 4.123 The Committee acknowledges that some detailed resources and training are already made available through the Queensland commission. However, the online training package does not refer to legislative requirements for insurance, how strata title insurance differs from other forms of insurance, cost factors, and strategies to consider when negotiating appropriate insurance coverage.
- 4.124 The Committee considers that, while there is a weak strata title insurance market in north Queensland, it is of paramount importance that Body Corporates more actively oversee their insurance affairs, ensuring that they are accessing the most competitive pricing available, and that the insurance coverage is adequately tailored to their individual complex.
- 4.125 This requires Body Corporates being able to confirm from their manager or insurance broker that a number of factors have been considered by the insurer in assessing the individual risk of a strata title complex. Such factors might include:
- alternative excess settings,
 - claim history, including claim frequency and size of claim pay-outs,
 - building materials, compliance with building codes for main buildings and other structures on the complex,
 - cyclone and disaster resilience of infrastructure and other assets on the complex,
 - fire protection systems and other mitigation devices,
 - presence of onsite manager, and
 - accurate valuation for full replacement.
- 4.126 The Committee considers that, given the complexity of strata title arrangements, Body Corporates should have access to improved resources to assist them in the management of their affairs, in particular in sourcing the most competitively priced and appropriate insurance cover available.

48 Strata Community Australia NSW, <<http://nsw.stratacommunity.org.au/page/education/free-online-executive-committee-training>>, viewed 7 March 2012.

Recommendation 7

4.127 **The Committee recommends that the Australian Government, through the Australian Consumer Law framework, work with the Insurance Council of Australia and the Queensland Commissioner for Body Corporate and Community Management to improve the information and education resources available to Body Corporates and better equip them in the management of strata title affairs, with a focus on:**

- **understanding the cost components specific to strata title insurance, such as unlimited liability, Stamp Duty and GST, and valuations based on full replacement costs,**
- **consumer awareness of the contractual obligations to disclose fees and commissions, and the responsibilities pertaining to the contractual relationships between Body Corporates and their appointed managers or management companies, and and/or insurance brokers, and**
- **recognition of the factors which may contribute to the risk profile of a strata title complex and in particular factors which may assist in negotiating decreased premium pricing, such as varying the agreed excess.**

The Minister for Financial Services should be provided with a summary of the measures undertaken to address these needs by 1 December 2012.

4.128 The Committee has reviewed the legislative arrangements for Body Corporates in Queensland and has concluded that there is significant scope for confusion amongst both consumers and professionals working in the sector. The Committee notes that strata title arrangements are characterised by a complex interplay between Australian, state and local government legislation. Given that the Committee has only focussed on the experiences of Body Corporates in Queensland in this inquiry, the Committee is aware that the situation is far more complicated on a national level.

4.129 While many of these legislative and regulatory requirements are there for the protection of individual unit owners, the Committee considers a review of the extent of these requirements is warranted.

4.130 The Committee concludes that full replacement cover for residential areas of strata title complexes is essential and must not be compromised.

Further, other essential components of a strata tile complex such as shared access ways must be insured for full replacement cover as part of the common property of a Body Corporate.

- 4.131 However, there are some aspects of a complex for which it may not be necessary to secure full replacement cover, if these are non-essential parts of the complex and if it is the collective agreement of the Body Corporate to cap the insured value.
- 4.132 The Committee considers there is scope to consider such flexibility. Non-essential items may include garden areas or sheds – items which are probably of a low value in proportion to the total value of a complex. However, these may also be the types of items most susceptible to damage during disaster events such as a cyclone.
- 4.133 In addition, there are some instances where a complex has a strata title arrangement in order to cover a small area of common property – such as a shared driveway or fencing. Given the complexity of strata title arrangements and the additional requirement they necessitate in relation to insurance, the Committee recommends that the dissolution of strata titles should be a more accessible option where this is appropriate.
- 4.134 The Committee repeats its concern that Body Corporate managers may not be subject to the same regulatory requirements for full disclosure of fees, commissions or relationships when they undertake an intermediary role to secure insurance cover. The Committee recommends that these requirements for transparency, accountability and independence be reviewed and strengthened as required.
- 4.135 The findings of the Western Australian inquiries into Body Corporate arrangements suggest that these issues are not confined to Queensland, and that a legislative review should take into account the complex legislative and regulatory requirements across all jurisdictions.

Recommendation 8

4.136 **The Committee recommends that the Attorney-General conduct a review of state and territory legislative and regulatory requirements around strata title insurance. The review should consider:**

- **options to provide strata title complexes with greater flexibility in their choice of insurance arrangements, including the availability of tailored arrangements that may offer capped**

- insurance cover on non-essential assets or infrastructure,
- the need to expand the role of the Financial Ombudsman Service to encompass strata title insurance issues,
- regulatory requirements to increase transparency in the disclosure of commissions and fees taken by intermediaries, such as insurance brokers and Body Corporate managers, and
- mechanisms to simplify the legal process for the dissolution of strata schemes.

The review should be completed by 1 October 2012. The findings and recommendations of the review should be raised with the Standing Committee of Attorneys-General.

Concluding remarks

- 4.137 The Committee understands that it has become almost impossible to source residential strata title insurance at sustainable premium levels, particularly in north Queensland. The Committee is aware that urgent action needs to be taken to ensure that premium levels do not continue to rise and that Body Corporates are able to access affordable and appropriate levels of cover.
- 4.138 It was clear to the Committee that increases in residential strata title insurance have placed many people under serious financial and emotional pressure. It is understandable that insurance-driven increases in Body Corporate fees of the magnitude described in this report have made many people feel extremely anxious about the future, and that it is almost impossible to budget for these increasing costs.
- 4.139 The Committee is acutely aware of the precarious position these increases have placed pensioners and retirees in, especially in the aftermath of the Global Financial Crisis which had such a disastrous impact on many people's superannuation and savings.
- 4.140 The Committee is conscious of the potential negative long-term effects that increases in strata insurance may hold for the economy of coastal north Queensland. The evidence already suggests a localised decline in property prices and investment, while the state struggles to get back onto its feet in the wake of the 2010-11 disaster events.
- 4.141 In its earlier report, *In the Wake of Disasters: the operation of the insurance industry during disaster events*, the Committee recommended the immediate establishment of a taskforce to address the rising costs and potential

market failure in the insurance industry across Australia. The Committee reaffirms its support for this recommendation and trusts that the Government will take appropriate action in a timely manner.

- 4.142 The Committee undertook this inquiry with the knowledge that the affordability of residential strata title insurance is an urgent issue. In recognition of this urgency, many of the recommendations set out in this report have clear timeframes associated with them.
- 4.143 The recommendations address the regulatory frameworks, methodologies for the assessment and pricing of risk, and consumer awareness. They dictate a strong and clear course of action that will unravel the complex and interrelated factors contributing to this issue and will enable appropriate reforms to be implemented.
- 4.144 The Committee confirms its support for a strong and competitive insurance industry in Australia; one that is able to fulfil its function of carefully assessing the cost of the risk underwritten and then calculating fair and equitable premiums accordingly.
- 4.145 The Committee urges the Australian Government to act quickly on the recommendations contained in this report, to conduct the necessary reviews and investigations and to carry out appropriate reforms where required and in a timely manner.

Recommendation 9

- 4.146 **The Committee recommends that the Australian Government outline the plan of reforms it will undertake, in conjunction with relevant State and Territory governments where necessary, in order to establish a competitive and affordable insurance market for residential strata title insurance.**

The plan should be announced before 1 December 2012, be informed by the reviews and investigations recommended in this report, and have a particular focus on the north Queensland area.