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YSP Podcast Transcript: Episode 349. Why we must resolve the conflicts of interest in our strata insurance arrangements - John Trowbridge

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Intro: Welcome to Your Strata Property, the podcast for property owners looking for reliable, accurate, and bite-sized information from an experienced and authoritative source.

Amanda Farmer: Hello and welcome to this week's podcast episode. I am your host strata lawyer, Amanda Farmer, and my guest this week is John Trowbridge. John has had a distinguished career as an actuary, consultant, executive company director and regulator working mainly in financial services with an emphasis on insurance-related businesses. He founded Trowbridge Consulting in the 1980s, becoming a leading actuarial and management consulting firm in Australia and Asia, specialising in insurance and merging with Deloitte in the year 2000.

John has held senior executive positions at QBE and Suncorp, and from 2006 to 2010, he was the APRA member for insurance. John chaired the Australian Government's review of natural disaster insurance following the 2011 floods, and in 2015 he chaired an industry working group to recommend reforms in the life insurance industry. Those reforms came into effect in 2018. In 2021, John conducted an independent strategic review for the Insurance Council of Australia on the affordability and availability of commercial lines of insurance in Australia.

The council accepted all 13 of his recommendations. Last year, 2022, John commenced an independent review of strata insurance concentrating then on the disclosure practices of strata managers and brokers, as well as the way in which commissions and fees are structured. John is currently working on the final phase of his review, which focuses on the affordability and availability of strata insurance. Now, I first mentioned John's work and shared his phase one and phase two reports in December last year. Just before Christmas, I spoke about John's findings during one of our regular and increasingly popular Friday live sessions over on our Facebook page. A link to that one in the show notes for this episode. That short chat sparked a lot of discussion, a lot of questions, and it became clear to me that while the topic may appear a little complex strata insurance practices, especially when it comes to disclosure, transparency, fees and commissions are of great interest to owners.

And slowly but surely, we are gaining a better understanding of precisely how much we just don't know about how our insurance premiums are calculated, who is being paid out of that premium and why it is so important that we do take the time to understand this so we can make better and informed decisions about our insurances and possibly in the process reduce the cost of our premiums.

Now, this conversation with John takes us further down this path of understanding and I think he does an excellent job of explaining what are otherwise on the surface complex arrangements. John and I spoke for close to an hour when we recorded this episode, so I've decided to do something I don't do very often. I think perhaps it's only been done once in the seven-year history of this podcast. I'm delivering this chat in two parts. Today you'll hear part one in which John explains the history of our strata insurance sector, how and why brokers came to be involved and why commissions and broker fees are today so firmly entrenched in our system.

John speaks to the lack of transparency around commissions and broker fees and why that's not only a problem but a source of a conflict of interest for our strata managers. John also speaks to how we might solve that problem and avoid that conflict. He explains why we need to step up and change the way we do things now before government intervenes. And John identifies the insurer stakeholders who are recognising this need to step up and change.

Part two of our chat will be published next week. At the end of this episode today, I'll pop back in to give you a heads-up on what John will be sharing with us next week in part two. Right now I'll take you over to part one of my chat with John Trowbridge. John Trowbridge, welcome to the show.

John Trowbridge: Thanks, Amanda. Nice to see you this morning.



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Amanda Farmer: Nice to see you too, John, and to be chatting with you online about this very important topic. Let's start here. Tell us why does there need to be a review of strata insurance practices? What is going wrong in this space?

John Trowbridge: Well, there are two main things. The first one is that there is a confusing situation where strata managers receive a share of broker commissions. Brokers then seek a broker fee from the strata manager, and that system is quite controversial in fact. The other reason is that we've seen affordability become a problem in strata insurance. Prices have risen quite sharply over the last three or four years and it looks like they will rise sharply again this year. And that creates affordability problems of different kinds and it also creates availability problems in some situations. So those two things are the background to why this project is being done.

Amanda Farmer: John, this broker commission, share of broker commission's, broker fee arrangement, is this something new or is this how strata insurance has always been done? Maybe if you can give us a bit of background.

John Trowbridge: Yes. Okay. Well, the origins of it, it's a historical development and it's nobody's fault that it's turned out the way it has because in the beginning, the beginning being in the 1970s when strata insurance first came onto the market as an individual product, there were brokers involved and CHU was the company that entered the industry, created the market. And the people at CHU realised fairly quickly that they had to deal with strata managers not directly with the lot owners. And they did that. And both sides did a very good job. Because the strata managers helped out at CHU, which was an underwriting agency, and the underwriting agency CHU helped educate the strata managers. And there was a commission paid by CHU to the strata managers. I think initially it was more like 5 or 10%.

Anyway, time passed SUU entered the market in the 1990s. There were still very few brokers. Brokers began to emerge in the two thousands, and by this time the commissions had risen probably for competitive reasons to 15% or 20%. And then in 2015, the New South Wales government legislated that there'd be three quotes for insurance given each year, arranged each year by strata managers. Strata managers obviously found that a difficult thing to do on their own and brokers came to their assistance. So this is all still a very logical development and a very sensible one. So you've now got two intermediaries, the strata manager, and you've got the broker as well, and they both want to be paid. Now what's happened is that the strata managers have wanted to maintain most or all of the 20% commission that they'd been getting before brokers got involved. But the brokers can't do their job without being paid.

So if they give a lot of their commission to the strata manager, then they not surprisingly say, "Well, I can do that for you, but you have to give me a broker fee." Which of course, the strata committee or the body corporate ultimately pays. So that's how the system evolved. But it's not a healthy system anymore because the share of commission is pretty high in most cases between 15 and 20%. And the broker fees, the lower level broker fees, the really competitive ones are something like 5% of the premium, but there are quite a few brokers out there now charging 10, 15, 20% in addition to the 20% commission that the strata managers receive.

Amanda Farmer: Right. So just clarify this for us, John. The commission is paid from the insurer to the broker. A share of that is then portioned out by the broker to the strata manager and the broker then also in addition to retaining part of the commission from the insurer, is also then paid a broker fee by the owners corporation?

John Trowbridge: That's correct. That's how it works.

Amanda Farmer: Now you've said this is not a healthy situation. Tell me how you became involved in performing this review. Who got you involved and who is the one who's recognising that this is not a healthy system?

John Trowbridge: That's a fair question. The answer to that question is that Robert Kelly, who's the CEO of Steadfast, he's been concerned about this issue for some time. And for a long time, he didn't know what he might be able to do about it or what others might do about it. The Royal Commission added weight to the concerns of him and other people. And then a year ago, more than a

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year ago, the government as a follow-up to the Royal Commission announced a quality of advice review, which was looking at commissions across the whole of the general insurance industry and the life insurance industry among other things. So Robert said to me, "Look, this is troubling me and I know it's troubling some other people could you have a look at it for me." That's really how it started.

And Steadfast has a big position in the industry. It owns CHU, it owns or part owns several brokers, and there are a lot of other brokers who are in the Steadfast network. So Steadfast arguably has something to lose in a way. But Robert also understands that in the longer run, unless the whole thing is fully above board, then somebody will intervene. And he rather thought that it would be better that he get myself in a private sector capacity to have a proper look at this rather than wait until ASIC or some other regulator or the government comes along and says, "Hey, we don't like this system. You have to change it."

Amanda Farmer: And do you think, or does Robert think that's a distinct possibility? I know you've got a lot of experience in this consulting advisory capacity, John, and have been involved with some legislative reform in the past. Having seen what you've seen so far at this stage of your review, do you think unless we change this from within, the government could intervene? Is that a reality?

John Trowbridge: Oh, I do think so. And there are two reasons, and those two reasons are why the first part of the project was broken into two parts. The first one is that most of these commissions and broker fees are not visible and not transparent to the owners corporations. Now, if it's your own home, you will know exactly what's going on. But when it's a strata property with a strata committee and a set of lot owners who are not on the committee and the strata committee being voluntary people, volunteers or honorary officers, they delegate most things to the strata manager. So the strata manager is the one who basically organises all of this. And when it comes to the broker, the strata manager is essentially in control of the broker appointment and the arrangements on broker fees and commission shares are essentially done between the two of them.

So the first problem is transparency or lack of adequate disclosure, and that's phase one of my work, which was completed in July. And phase two is about looking at these remuneration arrangements where in my view, the conflicts of interest are involved here, where the financial arrangements are done in most cases without any active involvement of the strata committee, meaning that the brokers and the strata managers are working it out for themselves. They're conflicts of interest that I believe need to be phased out.

Amanda Farmer: There's some pretty serious statements there, John, as to transparency, conflict of interest. You've mentioned there phase one of your review. Can you give us the summary of your conclusions at phase one or your recommendations that have come out of phase one, which I think you said had to do with that disclosure and transparency?

John Trowbridge: That's right. Well, I've come to the view that there needs to be a transparent disclosure regime, and I've recommended that there be standardised financial disclosures and a standardised disclosure process, which is a process involving the broker and the strata manager down to the strata committee. Also, that there be a description of the scope of services of the strata manager and broker. The submissions I received, many of them questioned what exactly the strata manager was doing or the broker was doing. A lot of strata committees are not very clear about that. There are some different models as well. And I've also recommended that there be an explanation of the business model and there's a single page template to answer that, the business model of the strata manager and the broker so that the strata committee can understand just what kind of business arrangement is being made.

And I've also put out a disclosure matrix because you'll be aware there's a process here each year. Firstly, the strata manager needs to collect information from the body corporate to send to the broker. When the broker and strata manager are satisfied that they have enough information, the broker then goes to the underwriting agencies or insurers and asks for quotes. The quotes come back. Then there's a discussion between the strata manager and the broker often without consultation with the strata committee and later on once that decision's made, then the broker goes back to the successful underwriter and says, "Please send me an invoice."

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So there's a process there that takes a little bit of time, some weeks or months depending on the particular way that everybody's works on it. So I've recommended in addition a set of steps there. Because one of the things that goes on at the moment is that the brokers generally do not know what information has been received by the strata committee. So in many cases, the whole deal is done between the strata manager and the broker. And after it's all done, that's when the strata committee knows a lot about it. Now, there is an intervening process where for AGMs there need needs to be some disclosure, but the whole thing's a bit mysterious for most people.

Amanda Farmer: John, I just want to be clear about this process and particularly that part of the process that you feel is happening between the strata manager and the broker and not involving the committee. At least in New South Wales, we have legislation that says the owner's corporation at a general meeting must confirm the insurances that are in place for that building. So at some point the policy is going before the owners at a general meeting for them to have a look at, for them to make sure that they're comfortable with and for them to vote that they approve.

I know being a committee member myself, that the insurance is often put in place, the insurer chosen the premium approved for payment by the committee, not by the owner's corporation because a renewal might come up and you're in between annual general meetings and your strata manager sends you the proposal that is sent through by the broker on behalf of the insurer and says, "Look, this is the proposal I've got. Please approve. This is the premium that we need to pay to have the mandatory insurances in place."

What part of this are you suggesting happens between the manager and the broker and is not drawn to the attention of the committee or the owners? Is it the fees themselves and the commissions themselves? Because I know as a committee member I'm definitely approving insurances before they're affected and then as an owner, I'm approving that insurance at a general meeting at a later date.

John Trowbridge: Well, the payments are usually not clear. In some cases they're disclosed. In other cases they're not.

Amanda Farmer: Do you mean payments of commissions and payments of broker fees?

John Trowbridge: Correct, yes. So there's a premium which includes commission and then there's a broker fee on top. Now those elements for quite a few brokers, those are included in the quotation material but never on one page. So if you want to understand exactly who's been paid what, then you almost have to be an accountant to work your way through it and put it all together. So I'm recommending that all that be put together according to the template that I've recommended, and that's had support incidentally from the Strata Communities Association and from NIBA, the brokers' association.

Amanda Farmer: So following your template, I as an owner should be able to see the commission that's going from the insurer to the broker, the portion of that commission that's then being passed onto the strata manager and then the broker fee that's being paid by the owner's corporation effectively through the strata manager back to the broker.

John Trowbridge: Correct. That's exactly right. So that's where the first part of the disclosure is needed. And the next part then is once the strata committee makes a decision about which quotation, and that will usually be done on the recommendation of the strata manager, and there's nothing wrong with that, then once that decision is made, the strata manager conveys that to the broker and the broker then goes to the insurer's underwriters and completes the process of having the policy written and the invoice issued for the premium. And at that point, that's the part that goes to the AGM, is it not?

Amanda Farmer: Yes.

John Trowbridge: Okay. So the part that goes to the AGM would never be seen normally by the broker because the broker just sends the invoice to the strata manager. And it's not the insurer's invoice, it's the broker's invoice because the broker has to add the broker fee and then sends the broker's invoice to the strata manager. And the strata manager may or may not disclose or show

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that invoice. In fact, usually would not show that invoice to the strata committee. Have you seen such an invoice?

Amanda Farmer: I can't say that I have, but that is quite shocking to me. If my money as a member of the owner's corporation and the money that the strata manager is holding in a trust account on behalf of my owner's corporation is then used to pay that invoice, I should be approving that invoice. Shouldn't I? As the secretary, as the treasurer?

John Trowbridge: That is what you approve. But in a number of cases, quite a few of the brokers simply, and I don't know whether this is at the initiative of the broker or the strata manager, but there's an item, a financial item, which is insurance premium. Now, if that's the only item you see, then I can tell you where there's a broker fee involved that is not the insurance premium, it's the insurance premium plus the broker fee.

Amanda Farmer: Okay, I'm with you. So when I'm approving what I think is the premium, I'm also approving a fee to be paid to the broker that has been wrapped up in that premium. Correct.

John Trowbridge: That's quite right. We're talking, by the way, all the time of situations where there is a commission and there is a broker fee. There are situations where that doesn't happen, but this is the one we're talking about now.

Amanda Farmer: To that point, John, does this happen in other commercial insurance arrangements where there are intermediaries like brokers or agents and representatives? If we step outside the strata context, I know in a freestanding home where I simply have my home and contents insurance and I pay that premium, I don't believe I'm dealing with a broker. In more complex situations like commercial buildings for example, do we see this insurance commission broker fee arrangement or is this unique to strata?

John Trowbridge: Well, it's unique really because in any other commercial situations, the owner is the one responsible for purchasing the insurance. There's no second intermediary. There's only the one which is the broker. So the broker may or may not disclose the commission, but certainly if asked will do so. There's often a modest broker fee, one or \$200, and that also occurs in strata insurance. But that's not what we're talking about here.

We're talking about a broker fee that is commensurate more or less with the size of the commission. So you end up with this double intermediary situation and a double payment. You don't get that in other forms of commercial insurance. And that's the difference. You've got the strata committee and the lot owners relying on a strata manager as their agent to set up all of these things. And the strata manager is then in a difficult position at times, because you would know as a legal person, Amanda, that in some parts of this process, the strata manager is acting as the agent of the lot owners or the body corporate. In other parts of it, the strata manager's acting as the agent of the broker.

Amanda Farmer: Just explain that one to us. The strata manager is acting as the agent of the broker. In what way?

John Trowbridge: The strata manager is working with the broker and often does a lot of the work with the broker and helps the broker to figure out what are the most appropriate insurance arrangements. And in doing that is acting as the agent of the broker. A lot of them are appointed as authorised representatives, which means they are effectively being delegated by the broker to do a regulatory piece.

Amanda Farmer: Part of the broker's work.

John Trowbridge: Yes.

Amanda Farmer: And that work being to gather information about what's going on at the building so that the insurer can be appropriately informed and also throughout the life of the policy processing claims, filling in claim forms. Is that part of the role that they do as an authorised representative?

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John Trowbridge: Yes, it is.

Amanda Farmer: So they get paid for that?

John Trowbridge: Yes, they should.

Amanda Farmer: From the strata manager's perspective, I have heard some strata managers say before, "Well, that's why we get a commission because we do that work."

John Trowbridge: Well, they might say that, but it's also the case that, and this is no secret, that the commissions that they get subsidise other services that they offer to the body corporate because in those cases, the commission is exceeding the cost of the work that they do on insurance. And some of them then use that to say, "Well, look, our fees, our charges as strata managers are as low as they are because we are getting a commission from the insurance." And that often satisfies strata committees when they know that. But it's still a conflict of interest to operate that way because the strata manager is not disclosing fully what's going on. And when they say the commission is allowing them to reduce their other costs, they're actually saying, well, it's as if the commission is somehow a free benefit that they get. But it's not because the body corporate pays it.

And the alternative here, and this happens in quite a lot of cases, you can operate on fees only where there are no commissions. And so in those cases, there's a net premium, not a gross premium paid, by the insurer. And in those cases, there's no commission so all of the costs, insurance related costs that are not premium, that is the charges by the broker and the strata manager are made directly to the owners' corporation. Now because of that difference, I've tried to make it very clear that everybody involved in this process needs to know whether it's a net premium or a gross premium that's being charged. Then that's part of the whole disclosure process.

Amanda Farmer: I know in New South Wales when owners' corporations are signing new contracts, which we call agency agreements with their strata manager, it is disclosed on the front page of the contract whether or not the fee that's paid to the strata manager will be inclusive of commissions or have commissions payable in addition, or the strata manager will not accept any commissions. And certainly at each annual general meeting, I think you alluded to this earlier, John, there does need to be a disclosure by the strata manager if they are accepting commissions, what those amounts have been and an estimate for the next 12 months.

I think what I've read in your report is that you feel that's still not enough disclosure, and we are missing a piece here where the owners are approving the insurance premium. And I'm with you on this because as I said, I've been in this position and I certainly haven't previously been aware of what I'm approving, that that premium is hiding these other fees including broker fees that are then being paid.

John Trowbridge: That's right. And the disclosure required under the legislation is only about commissions, the broker fees are not visible. Now, I think that's what you're saying.

Amanda Farmer: Yes. And let's talk about that because I think that takes us to phase two of your report. Phase one, we've talked about this need for proper disclosure, transparency, and understanding of the business model. Phase two, if I remember correctly, you have recommendations about this entire model of broker fees and commissions, and you want that to be scrapped, if I'm putting that correctly.

John Trowbridge: That's right. Because of the conflict.

Amanda Farmer: And that's part one of my chat with John Trowbridge. Coming up next week, part two. John will further explain this conflict of interest and how he believes strata managers are failing to properly recognise and manage this conflict. John and I talk about commissions not necessarily being fair charges for the work that's actually done on insurance matters by strata

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managers. John suggests some alternate options for remunerating strata managers and brokers for the work they do on insurance matters to avoid these conflicts and ensure greater transparency, maybe even save owners some money.

And in part two, John speaks about the availability and affordability of strata insurance across the country, explaining what's driving the price increases and how they might be better controlled. Part two next week not to be missed. I'll catch you then. Bye for now.

Outro: Thank you for listening to Your Strata Property, the podcast which consistently delivers to property owners reliable and accurate information about their strata property. You can access all the information below this episode via the show notes at www.yourstrataproperty.com.au. You can also ask questions in the comments section, which Amanda will answer in her upcoming episodes. How can Amanda help you today?



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