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OF NEW SOUTH WALES

The Hon. Anthony Roberts
Minister for Fair Trading
Level 36, Governor Macquarie Tower
1 Farrer Place
SYDNEY NSW 2000

by email and post

24 August 2011

Dear Minister,

RE: SUBMISSION FOR THE INTRODUCTION OF MANDATORY PROFESSIONAL INDEMNITY INSURANCE

We refer to recent discussions in relation to the introduction of mandatory professional indemnity insurance for practicing real estate agents in New South Wales.

ENCLOSURE

- Submission for the Introduction of Mandatory Professional Indemnity Insurance for Real Estate Professionals

I thank you for the opportunity to provide the attached submission and would value the opportunity to discuss the matters contained within our submission at your convenience.

Yours faithfully,

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To The Minister for Fair Trading

The Hon. Anthony Roberts MP

Submission

For the Introduction of Mandatory Professional Indemnity Insurance For Real Estate Professionals

v. 19 August 2011

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CONTENTS

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1. EXECUTIVE SUMMARY

Professional indemnity insurance was intended to form an integral and significant part of the regulatory environment for the delivery of real estate services in NSW. The failure of successive Fair Trading Ministers to activate the insurance component of the legislative architecture as contemplated by parliament has exposed and continues to expose consumers to loss.

The concept of utilising insurance as a part of an overall management of risk is widely accepted and it is a complete anomaly that consumers are not afforded that protection when receiving services from a real estate agent.

It would, we believe come as a complete surprise too many consumers that real estate agents are not required to have insurance as a pre-requisite of offering their services. That surprise would only be exacerbated should they discover that parliament had always intended to provide consumers with protection, but successive ministers, despite having the authority to act unilaterally have failed to do so.

2. INTRODUCTION

This Real Estate Institute of New South Wales (the "Institute") submission is in support of recent representations in relation to the introduction of mandatory professional indemnity insurance for real estate agents in New South Wales.

The Institute is the largest professional association of real estate agents and other property professionals in New South Wales. The Institute seeks to promote the interest of members and the property sector on property related issues, and in doing so the Institute believes it has a substantive role in the formation of regulatory policy in New South Wales.

The Institute is grateful for the opportunity to lodge this submission and is available to discuss the issues raised in the submission with the Minister and/or Policy Officers of NSW Fair Trading if required.

3. THE NEED FOR PROFESSIONAL INDEMNITY INSURANCE (PI INSURANCE)

There are identifiable and inherent risks associated with the provision of the services provided to consumers by real estate agents. Those risks can to some extent be managed through a well-structured regulatory environment and the voluntary adoption of best practice policies and procedures. That said, however, risks cannot always be totally eliminated and, accordingly, recipients of services may be exposed to loss and injury from the realisation of those risks. The Institute accordingly advocates for the introduction of mandatory PI Insurance to respond to potential consumer loss.

In New South Wales the principal regulatory instrument for real estate agents is the *Property, Stock and Business Agents Act 2002* (the "Act"). There are obviously other legislative instruments that agents need to be cognisant of such as the *Fair Trading Act* and the Australian Consumer Law. It is the Act and the *Property, Stock and Business Agents Regulation 2003* (the "Regulation") however, that specifically provides the main framework for agency practice.

When the Bill was introduced by the then Minister for Fair Trading, Mr John Aquilina, his Second Reading Speech (9 May 2002) of the *Property, Stock and Business Agents Bill* contained a number of comments in relation to the consumer protection aspects of the Bill and that professional indemnity insurance was an integral part of that consumer protection strategy. Mr Aquilina said:

> *"The core proposals in the Bill – the introduction of competency standards, mandatory continuing professional development and professional indemnity insurance – provide the framework for modernisation of the property industry."*

> *"The introduction of professional indemnity insurance requirements is viewed as a means of raising industry standards and enhancing consumer redress in relation to quality of service issues. It is anticipated that this attention to risk management will result in fewer claims by consumers and lower premiums for licensees. I must emphasise that professional indemnity insurance is as* <u>*important an element*</u> *of the reform package as the recognition of competency standards and the introduction of continuing professional development. It is envisaged that they will work hand in hand to lift the expertise and raise the ethical standards of the industry."* [emphasis added]

What is clear from Mr Aquilina's comments was that the Act was designed with a three tiered strategy, with each tier supporting and complimenting the others. The three tiers are:

1. Education. Requiring real estate agents to complete a competency based training regime, to provide them with the requisite skills to deliver a competent service to consumers;

2. CPD. The maintenance of the real estate agents' professional skills and knowledge is achieved through mandatory continuing professional development; and

3. Insurance. Mandatory PI insurance would operate as a safety net to respond to a consumers' loss or injury.

Mr Aquilina also opined that as a result of mandatory PI insurance, industry standards would be raised and the quality of service improved. Finally, it appears that he was of the view that the cost of premiums would reduce for agents as a result of mandatory PI Insurance leading to increased competition between insurers.

It is disappointing that despite the accommodating legislative architecture for consumer protection which exists in the Act, one tier (PI Insurance) has not, to date, been introduced, despite repeated calls from the Institute.

The Institute is able to offer no explanation, plausible or otherwise, for the previous government's decision not to mandate PI Insurance as a condition precedent to practice by real estate agents.

It has been suggested by some that PI Insurance is a business expense and is unrelated to licensing. That, with respect, is a contrary view to that contained in section 22(1) of the Act, which states as follows:

> *"The Regulations may make provision for or with respect to requiring the holder of a license to be insured under a policy of professional indemnity insurance in force with respect to the licensee or his or her employer. It is a condition of a license that the holder of a license be insured as required by any such Regulations."*

That section displays Parliament's very clear intention that PI Insurance and licensing would go very much hand in hand, which is consistent with the position taken in other jurisdictions such as Tasmania.

Depending on the specific cover purchased, PI Insurance, generally speaking, would respond to the following claims:

- Misleading and deceptive conduct;
- Personal injury sustained by tenants in a rental property or by the general public during an open house inspection; and
- Breach of contract.

Specific claims examples are set out below.

It is also worth noting that real estate PI insurance claim statistics reveal that approximately 60% of claims arise out of property management and personal injury claims account for approximately one third of all claims.

4. CONSUMER DETRIMENT

The rationale supporting the need for mandatory PI Insurance is quite simple and there are two main public policy arguments for mandatory PI Insurance.

The first is that it will ensure that a consumer will almost always have an avenue for redress for their loss in the event of wrongdoing on the part of the agent. Currently, a consumer who sues a real estate agent who does not carry PI Insurance will only be able to recover money from the personal assets of that agent (assuming there are any), which may not be sufficient compensation.

The second argument is that liability should be borne by the party responsible for any wrongdoing (i.e. the real estate agent, or ultimately his or her insurer) and not the public purse.

5. THE COMPENSATION FUND

Some might argue that the Fund offers sufficient consumer protection in all instances.

However, in reality, the Fund has a useful but limited application because it is capped, and will not respond to all potential losses which consumers may suffer as a result of the services provided by a real estate agent. This is evident from section 175(4) of the Act which provides:

> *"If the total amount of claims or judgments (or both) exceeds the aggregate sum provided for by this section, the Director-General has an unfettered discretion to determine the division and allocation of the available money among the various parties (whether or not to the exclusion of any one or more of them)."*

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Importantly, please note that the Fund only responds where there has been a failure to account for monies held by a real estate agent. Essentially, this is in relation to trust account defalcations by real estate agents.

The Fund will also not respond to a myriad of claims that PI Insurance will.

PI Insurance responds in more circumstances and provides greater protection for consumers.

By way of some examples, the Fund would be of no value to a consumer where:

1. a loss is incurred by a consumer, but not as a result of a failure to account:

   - Negligence of a licensee, e.g. *Hunt v RTA of NSW & Anor [2010] NSWDC 88*. In this case, the Court awarded a plaintiff $843,136 plus costs (apportioned 75%/25% between the agent/owner) after the plaintiff's arm smashed through a glass door. The case dealt with whether or not the agent was negligent in failing to replace the relevant glass panel with safety glass. An appeal as to quantum was later settled out of Court. The plaintiff would not have had a claim against the Fund as there was no failure to account by the agent;

   - Breach of retainer by a licensee, e.g. *Markson v Cutler & anor [2007] NSWSC 1515*. In this case an agent was held liable to indemnify a consumer against the legal costs the consumer incurred as a result of the agent's negligence. The costs were very significant. The consumer would not have had a claim against the Fund.

2. A trust account defalcation exceeds $500,000 or related failures to account exceed $2,000,000 (subject to the Minister's discretion)[1]. In this regard, multiple defalcations by one licensee are not uncommon. Two recent examples include:
   - Belle Property, Byron Bay where the reported total alleged misappropriation is currently "more than $550,000.00"[2]); and
   - the 78 claims totalling $444,739.38 in the case of *Olde and Anor Re Propestate Pty Ltd (In Liquidation)* [2009] NSWSC 859).

3. A consumer has not made a written claim on the Fund within 12 months after becoming aware of the failure to account; or 2 years after the date of the failure to account, whichever period ends first[3].

6. EXPENSE

Another unmeritorious argument is that PI Insurance is unaffordable for many real estate agents. In the wake of the HIH collapse that argument may have carried some

[1] Section 175, *Property, Stock and Business Agents Act 2002*
[2] http://www.byronbay.org/?tag=property-services-compensation-fund
[3] Section 173, *Property, Stock and Business Agents Act 2002*

weight, however that is certainly no longer the case and has not been the case for many years.

There is currently a wide selection of PI Insurance providers in the current market and, by way of example, a small real estate agency could purchase $2 million of PI Insurance for under $800

Clearly, the costs of PI Insurance at this level are not a significant expense when compared to the overall costs of running a real estate agency.

7. THE INSTITUTE'S RESPONSE

As stated above, the Institute has repeatedly called for the mandatory introduction of PI insurance which would give effect to the legislative intent of Parliament contained within the Act. As government to date has failed to mandate compulsory PI insurance for license renewal the Institute in the interest of consumer protection has resolved that member agents of the Institute will be required to purchase $2 million of PI insurance as a condition precedent of membership of the Institute from 1 July 2012.

Consumers therefore who deal with a Institute member will be afforded that protection and an avenue to seek redress for loss, however, those agents who elect not to be a member of the Institute and do not hold PI insurance will continue to expose consumers to risk.

It should be noted from the Institute's research that in excess of 75% of real estate agents voluntarily purchase PI insurance, accordingly they would suffer no impost with the introduction of mandatory PI insurance.

8. THE EXPERIENCE OF OTHER INDUSTRIES

The concept of mandatory PI insurance is not a phenomenon limited to real estate practice.

In NSW, PI Insurance is compulsory for legal practitioners, conveyancers, architects, registered tax and BAS agents and accredited certifiers, to name a few of the other professions who deal in, and around, the property market. It is anomalous that real estate agents are exempt from any requirement to maintain PI Insurance.

The Institute has no doubt that it would astound many consumers to discover that real estate agents are not required to maintain PI Insurance.

The Institute believes that they would be similarly surprised to discover that despite having the power to mandate compulsory PI Insurance since 2002, a succession of

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Fair Trading Ministers have **deliberately** failed to act to protect consumers despite the Institute's repeated calls for the Minister's to do so.

I would welcome the opportunity to discuss the contents of this submission further with you at your convenience.

Yours sincerely,

Tim McKibbin
CEO