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By email: [HBCreform@sira.nsw.gov.au](mailto:HBCreform@sira.nsw.gov.au)

**Re: SIRA consultation on Home Building Compensation Premiums and Eligibility Guidelines**

Dear Richard,

Thank you for giving the Office of the NSW Small Business Commissioner (OSBC) the opportunity to comment on the SIRA consultation on Home Building Compensation premiums and builder eligibility guidelines.

The OSBC advocates on behalf of small businesses in NSW, provides mediation and dispute resolution services, and speaks up for small business in government.

Please see the OSBC's comments concerning the focus questions on both discussion papers below:

**1.) Home Building Eligibility Guidelines Discussion Paper**

**Questions 1-4: Insurance providers and builder's eligibility**

The OSBC:

- believes that providers will need the flexibility to set their own standards within certain limits to issue an eligibility profile, as long as they meet certain principles. The compulsory limits dictated by SIRA should provide enough regulation;
- encourages the use of portable eligibility profiles (which will minimise administration). The insurance provider would need the small business owner's permission to access their eligibility profile from other providers and clear guidelines would be required on what level

of data is publically available. The OSBC favours standardized data capture, shared on a centralised system, to reduce the burden on small businesses;

- believes the factors listed below in response to Questions 10-15 , in addition to any publically available information, should be shared amongst insurance providers;
- proposes that any relevant financial management education awarded to owners and employees also be shared amongst providers. The OSBC suggests these might be taken into consideration within the eligibility requirement framework (as well as premium guidelines discussed below); and
- suggests that provided a contractor meets an insurance provider's minimum eligibility requirements, they should be granted insurance.

#### Questions 5-9: How eligibility affects builders and why it must be fair

The OSBC has worked previously with icare on challenges small businesses have in interpreting and understanding what steps a builder must take to meet the capital requirements of the Home Building Compensation Fund (HBCF). Feedback is that the HBCF is cumbersome and difficult for small builders to use.

- the 'Certificate of Eligibility' and review process is particularly complex for small businesses to understand/navigate. The type and format of information required for builders to be considered needs to be clearly outlined;
- Communicating through brokers to the insurance agents adds unnecessary complexity;
- Builders from ESLspeaking backgrounds would find this process particularly difficult;
- There is no assistance provided to help businesses act on and interpret where improvements to their business need to be made once eligibility is granted or rejected. It is important for rejected applicants to understand how they need to tailor and/or improve their business operations in order to meet eligibility requirements in the future. Approved applicants may require advice on how to introduce new business systems or processes in order to manage the increased volume of work;
- Improving builders' understanding of the reason behind the need for HBCF insurance and the purpose of the HBCF scheme is also important; and

- The OSBC recommends the integration of financial management education requirements within the licensing framework of NSW<sup>1</sup>. The lack of financial management and business skills are a principal cause of insolvencies in the building and construction industry. The following five causes made up 62% of total causes of construction industry insolvencies from 2009-10 to 2013-14:
  1. under capitalisation
  2. poor financial control including lack of records
  3. poor management of accounts receivable
  4. poor strategic management of business; and
  5. inadequate cash flow or high cash use.<sup>2</sup>

Such causes may result in either defective work (if shortcuts are required to complete the project), or non-completion (if insolvency occurs). The Australian Senate Economics References Committee concluded that “some form of financial and business skills training should be a pre-requisite for the registration of a builder’s or contractor’s license”<sup>3</sup>.

#### Questions 10-15: Managing/excluding risks versus pricing risks, and eligibility and new builders

- The following factors should all be considered in the eligibility risk assessment:
  1. type of works undertaken (type, value, completion (or not) and role)
  2. licence (inc historical licences; licences in other states, and any disqualifications)
  3. education (business planning, management, operational)
  4. prior insolvencies (for any company owned, or supervised in the past)
  5. finances (past three years financial statements, including turnover and sources of income, including percentage of income from works)
  6. work history (including prior defects)
    - a. experience in scheduling, coordinating and successfully completing construction projects
  7. prior claims (from all associated businesses including current)
  8. previously declined insurance; and
  9. prior litigation, including filings to the NSW Civil and Administrative Tribunal or equivalent;

<sup>1</sup> OSBC, Submission: Reform of the Home Building Compensation Fund Discussion Paper, February 2016.

<sup>2</sup> Submission by the Australian Securities and Investments Commission – Inquiry into insolvency in the Australian Construction Industry (Submission 11), April 2015, page 20.

<sup>3</sup> Australian Senate Economics References Committee, ‘I just want to be paid’: Insolvency in the Australian Construction Industry, December 2015, page 174

- Given the significant claim size arising from multi-unit dwellings, it may be beneficial in treating the insurance requirements for such developments separately;
- The OSBC is in favour of all measures outlined in Questions 13-16.
- The pricing of 'high risk' contractors paying a loading of up to 30% on top of the premium, is beneficial for all parties, allowing contractors additional scope, whilst ensuring a higher balance of funds to cover the excess risk;
- The OSBC is also in favour of the Building Contract Review Program (BCRP) and would argue that greater supervision in a similar vein, allowing an alternative pathway for smaller contractors to gain access to eligibility for HBC insurance in a closely monitored environment, is beneficial for all;
- Adoption of a tiered licensing approach should also be considered as a means of entry for new builders. Contractor licences for general building work in NSW allow builders to perform a range of building work that doesn't adequately represent the different levels of skill required for different types of building work (i.e. a single story building vs a multi-level dwelling);
- In a similar vein to the legal industry, a new builder could be required to work for a period of time (i.e. 2 years) under the supervision and sign off of an experienced builder, or a builder in a higher tier (who would ultimately be held responsible), if the industry were to adopt a tiered licence approach; and
- The OSBC is in favour of the sharing of eligibility profiles amongst providers. Doing so will minimise administration and allow builders to 'shop around', keeping the market competitive and innovative.

#### Questions 17-19: Eligibility and regional or cross-border businesses

Undertaking cross border work within the construction industry has its challenges, given that the differing laws and regulations between states is poorly understood by businesses, regulators and consumers alike.

- Similarities and differences between laws and regulations should be available as an education module as part of the licensing procedure;
- Information sessions, publications and visits to construction sites in order to answer questions and educate by members of the insurance industry from neighbouring states is encouraged;

- SIRA and any HBC providers should ensure that any cross-border insurance provisions be described as comprehensively as possible in clear layman language, and
- Eligibility requirements in terms of skills and education should not vary between metropolitan and regional areas, however financial requirements might differ in line with the different pricing models.

#### Questions 20-21: Eligibility and new HBC products

- The OSBC encourages the use of different eligibility standards depending on the type of product offered and the product's associated risk;
- A more tiered eligibility standard allows for new and innovative products to enter the market, which improves consumer protection and allows builders to structure their cover according to their needs, experience and risk profiles; and
- The eligibility guidelines should specify appropriate standards for any additional insurance products that the insurer may want to incorporate. This allows for a more transparent system/platform whereby builders will be able to access information to inform themselves further.

#### Questions 22-26: Eligibility data and analytics

- In principle the OSBC supports the use of data analytics and enhanced information-sharing between building regulators to detect and manage builder insolvency. However, this information should not be available to the general public. The eligibility profiles currently available on Construction Assist should suffice as a way to inform the general consumer;
- SIRA would have to develop a framework that ensures uniformity across the data analysis and ensuring it accurately reflects risk. A strong framework will need a large amount of data with ongoing periodic updates to accurately reflect the likely performance of a company;
- The individual HBC providers should be able to decide whether or not to use the information gathered in their assessments, however all providers should have access to the same information. HBC providers may opt to only provide certain products based on such information being provided, or otherwise insist on a premium in its absence;
- Given the sensitivity of such information, SIRA would have to develop a strong framework in line with what the banks use and limit the amount of information provided to

individual HBC companies to a 'need to know basis' only, and only once a prediction tool has been developed that is acknowledged as working accurately; and

- Any sharing of information with HBC providers would have to have the individual or company's approval in line with traditional data sharing and privacy standards. Findings/determinations should be made available to the individual construction companies and builders who apply for insurance (to assist them in building strong profiles as well as educate/inform).

## **2.) Home Building Compensation Premium Guidelines Discussion Paper**

### Questions 1-3: Premium principles

- The OSBC agrees with the draft principles outlined, however would suggest adding the following as found in relation to Motor Accidents Insurance regimes

'promote competition in the setting of premiums and in doing so keep premiums affordable'.

### Questions 4-11: Premium filings

- The use of brokers increase costs for the HBCF scheme and ultimately the builder, therefore brokerage fees will have to be monitored and regulated so as not to inflate costs to small business owners;
- In addition to the evidence submitted, the following information should be made available to the contractor when any HBC provider submits a premium filing:
  1. the fact that filings have been made (and the date that such filings were made)
  2. the key actuarial assumptions underpinning the filing; and
  3. the date filings have been approved/rejected (and accompanying reasons and remedial action if the latter), and
- Any additional information/templates to support the filing procedure would be welcomed by the OSBC.

### Questions 12-20: Risk based premiums

- The OSBC supports the introduction of risk based pricing models that more closely reflect each individual level of risk;

- Rural and metropolitan location of projects should be taken into account in undertaking premium pricing in order to keep premiums proportionate to likely profit and risk;
- The OSBC supports regulation by SIRA with HBC providers developing risk rating criteria, risk loadings and discounts, in order to ensure that undue risk is not taken on by independent insurers. Such regulations and guidelines should be made public to ensure transparency and understanding throughout the construction industry;
- During 2015, WorkCover NSW introduced a two tier premium calculation process: premiums for medium and large employers and premiums for small employers. Amongst the changes, employers are now eligible for premium discounts between 5 to 20% at the end of the year where they perform better than the compensation claim costs scheme average. This was introduced for the purpose of encouraging employers to improve their workplace safety systems. WorkCover NSW also created a number of incentives to 'reward' employers for performance. One of these incentives is the 'Return to Work Incentive', rewarding employers who help injured workers return to suitable work safely and the 'Employer Safety Reward', which is available to employers who maintain a safe workplace and do not incur any premium impacting claims for four consecutive years. The structure of home building risk insurance in NSW can similarly replicate the processes, mechanisms and incentives in place under the NSW Workers Compensation Scheme to encourage behaviour that will benefit the NSW construction and building industry;
- The OSBC is in favour of more flexible eligibility standards such as paying a premium loading or surcharge in order to take on additional work beyond a contractor's eligibility limit. This provides the opportunity for small businesses to grow in a controlled environment, without unbalancing the insurance system;
- The OSBC would encourage the Building Contract Review Programme service provider to undertake such a review to ensure the competence of the builder to price and manage a particular project in taking on this additional work; and
- The OSBC would be in favour of risk-adjusted premium subsidies as a way of sharing risk throughout the industry but would wish for such a model to work in tandem with businesses being able to load their premium or excess (rather than the two models being mutually exclusive), to encourage the market to support small businesses in expansion and growth.

#### Questions 21-27: Premiums for new HBC products

- The OSBC agrees with insurance coverage being split for loss arising from non-completion and for loss arising from defective work. There are different risks associated with each of these events and splitting the insurance coverage allows for more accurate

premium calculation. The OSBC is supportive of premiums that further encourage innovations such as this, yet are optional for (small) businesses; and

- The OSBC recommends that any 'first resort cover' offered by private insurers or by HBC products must be limited to 'add on' products undertaken in addition to 'split cover' products. Any HBC product offered by an HBC provider should be appropriately controlled by SIRA. Small business owners require simple language, and wherever possible standard definitions within all offered products.

To discuss any aspect of this submission please contact Harriet Platt-Hepworth via email on

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Yours sincerely

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**Robyn Hobbs OAM**  
NSW Small Business Commissioner  
22 September 2017