

icare's response to SIRA's consultation paper on HBC construction type definitions

13 September 2021

Executive Summary

Thank you for the opportunity to provide this submission to the review of the HBC construction types definition consultation paper conducted by the State Insurance Regulatory Authority (SIRA).

Following the development of claims data regarding the sustainable rates for duplexes relative to single dwellings and multi-dwelling new constructions, icare has reviewed SIRA's consultation paper.

icare believes that this analysis supports the industry and community feedback received by icare, as well as the issues raised by the Independent Pricing and Regulatory Tribunal (IPART) regarding construction classification.

icare confirms that:

- the total sustainable premium for the Home Building Compensation Fund (HBCF) will not be affected by category changes, as net risk remains fixed;
- the current categories are non-optimal and icare would support any of the proposed changes as improvements;
- Option 1 is viable and provides the most flexibility. If icare was to submit an initial filing in regard to proposed categories, it would closely resemble 2A, though amended to clarify granny flats could be included in C01; and
- Option 2A and Option 2B are viable, each with their benefits and challenges, and could reduce builder and homeowner confusion regarding construction categories.

Analysis of issues or considerations with current Construction Types

Granny Flats

A Granny Flat, regardless of whether it is attached to- or detached from- a New Single Dwelling is presently categorised as a Duplex/Triplex (C09) construction. This attracts a C09 premium rate which is currently paired to C01, but is likely to increase in time (potentially materially so, with the changes included in the consultation paper).

Anecdotally, builders support recognising Granny Flats as a New Single Dwelling under the C01 category given that Granny Flats are not capable of being subdivided or sold separately.

icare has verified the contract, premium and policy mix to show the impact of the change from 2015-2020 (i.e. the period over which duplexes have held a separate data classification), and advises that no material detriment in premium sustainability (on a portfolio or per contract basis) has been identified. The data suggests that the impact of categorising Granny Flats as C01 would be immaterial owing to low volumes. Granny flats/studios represent a low volume of contracts within the overall mix of single dwelling and duplex/triplex contracts as shown in Figure 1 below (denoted by the black band).

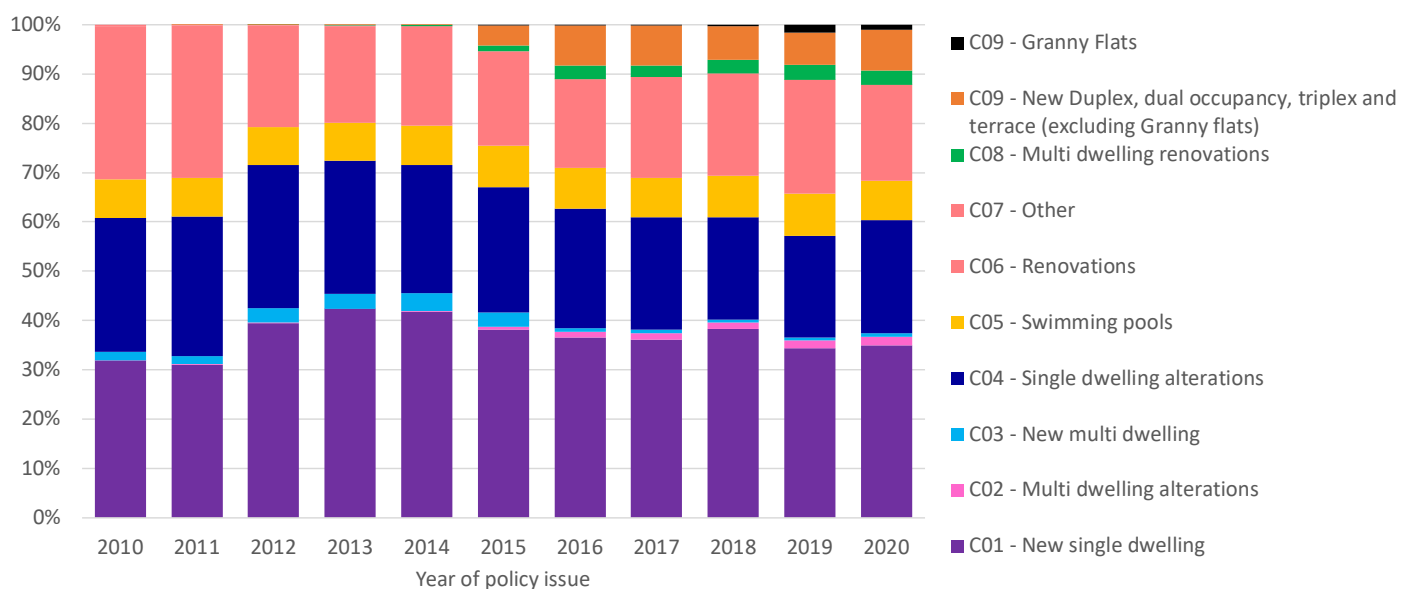


Figure 1: Policy mix of construction categories with Granny flats separated out

By charging the lower C01 premium rate, icare estimates that the premium forgone would be 0.4 per cent of total premium. There is very little data to analyse for differences in claims risk; there are only two affected projects and four claims in total.

Excluding land title from premium price setting?

Historically, the HBCF has not limited the interpretation of these category descriptions to only where a strata or community title exists. Company title and multi-dwelling buildings (blocks of flats, apartments, units etc) owned by the one entity have also been included in the C02, C03 and C08 classifications.

Reference to strata and community title as determinant has been a more recent approach in line with the guidelines to address the emerging trend of strata title duplexes and large community title developments that contain shared facilities such as roads, service access easements, community buildings etc.

As a matter of planning and construction process, at the time of taking out HBC insurance for C03 projects, it is unlikely that any strata or community title scheme has been (or could be) registered.

This makes administration challenging for builders and distributors and makes policy and premium compliance reviews complex for icare in determining a 'point in time' against which to review whether premium criteria have been satisfied.

A strata-titled duplex, where the number of dwellings constructed equals two, is presently categorised as a Multi-Dwelling. This attracts a Multi Dwelling premium rate which is materially higher than the Duplex/Triplex (C09) category.

The data suggests it would be reasonable to exclude land title from premium price setting, noting that:

- at present there are low volumes of strata titled duplexes in the scheme; and
- the claims data indicates the claims risk is aligned closer to the current C09 category than the C03 category.

In Figure 2, the low volumes of strata titled duplexes are denoted by the light blue band, and the remainder of C03 policies are denoted by the dark blue band.

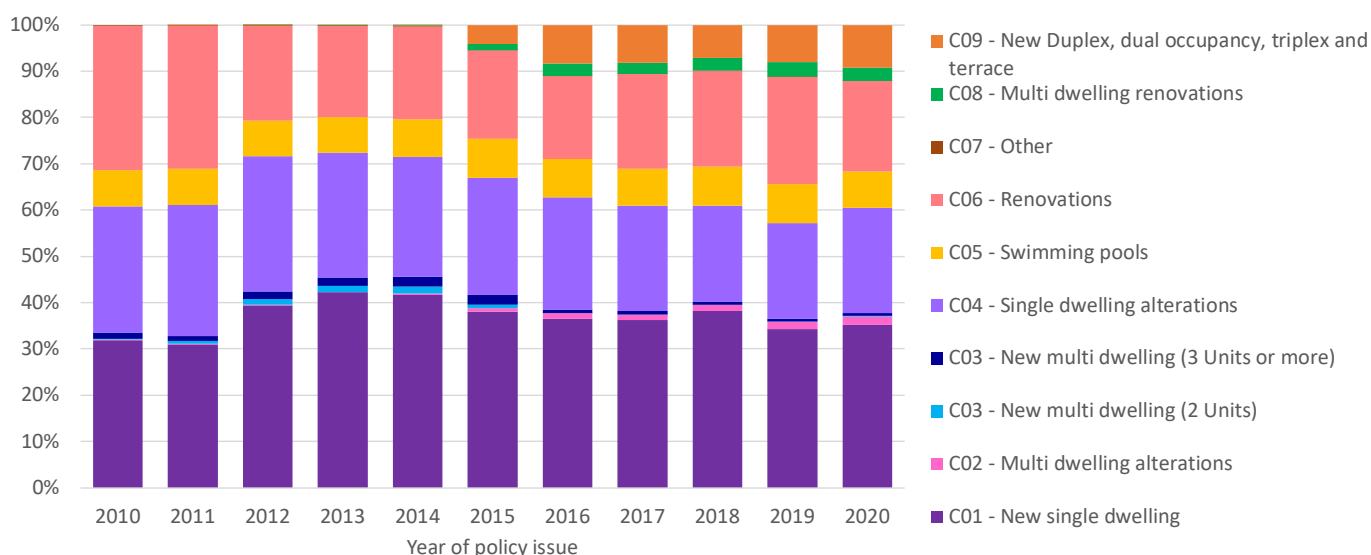


Figure 2: Policy mix of C09 and C03 construction categories

In Figure 3, the average cost of strata titled duplex claims on an incurred basis (light blue line) also lies closer to C09 (orange line) than C03 (dark blue line) for constructions over a period between 2018 to 2020 where a sufficient volume of claims data has built up. Figure 2 suggests that the claims costs of strata-titled duplexes is actually closer to the ordinary duplex claims costs rather than the multi-unit claims cost.

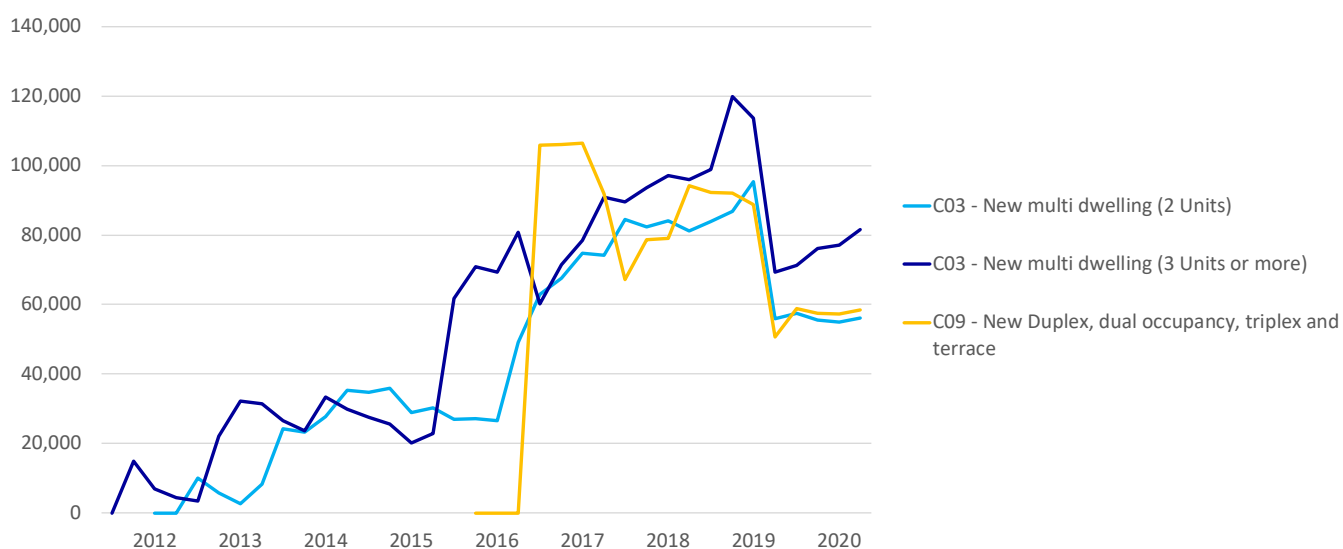


Figure 3: Average cost of Strata titled duplex claims relative to C09 and C03 constructions (for fully or partially accepted claims or denied claims)

There are limitations in estimating the impact of the proposed changes from historic data . icare has considered two transitioning cohorts of claims as proxies for the transition impact, although these are not comprehensive and there may be affected cohorts not captured within the existing dataset:

1. single storey Multi Dwellings moving from C03 to C01; and
2. Multi Dwellings with two dwellings moving from C03 to C09.

Subject to the ambiguity and limits of the data, icare believes that these are the closest and most suitable proxies, as these represent the transition of strata-titled duplexes into the C03 category and the transition of single story Multi Dwellings into C01.

Cohort Materiality

Both cohorts have grown in size since 2015, as a proportion of the C03 category, and relative to C09.



Figure 4: Mix of strata affected work by contract value relative to construction categories

Over the last two years, single storey Multi Dwellings have accounted for roughly 15% and Multi Dwellings with two dwellings for around 10% of all multi-unit policy placements.

Between 2010 and 2015, multi-unit policy placements with two dwellings grew. The data suggests that these were possibly absorbed into C09 once C09 coding commenced, but there appears to be an upwards trend in this category in 2021. Similarly, single storey Multi Dwellings policy placements also appear to be growing.

Cohort Claims

In order to provide context of the impact on claim costs, icare has examined the total movement in reported incurred claims cost each year for the cohorts described above (i.e. payments in the year plus movement in case estimates).

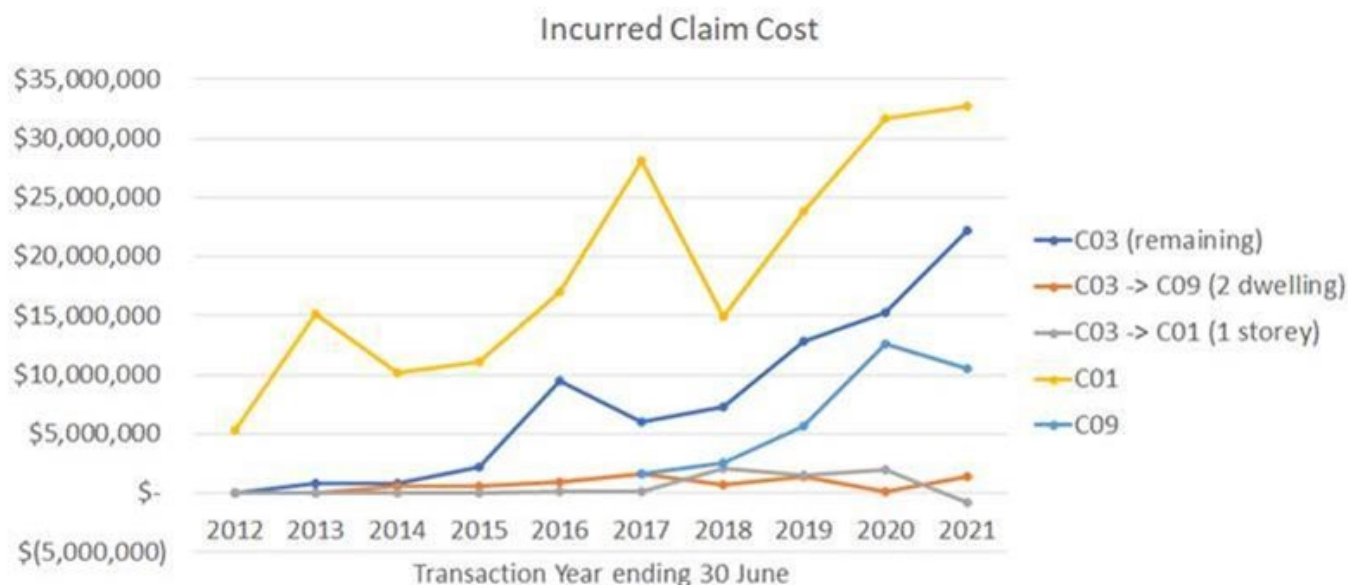


Figure 5: Incurred claim cost over time

The C03->C01 (one storey) cohort accounts for 7% of the total C03 incurred cost movement over the last four years, and the C03->C09 (two dwelling) cohort accounts for 6%. icare emphasises that these percentages are not directly comparable to the premium percentages above for a number of reasons, including (but not limited to):

- incurred claim movements in the last four years relate to premium written in the past (potentially back to 2010), and the volume of premium for each cohort varies significantly over time; and
- there is no development of costs to ultimate (i.e. there is significant potential for the cost of individual claims to develop)

While the specific claims cost remains uncertain, the proportion supports the supposition that these are not primary drivers of pricing.

Future Premium Impact Scenarios

In considering the long-term impacts on future target premium rates of transitioning to the proposed new definitions, icare has assumed that target premium rates remain equal to sustainable premium rates for FY2022/23 and that the total premium pool is unchanged (because the total risk profile of the book is unchanged).

icare has developed scenarios which assume that the C03->C01 (1 storey) cohort accounts for 15% of multi-dwellings and the C03->C09 (2 dwelling) cohort accounts for 10% of all multi-dwellings projected.

icare has considered seven scenarios (S1 through to S7) and under each scenario icare assumes the target premiums for the transitioning cohorts are between 0% to 150% (where 0% means the cohort is will experience losses like C01 or C09 whilst 100% means the cohort experiences losses like C03).

	S1	S2	S3	S4	S5	S6	S7
C03 -> C01 (1 storey)	-	100%	100%	-	50%	150%	150%
C03 -> C09 (2 dwelling)	-	100%	-	100%	50%	-	100%

After transitioning, there will be new target premium rates for the new C01, C03 and C09 categories, and the transitioning categories are aligned with the new category. For example, C01 rates may increase from 0.719% to 0.778% under S3 when the incoming single storey multi units are in fact as risky as C03, or remain unchanged at 0.719% under S4 when the incoming cohort is identical in risk to C01. Throughout the scenarios, the overall risk profile is unchanged so the overall target premium rate remains at 1.152%

Rates after transition

Category	Current	S1	S2	S3	S4	S5	S6	S7
C01	0.719%	0.719%	0.778%	0.778%	0.719%	0.748%	0.808%	0.808%
C03 -> C01 (1 storey)	5.062%	0.719%	0.778%	0.778%	0.719%	0.748%	0.808%	0.808%
C03 -> C09 (2 dwelling)	5.062%	1.589%	1.771%	1.589%	1.771%	1.680%	1.589%	1.771%
C03 (remaining)	5.062%	6.394%	5.062%	5.525%	5.931%	5.728%	5.091%	4.628%
C09	1.589%	1.589%	1.771%	1.589%	1.771%	1.680%	1.589%	1.771%
Total	1.152%	1.152%	1.152%	1.152%	1.152%	1.152%	1.152%	1.152%

Figure 6: Base premium rates for cohorts under different claim scenarios

Premium Rate Change Scenarios

Category	S1	S2	S3	S4	S5	S6	S7
C01	-	8%	8%	-	4%	12%	12%
C03 -> C01 (1 storey)	-86%	-85%	-85%	-86%	-85%	-84%	-84%
C03 -> C09 (2 dwelling)	-69%	-65%	-69%	-65%	-67%	-69%	-65%
C03 (remaining)	26%	-	9%	17%	13%	1%	-9%
C09	-	11%	-	11%	6%	-	11%

Figure 7: Premium Rate Change from considered scenarios

Premium Volume Change Scenarios

FY22/23 Target Premium Rate Change

Category	S1	S2	S3	S4	S5	S6	S7
C01	-	4.3m	4.3m	-	2.2m	6.5m	6.5m
C03 -> C01 (1 storey)	-4.4m	-4.3m	-4.3m	-4.4m	-4.4m	-4.3m	-4.3m
C03 -> C09 (2 dwelling)	-2.3m	-2.2m	-2.3m	-2.2m	-2.3m	-2.3m	-2.2m
C03 (remaining)	6.7m	-	2.3m	4.4m	3.4m	0.1m	-2.2m
C09	-	2.2m	-	2.2m	1.1m	-	2.2m
Total	-	-	-	-	-	-	-

Figure 8: Projected per cohort premium impacts from considered scenarios

While the above figures 6-8 indicate a range of outcomes, and there remains considerable uncertainty, icare considers scenario 4 or 5 to be the most reasonable outcomes while scenario 1 and 7 are less likely.

Construction type C07

At present, there are insignificant certificate volumes being issued under the Other (C07) category and icare believes the existence of this category creates a risk of premium arbitrage and administrative complexity with limited to no benefit. Given such low volumes (five policies in FY20/21), icare believes that the impact of removing this category will be immaterial to the scheme.

Majority of Work'

This term determines whether a particular project would fall within the C02 / C04 or C08 / C06 construction types. The definitions might benefit from an explanation as to whether 'majority of work' is determined by its price / cost / value or actual content as a percentage of the overall project.

The current practice of HBCF is to test against both measures (i.e. if either the price etc. or content is in the majority then C02 or C04 is the appropriate classification).

To the maximum extent possible, this should be objective and contestable. icare believes that there is a risk of gaming in this determination, depending on the documentation submitted with the insurance application.

'Major Element'

This term is defined within the legislation and used in the paper. icare understands that because the definition is relatively new, there is significant controversy among lawyers (or at least a lack of legal consensus) on what constitutes a major element in particular cases at the moment (e.g. whether a driveway or a drainage pipe constitutes a major element). The 'load-bearing' part of the major element test might mean that a little less work is caught than under the concept of 'structural', but this is not entirely clear. icare notes that this new definition may not include structural alterations and additions to duplexes, townhouses, or villas as they are not Class 2 buildings.

Work Undertaken in Stages

It is a reasonably common practice for homeowners (particularly owner-builders) and developers to undertake work in stages using different contractors. Where a project initially involves C01, C03 or C09, the definitions might benefit from advice being included as to whether work undertaken after the initial stage should continue to be classified as C01, C03 or C09 or classified based on the content of the ultimate or total work being contracted (e.g. an internal fit-out would be C06 / C08 or C02 / C04).

Possible issues impacting the development of a position on the issue may include the feasibility of insurers being able to enforce and comply with any position; how far does it extend (e.g. where only structural landscaping is separately contracted should this be categorised as C01); and eligibility / licensing impacts where the contractor is not licensed as a builder.

Which of the options outlined in this paper do you prefer and why?

3.1. Option 1 – Require icare to define the construction types it proposes to price against as part of its premium filings instead of defining construction types in SIRA guidelines

While icare does not necessarily have a preferred option, it does not object to Option 1 being adopted, as it enables icare to both address the identified issues raised above and have a clearer and faster process for addressing future issues. icare agrees with the benefits of the option described in the paper.

icare recognises the benefits of flexibility in a competitive market. The basis for the original adoption of the C01 – C07 categories by the NSW Self Insurance Corporation (SICorp) was that these were the categories required by NSW Fair Trading of all insurers (including SICorp) for reporting purposes. The former private insurers each had their own risk categorisation in relation to work being covered by policies that the insurer issued. In order to provide a standard approach to reporting and analysis of scheme data, insurers would funnel or map their own data into the C01 – C07 categories which had been agreed upon between Fair Trading and the private insurers.

icare also acknowledges the risks detailed in the paper. The administration of filings around categorisation is unlikely to be material relative to overall HBCF administrative and regulatory obligations. icare and SIRA already commit significant resources to reviewing and applying classifications and HBCF makes significant investment in distributor and builder education and communication. Inclusion in the filing process would not be unduly onerous.

icare could engage with SIRA around information capture to enhance opportunities for future performance monitoring. The change in categories may, equally, provide opportunities to enhance understanding of scheme performance. As an example, the C02 category was originally used by NSW Fair Trading for new multi-dwelling projects over three storeys, later amended by SICorp, with the addition of the C08 and C09 categories, to provide more data and premium differentiation for alterations and rectification works undertaken to multi-dwelling buildings and the construction of new duplexes etc.

3.2. Option 2A – Retain self-contained descriptions of categories with edits

While icare does not necessarily have a preferred option, it does not object to Option 2A being adopted. icare agrees with the benefits and acknowledge the risks associated with the option as set out in the paper.

icare also acknowledges and confirms SIRA's comment that net pricing would remain unaffected and that costs would transition between categories.

If Option 2A were adopted, icare recommends that a decision be made in regard to the administration and indemnity of common property claims. Currently, policies issued as C03, C02 and C08 allow for common property claims, and if these are in future issued as C01 / C09, C04 and C06, a policy position will need to be adopted.

Possible issues that may need to be addressed would include but may not be limited to:

- Presently HBCF will not accept a claim in relation to common property from individual owners. The claim is required to be submitted by the relevant owners' corporation or community association. icare understands this to be a matter of law, as the common property only vests in the owner's corporation.
- icare recommends that there needs to be confirmation that regardless of certificate pricing, categorisation or structure, common property claims can only be made by the owner's corporation and lot property claims by lot owners.

- Assuming the intention remains for policies issued as C01 / C09, C04 and C06 to respond in the event of a common property claim, it must be identified how the claim will be allocated across certificate limits. Presently with only one policy issued covering all dwellings classified as C03 (with a separate Certificate of Insurance for each dwelling) payment of a common property claim reduces the amount of remaining cover for each dwelling in the strata or community scheme by an equivalent amount.

The above is not raised as grounds for not supporting the option but rather as policy issues that would need to be worked through as part of any implementation.

icare also makes the following comments on the table accompanying Option 2A definitions:

- icare suggests that an explanatory note be added as to what is meant by the text '*and where any dwelling is partially or wholly located above another dwelling, or where there is common space below such dwellings,*' would be appropriate should the option be adopted. Is it meant to exclude a single dwelling in an otherwise commercial, office building etc.? Is there a possible contradiction with the explanation elsewhere in the table classifying work undertaken within an individual dwelling not involving common property as C04 or C06?
- An explanatory note would be appropriate as to what constitutes a fire compartment.
- Categories C02 and C08 do not contain details as to work included / excluded, in contrast to categories C04 and C06. It is not clear whether this is intentional.
- An explanatory note would be appropriate as to the distinction between '*Installation or non-cosmetic alteration of fixed roof coverings of any material (e.g. tiles, slates, sheeting) or roof flashing*' which is deemed to be C02 and C04 and '*like for like replacement of roof coverings not involving any work to the roof framing elements*' which is deemed to be C06 and C08.

3.3. Option 2B – Define premium categories by reference to the Building Code of Australia and 'major elements' of a building

icare notes the advice contained in the paper that the benefits and risks of this option are similar to Option 2A and that the accompanying table takes an approach of defining categories of work by reference to the Building Code of Australia (BCA) while seeking to achieve the same outcome as Option 2A.

icare's comments in respect to Option 2A, detailed earlier in this submission, should be considered where relevant to Option 2B. Again, while there are foreseeable impacts on HBCF systems (particularly dealing with common property claims) should this option be implemented, icare does not object to it being adopted (subject to sufficient time for IT system modifications).

icare agrees with the additional benefits and risks associated with the option as set out in the paper. icare shares the concern that for homeowners (in particular), as well as brokers, insurers and even some contractors and developers who are not familiar with the BCA / National Construction Code, there is a risk it may make the definitions harder to understand. Ambiguity will increase the risk of unintended customer outcomes and disputes.

For example, terms like manor house, which is used in the paper, relate to a reasonably recent Planning NSW initiative provided for in the Low Rise Housing Diversity Code:

*A Manor House is a single **residential building containing three or four dwellings on one lot of land.** They can be a studio or a 1, 2, 3 or even 4-bedroom dwellings. Each dwelling has its own entrance and amenities and a Manor House can be up to two storeys high (excluding any basement).*

Many insurers, brokers, homeowners and even some builders may not yet be familiar with the terms, or new terms that arise as the code evolves.

Agreement between SIRA and insurers would need to be reached on responsibility for dealing with queries from homeowners and contractors as to the relevant classification to be applied to a project (e.g. where approval may not be required for the work and as such there is no advice from a Council or certifying authority to use as a reference).

icare anticipates that in the short term both icare and SIRA would need to retain building experts to assist in the determination of categorisation disputes.

Finally, in relation to the table accompanying Option 2A, at Category C05, icare asks: does the description cover work greater than that set out in the examples or further detail column and as provided for in Schedule 4 of the *Home Building Regulation 2014* (e.g. does it permit 'structural landscaping' work such as pergolas etc. in addition to 'landscaping')?

icare's responses to the consultation questions

1. Do you agree with excluding land title from premium price setting? Please indicate your reasons

Subject to resolving questions around common property claims, icare supports excluding title from premium price setting as a means of balancing the risk between duplexes and multi-storey buildings. This will require changes on HBCF systems (particularly dealing with common property policy issuance), which would require suitable lead time.

2. Which of the options outlined in this paper do you prefer and why?

While icare does not have a preferred option, it does not object to any of options 1, 2A or 2B being adopted and will work with SIRA and stakeholders to ensure successful implementation.

3. If icare were required to define its own construction categories for premium purposes, when and how should industry be notified or consulted about proposed future amendments?

Consensus has been reached with industry and brokers that a minimum of three months' notice is required in relation to changes of premium. A similar period would be appropriate in relation to changes to construction categories.

A further three months might be appropriate to enable full consultation with all stakeholders particularly industry associations, brokers, and builders (whether direct or via brokers and industry associations), organisations representing developers, owners corporations, strata managers, consumers etc. Contact with homeowners may be problematic, although icare can sample claimants and policy holders.

icare envisages any proposed material changes having to be cleared with SIRA in the first instance, which may require a submission in advance of filings.

4. If you prefer Option 2A or 2B, are the categories appropriate? If not, what changes do you recommend and why?

The comments and observations herein concerning Options 2A and 2B detail possible matters to be resolved and provide an explanation thereof.

5. If you prefer a different option to the ones outlined in this consultation paper, please explain your preferred approach and the reasons.

icare does not have any fundamentally different options to submit for consideration. icare notes the above consideration of the benefits and materiality of inclusion of granny flats in C01.