

Home building eligibility guidelines

Discussion paper

August 2017

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Minister's foreword



In June the NSW Government passed legislation to overhaul the current Home Building Compensation (HBC) Scheme. The *Home Building Amendment (Compensation Reform) Act 2017* creates a pathway for private insurers to re-enter the scheme and will assist to put it on a sustainable financial footing. The future HBC scheme will enable competition through product differentiation, market specialisation and risk-based pricing. The new scheme will also encourage innovation and best practice claims handling.

More than 55,000 homes built and renovated each year are covered by this scheme. Importantly the new legislation retains the same high level of protection for homeowners undertaking new builds and renovations.

The NSW Government undertook extensive industry consultation prior to embarking on legislative reform. In a similar vein, the State Insurance Regulatory Authority (SIRA) will consult with the industry on the design of the licensing guidelines.

This discussion paper provides an opportunity for industry and community input regarding the eligibility of builders and tradespeople to access insurance or alternative indemnity products under the scheme.

A builder or tradesperson must have eligibility in order to do work that is covered by the scheme. This means access to HBC eligibility is a cornerstone of most residential building work and therefore an effective scheme should seek to reduce pressure on the premiums that builders and tradespeople, and ultimately homeowners pay. This objective also needs to be balanced against the need to offer access to the scheme for a wider cohort of businesses, including new market entrants and those with existing operations in our jurisdictions.

The NSW Government is determined to put the scheme on a sustainable financial footing and make it accessible to new market entrants. We also need to be smarter about how we assess and manage insolvency risk, which requires a greater investment in data analytics and actuarial capabilities.

I encourage you to comment on the questions raised in this discussion paper. With your help, the NSW Government can deliver a system that continues to protect homeowners, while achieving a system that provides greater choice and is easier to navigate for the building industry.

A handwritten signature in black ink, appearing to read 'Victor Dominello'.

Victor Dominello MP
Minister for Finance, Services and Property

Introduction

The role of SIRA

The State Insurance Regulatory Authority (SIRA) is the NSW Government organisation responsible for regulating home building compensation, motor accidents compulsory third party (CTP) insurance and workers compensation insurance in NSW.

What is home building compensation?

The Home Building Compensation (HBC) Scheme provides a safety net for homeowners. It is designed to reduce the impact of a financial loss if their contractor fails to complete or fix defective work. Since 2002 it has been a 'last resort' scheme, focused on losses due to contractor insolvency, death or disappearance.

By law, any contractor (a licensed builder or tradesperson) must buy HBC insurance for residential building work valued at more than \$20,000 inclusive of GST, such as new home constructions (including multi-unit buildings of three storeys or less) or home renovations.

The NSW Government provider, icare Home Building Compensation Fund (HBCF), has been the sole provider of HBC insurance since private insurers left the market in 2010. Contractors can only buy HBC insurance from icare hbcf if they pass an eligibility assessment, and may be restricted in the type, value and number of projects for which they may buy insurance cover. This makes access to eligibility critical for any contractor wanting to do work that requires HBC insurance.

The current HBC Scheme has not been financially sustainable, and as a monopoly product, builders and consumers have had no choice of product or provider to suit their needs.

What's changing?

On 20 June 2017 the NSW Parliament passed legislation¹ to overhaul the HBC Scheme. The changes will allow competition into the market, ensuring the scheme's financial sustainability and maintaining high levels of consumer protection.

Private providers will be able to enter the market alongside icare hbcf in 2018. They will also be able to offer new HBC products that can cover additional risks (such as 'first resort' cover) or that include additional services for contractors or homeowners. SIRA will be responsible for licensing and regulating HBC providers (insurers and alternative indemnity providers), and will set the standards HBC providers must use, such as for contractor eligibility, premiums, and claims.

¹ Home Building Amendment (Compensation Reform) Act 2017

How you can get involved

SIRA will consult on the key design features of the new HBC Scheme before it commences in 2018. We're seeking input from industry, consumers and other interested stakeholders.

We will consult about the following topics in three phases between August and December 2017:

- Phase 1: Eligibility and premiums
- Phase 2: Business planning, prudential regulation, claims handling, HBC provider licensing and market practices
- Phase 3: Regulations.

We will publish discussion papers and other documents about each topic you can respond to. We will also meet with industry and other associations to seek their input.

Executive Summary

Purpose of this discussion paper

Licensing and HBC eligibility together determine which contractors (builders and tradespeople) are able to contract or do residential building work that requires insurance cover under the HBC Scheme. These measures are intended to limit risks to homeowners from contractors not having sufficient technical expertise for the work, or having insufficient business and financial capacity to successfully manage and complete projects, and resolve any outstanding problems with the work.

A well designed eligibility system should exclude or limit the involvement of contractors who present a high risk of causing unrecoverable losses to homeowners who are indemnified by the HBC Scheme. By reducing the cost of claims, eligibility should reduce the costs of HBC insurance for contractors, and ultimately homeowners.

An eligibility system cannot eliminate all risk. It must strike a balance between limiting HBC Scheme costs while avoiding unreasonable inhibitions on contractors' ability to trade. Some contractors have told us they think the current system imposes requirements that are difficult or costly to meet, and that it's sometimes hard to understand why some eligibility decisions have been made and what the contractor can do to get a better outcome.

Currently, HBC eligibility is determined by the NSW Government's provider of HBC insurance, icare hbcf. Under legislation recently passed by the NSW Parliament, SIRA will be able to issue insurance guidelines² about eligibility (eligibility guidelines) that will regulate the HBC eligibility standards. These will be used by all HBC providers (insurers and alternative indemnity providers licensed by SIRA, including icare hbcf).

The purpose of this discussion paper is to seek input about what standards SIRA should set in the eligibility guidelines.

² This is provided for by the insertion of new section 103EC in the *Home Building Act 1989*.

How to have your say about the eligibility guidelines

This discussion paper includes a series of focus questions and explanatory material. We invite you to read this paper and provide comments. You may wish to comment on only one or two questions of particular interest or all of the issues in this discussion paper. You can also comment on additional matters if you want to. You can make a submission by sending an email to hbcreform@sira.nsw.gov.au by COB on Friday 15 September 2017.

Important note: All submissions will be made publicly available. If you don't want your personal details or any part of your submission published, please indicate this clearly in your submission together with reasons. Automatically generated confidentiality statements in emails are not sufficient. You should also be aware that, even if you state that you don't wish certain information to be published, there may be circumstances in which the government is required by law to release that information (for example, in accordance with the requirements of the *Government Information (Public Access) Act 2009*).

What is eligibility?

In order to be able to do, or contract to do, work requiring HBC insurance, contractors must have two things:

1. Contractor licence under the *Home Building Act 1989*

Licences are issued by NSW Fair Trading. They are required by all builders and tradespeople who contract to do residential building work where the total cost of labour and materials is more than \$5000, or specialist work of any value (e.g. electrical wiring, or plumbing and drainage work).

The licence can be issued to a person, partnership or corporation. It ensures that the licence holder is or employs a person who satisfies minimum prescribed technical training and experience requirements for the work authorised by the licence. In addition, the licence provides a mechanism to exclude some people from running a building business (e.g. because they're an undischarged bankrupt or have been convicted of certain types of offences). The licence also provides a mechanism to collect and publish some information for homeowners about the contractor and a means for holding a contractor accountable for their conduct and their statutory warranty obligations to homeowners for work they've performed.

2. Eligibility to buy HBC insurance cover for projects

Eligibility is an additional layer of requirements that apply to contractors who want to do residential building work that requires HBC insurance (such as building houses, or multi-unit residential developments up to three storeys high). Eligibility is only relevant where contractors intend to do residential building work over \$20,000 in value.

Eligibility is intended to ensure that contractors only take on work that they can manage without presenting an unacceptable risk of claims on the HBC Scheme.

Contractors must apply for an eligibility assessment that requires detailed information about their history, business and finances³.

The output of the assessment is an eligibility profile that sets out the number, value and type of construction projects for which the contractor may buy HBC insurance. Contractors who are assessed as high risk may have eligibility declined, or special conditions included in their eligibility profile.

Why have eligibility?

The licence and eligibility systems are intended to limit risks to homeowners from contractors not having sufficient technical expertise for the work, or having insufficient business and financial capacity to successfully manage and complete projects, and resolve any outstanding problems with the work.

Since 2002 the HBC Scheme has been a 'last resort' scheme that homeowners can only claim against if the contractor has died, disappeared or become insolvent. Builder insolvency currently accounts for around 95 per cent of claims and costs in the HBC scheme. As a result, a contractor's solvency is an important focus of the current eligibility regime.

However, the NSW Government's reforms are intended to enable new HBC providers to enter the market and offer innovative products that may include additional claims triggers. Under the reformed scheme, some products may be offered that are more like 'first resort' products where claims may be made in some circumstances where the builder is still solvent and trading.

An eligibility system will still be required in the reformed HBC Scheme. SIRA's eligibility guidelines will need to accommodate a more diverse range of product offerings and HBC providers, while supporting a sustainable scheme with some level of alignment of standards across providers.

To date, a builder's eligibility has generally been expressed in a dollar amount of work that they can take on, usually over a given period of time. For example, based on a builder's history and financial position, they might be eligible to buy insurance covering \$1 million of work per year. Eligibility therefore deals with not just whether an insurer is willing to insure a given contractor, but also what *amount* of insurance they're willing to provide.

Focus questions

1. **Should the eligibility guidelines give HBC providers the flexibility to set their own standards within certain limits to issue an eligibility profile, as long as they can demonstrate they meet certain principles. Or should SIRA prescribe in detail the standards and criteria that all HBC providers must apply?**
2. **Should contractor eligibility profiles be portable between HBC providers, so that a contractor may buy HBC insurance from any provider without needing to be reassessed?**

³ The current eligibility standards are established in Market Practice Guidelines made under section 91A of the *Home Building Act 1989* together with additional matter in the underwriting guidelines issued by icare hbcf.

Focus questions

3. SIRA intends to collect and share some information between HBC providers to help manage scheme-wide risks and potentially reduce the amount of information that a contractor would need to resupply when applying to a new provider for HBC insurance. What information should SIRA require be shared? What information should SIRA not share? Please provide reasons.
4. Should HBC providers be obliged to offer insurance to any contractor who meets that provider's eligibility criteria (or should they retain some discretion)?

How eligibility affects builders and why it must be fair

Eligibility profiles could, by design, act to restrict trade for contractors if they reach the limit of their eligibility. At that point they're unable to access HBC insurance to take on new work. Some contractors have advised SIRA that they think the eligibility assessment process can be difficult or costly to comply with. Some contractors think the eligibility application process is difficult to understand and they're unclear about what they need to do to get a better assessment outcome.

While affording a degree of consumer protection, for an eligibility system to be effective it must set the threshold for excluding or limiting trade by contractors at a level that strikes a good balance between preventing premium costs being unreasonably high and not unreasonably restricting the ability of contractors to trade (which can also affect the availability and choice of contractor for homeowners).

The costs of complying with eligibility processes also need to be proportionate to the risks that the eligibility system is actually able to manage. The eligibility system should only impose costs on contractors and their customers, where those costs are required to assess and manage insolvency risks.

Focus questions

5. What aspects of the current eligibility system are the most difficult or costly to comply with? Please provide examples or estimates of relevant costs.
6. Are there any requirements of the current eligibility system that are difficult to understand or can improve to provide more transparency about what contractors can do to improve assessment outcomes?
7. Is there particular information or other requirements of the eligibility system that you think are not effective at reducing risk or should be reviewed? Please advise which they are and your reasons.
8. Are there matters not currently considered in the eligibility process that should be considered? What are they and why?
9. Do you agree that eligibility methodology should be transparent (public) and based on objective and evidence-based elements (please give reasons)?

Managing/excluding risks versus pricing risks

A general principle of insurance is that insured risks must be fully priced, to ensure the total premium pool will be sufficient to pay expected claims and other relevant costs over time. In setting premiums, an insurance provider may consider risk mitigation

controls that could reduce the frequency or size of claims. Where the risk is assessed as excessively high, such that the financial (and social cost) to the insurance scheme is unacceptable, eligibility to purchase insurance may be denied.

The HBC Scheme currently prices and mitigates risk in several ways:

- Above a certain threshold of risk, contractors are denied eligibility so the scheme does not factor in the cost of insuring them.
- Depending on risk assessments the contractor may be restricted in the number, value and type of projects they may get cover for.
- Depending on the contractor's risk profile, they may receive a discount or loading of up to 30 per cent on top of the base premium.
- The base premium price for HBC insurance varies depending on the type of project. Some of the seven categories of work types are charged a low premium, while others attract a higher premium depending on the risk:
 - C01: New single dwelling construction
 - C02: Multi dwelling alterations/additions (i.e. majority of work is structural) – any number of storeys and including duplexes, triplexes, terraces, villas, townhouses or multi dwelling units
 - C03: New multi dwelling construction (three storeys or less) – duplexes, triplexes, terraces, villas, townhouses etc. or multi dwelling unit construction (e.g. blocks of units, flats etc.)
 - C04: Single dwelling alterations/additions (i.e. majority of work is structural)
 - C05: Swimming pools
 - C06: Renovations (i.e. majority of work is non-structural): single and multi-dwelling
 - C07: Other – not included above.

Focus questions

10. What factors should be considered in the eligibility risk assessment?
11. Which factors are most important and why?
12. The current eligibility system can restrict contractors to certain types of work as outlined in the seven factors, above. Are there issues with this approach or the particular categories that are used?
13. Could the threshold where contractors are denied eligibility be made more flexible if contractors were charged a higher premium or were subject to risk controls such as greater supervision of the contractor by the HBC provider? If so, how should SIRA regulate such arrangements?
14. Could eligibility profiles give contractors scope to take on extra work beyond their current limit? For example: if they were willing to pay a higher premium for HBC insurance or were subject to risk controls such as greater supervision of the contractor by the HBC provider? If so, how should SIRA regulate such arrangements?
15. Are the current dispute resolution mechanisms to resolve eligibility decision disputes appropriate? Are there any material issues and what could be done to address them?

Note: we have asked related questions about pricing in our discussion paper on premium guidelines.

Eligibility and new builders

icare hbcf manages a Building Contract Review Program (BCRP) to assist new members of the building industry, as well as existing small to medium contractors without demonstrated experience for proposed projects. Contractors who participate in BCRP receive mentored project management experience.

A BCRP service provider reviews only the competence of the builder to price and manage a particular project. Their role is not to ensure compliance with building standards by the participant builders.

The BCRP is intended to provide a transition to formal HBC eligibility. Contractors can apply to have the requirement removed from their eligibility conditions once they have demonstrated satisfactory competency for the relevant project type.

The introduction of other HBC providers and products to the HBC Scheme may mean that alternative pathways can be provided for new and small contractors to get access to eligibility for HBC insurance.

Focus question

- 16. How can the eligibility guidelines best support or encourage HBC providers to include better access for new and small contractors to be classified as eligible, while ensuring that homeowners and the scheme are not exposed to unreasonable risks?**

Eligibility and regional or cross-border businesses

Each Australian state and territory (except Tasmania) has an equivalent scheme to NSW's HBC Scheme, however, each operates differently. Where a contractor operates in NSW as well as a neighbouring jurisdiction, they might need to navigate and comply with more than one set of eligibility arrangements (e.g. in regions such as Queanbeyan/Canberra, Albury/Wodonga, Tweed/Coolangatta).

The current insurance product provided by icare hbcf applies different pricing depending on whether work is being done in a metropolitan or regional location. Policies in regional areas currently receive a pricing discount.

Focus questions

- 17. In terms of getting and maintaining eligibility under the current scheme, what specific challenges do contractors face when operating across NSW's borders?**
- 18. How can the eligibility guidelines better support contractors who operate across NSW's border regions?**
- 19. Should the eligibility requirements vary for contractors who work in regional locations?**

Eligibility and new HBC products

These reforms are designed to enable and encourage product innovation by HBC providers.

The legislation passed by the NSW Parliament includes provisions to ensure that HBC products can offer additional products that are consistent the minimum requirements of the *Home Building Act 1989* and its regulations. Regulations can also be made to provide examples of additional items that may be provided for as part of HBC insurance products.

This is intended to enable the bundling of related services and options for contractors or homeowners, and also allow products such as ‘first resort’ cover to be offered where a homeowner can claim in some circumstances where the contractor is still solvent and trading.

The legislation also enables HBC insurance to be provided in the form of two separate insurance policies (currently all insurance must be in one contract that provides a minimum of \$340,000 of cover against all the risks required to be insured). These split cover products are:

- a **construction period insurance contract** to provide a minimum of \$340,000 of cover for home owners against a risk of loss due to non-completion and associated breaches of statutory warranty during the construction period, and
- a **warranty period insurance contract** to provide a minimum of \$340,000 of cover for homeowners against the risk of loss after the work is complete for the duration of the statutory warranty period.

Focus questions

20. Should the guidelines specify different eligibility standards depending on the type of product to be offered? For example, if the HBC provider proposes to perform quality assurance checks and oversight progress payments, could the standard to issue an eligibility profile be lowered to reflect these risk controls?
21. Should the eligibility guidelines specify appropriate standards for any additional insurance products (in excess of minimum HBC insurance requirements) that HBC providers might want to incorporate?

Eligibility data and analytics

A key focus of SIRA will be to ensure that eligibility standards are informed by the best possible evidence and data. This should support standards that are effective and proportionate to the risks we’re seeking to control.

Data can be also be used to proactively identify emerging industry-wide risks/issues. This can help inform government interventions such as prioritising enforcement activities, or industry training and education that responds to and mitigates risks.

For example, the NSW Data Analytics Centre is developing a tool to predict insolvency of contractors who have applied for HBC insurance. The initial phase of development of the tool indicated a confidence level of 85 per cent. SIRA anticipates that reviewing additional data collected from within government may improve our ability to predict insolvency or other matters relevant to claims. Relevant data may include additional data concerning disciplinary or enforcement action concerning contractors, consumer complaints, certification of building and development work, planning system data, or information from publicly available data sources outside the NSW Government.

Publication of data and information may also help consumers, contractors and other parties. Currently, information about the eligibility profile of every contractor is published on the contractor's public profile in the NSW Construction Assist portal⁴. This includes whether they are classified as eligible, and for what types of work. If the contractor is a builder, and is not eligible under the HBC Scheme, a condition is published on the builder's licence record that they may not contract to do work that requires HBC insurance. That record is published on both a public register of licences⁵ and on their Construction Assist profile.

Focus questions

22. **Whatever the eligibility standards, should SIRA require that HBC providers collect certain data from contractors that contributes to predicting insolvency or other relevant factors?**
23. **Designing and building suitable systems to integrate data and apply analytics will take time and resources. What data projects should SIRA prioritise to support the HBC scheme?**
24. **Should SIRA develop assessment tools and make these available to all HBC providers to support their eligibility assessments, or should it be up to individual HBC providers to decide whether and how to apply their own data analytics models?**
25. **SIRA may seek to use data to improve how the eligibility requirements apply to different contractors (e.g. so that the process is less burdensome for some contractors). How can SIRA best support HBC providers with such an approach?**
26. **What information about contractor eligibility should SIRA make publicly available? In what ways and what formats should the data be made available?**

Next steps

We will review all submissions and prepare a summary of your feedback, which may be published on the SIRA website. Information provided through this consultation process will be used to develop regulatory options for consideration by the government.

Any questions or enquiries regarding this discussion paper should be emailed to hbcreform@sira.nsw.gov.au

⁴ NSW Construction Assist Portal

⁵ NSW Licence Check portal

Disclaimer

This publication may contain information that relates to the regulation of workers compensation insurance, motor accident third party (CTP) insurance and home building compensation in NSW. It may include details of some of your obligations under the various schemes that the State Insurance Regulatory Authority (SIRA) administers.

However to ensure you comply with your legal obligations you must refer to the appropriate legislation as currently in force. Up to date legislation can be found at the NSW Legislation website legislation.nsw.gov.au

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