

State Insurance Regulatory Authority

Home Building Compensation Fund Review Team

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Reform of the home building compensation fund



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Sedgwick Australia Pty Ltd ('Sedgwick')¹ welcomes the opportunity to provide insights to the review of the Home Building Compensation Fund ('HBCF').

This review comes at a time of higher risk for builder collapse, and unprecedented levels of complaint regarding home building standards in New South Wales.²

Fortunately, a decade of government led digital innovation in New South Wales, with a growing focus on data transparency and analytics, has created a foundation for meaningful improvement to the HBCF and delivery of greater consumer protections.

Sedgwick's insights regarding the proposed reforms are made based on Sedgwick's:

- Experience as claims provider to the equivalent home warranty schemes in Queensland and Victoria, operating under the *Queensland Building Construction Commission Act*³ and the *Domestic Building Contracts Act*.⁴
- Forensic Building consultancy practice, which has a focus on defect quantification, rectification, and large-scale rebuilding/reinstatement processes for the insurance sector.
- Demonstrated experience in developing innovative claims solutions specifically for home warranty schemes, to expedite the claims pathway for the benefit of homeowners and the building sector.
- Experience with adoption of new technologies to harmonise building data and to ensure rectification processes are carried out for consumers efficiently, for example using digital twins in both the pre-defect period and the defect assessment phase.⁵

¹ Sedgwick Australia Pty Ltd, part of Sedgwick Global, has over twenty years' experience working with Government bodies in Australia, the insurance industry, law firms, asset managers and home owners to deliver services including; forensic investigation (causation) on domestic and commercial property, audit reports (defect identification), scopes of work and dispute resolution expert witness services, forensic engineering services, quantity surveying and construction management. Sedgwick has over 650 colleagues across Australia, providing specialty services to Government agencies, general insurance industry and private entities.

² NSW Fair Trading; Average of 11,000 complaints per annum since 2019 regarding defective or incomplete work.

³ *Queensland Building Construction Commission Act 1991 (Qld) ('QBCC Act')*; See Part 5.

⁴ *Domestic Building Contracts Act 1995 (Vic) ('DBC Act')*

⁵ Sedgwick compresses rectification assessment by using digital twin technology, allowing experts globally (if necessary) to review all aspects of a building to ensure the most appropriate rectification processes are implemented in the minimum amount of time. Sedgwick also captures a digital twin post-construction, creating a benchmark for the condition and value of a building for reference later should defects manifest. Consolidation of digital twin outputs, from industry and government, in a central repository is one initiative that NSW is uniquely placed to consider and that would revolutionize management of the built environment.

In NSW, Sedgwick has provided assessment and tendering services under the private insurer model with CGU/Lumley, Calliden, Vero, QBE, Allianz and the NSW Government. Additionally, Sedgwick has supported NSW Government programs, such as; Managed Builder Program (MBP) and Building Contract Review Program (BCRP) to manage underwriting risk. This exposure provided Sedgwick valuable insights to the shortcomings of builders in the administrative aspects of projects.

Outside of New South Wales, Sedgwick has administered in excess of 3,500 home warranty claims in the last three years, an average of more than 5 per business day, where a builder has been unable to continue operations leaving a homeowner with significant financial exposures, and often an unfinished or defective property.

Sedgwick's management of claims in Queensland and Victoria have equipped team members with a deep understanding of what causes builder collapse, the warning signs, the impacts on consumers, as well as statutory and procedural gaps in compensation mechanisms that could be adjusted.

This submission provides Sedgwick's responses in two parts:

- PART A** Commentary on the purpose of the HBCF within NSW under the *Home Building Act 1989*.⁶
- PART B** Comments specific to reform proposals advanced by SIRA.

⁶ *Home Building Act 1989* (NSW) ('HBA').

PART A – Purpose of the HBCF

Consumer understanding of the nature of the HBCF product has improved, thanks to the efforts of SIRA and others. However, there is still widespread confusion regarding what the product delivers, for whom, and how.

As with many insurance products, consumer interest in these matters may typically crystallise only when the worst has happened and a claim for indemnity is being made. A secondary effect of this poor understanding is that, despite ample warning, checklists and guidance from government, consumers eager to commence building works may neglect to ensure a builder has obtained the necessary insurance.

Sedgwick's experience with home building compensation indemnification products in the three (3) East Coast States has led to the creation of five key observations about the product:

Cover is critical

Home building compensation schemes are essential for consumer protection and recovery. Proposals to reduce capacity, reach or availability are not to be cavilled with, lest consumers be left with a significant risk unable to be addressed by commercial general insurance products.

Opportunity for improving industry

Statutory schemes, in their present form, could do significantly more to improve longer term outcomes for stability and performance in the building sector, by reducing information asymmetry and allowing risk based pricing, so that price signals are sent regarding bad builder risks.

Underwriting efficiency

Information asymmetry and underwriting policy for statutory schemes, leave little capacity for commercial insurers to competitively underwrite home building compensation schemes. There is considerable scope for pro-technology governments to partner with industry to harness existing insurtech capacity to deliver deeper insights into the built environment, its construction and the management of building risk.

Specialist claims management

Claims management for a home building compensation event requires considerable experience in forensic building claims management and a strong network of experts able to provide scopes, reports and consumer engagement in a timely and sensitive manner

Essential to achieving a positive outcome for the impacted homeowner is the establishment by the claim manager of an actively managed panel of builders and trades. Without these, costs cannot be managed effectively and quality of the works cannot be guaranteed. The practice of simply posting a scope online and calling for responses from any builder who believes they can perform the works leads to unsustainable outcomes over time. In our experience, not all builders have the skill, experience or structure to be able to effectively deliver works required on warranty claims

Education

Rebuilding or repairing a failed project requires a different set of skills from those involved in first instance rebuilding or repair. Sedgwick has invested significantly in training specialists for handling Home Warranty schemes for 18 years by employing experts from the Construction industry experienced at project recovery.

Sedgwick is committed to continuing to assist in educating the construction sector on the special nature of this work, as well as to help educate consumers about home building compensation products.

PART B – Specific reforms

Reform idea 1 - *Cover victims of unlawfully uninsured home construction*

If a builder fraudulently fails to comply with s 92(1)⁷ by not holding a valid contract of insurance (or approved alternative indemnity product), and another party to the contract suffers relevant loss, consideration for minimum compensation from the HBCF should be considered upon application; on the following basis:

1. The builder acted fraudulently by relying upon an invalid certificate, or by purporting to have a certificate of insurance.
2. The homeowner can demonstrate that contractual remedies have been sought from the builder and, if applicable, directors of the building company and any related corporate entities.
3. That the defective or incomplete residential building work be works that were substantial and were subject to planning consent.
4. Any compensation considered should be capped to 50% of costs for defects and/or unfinished works, to a maximum of \$55,000.
5. The homeowner is able to provide detail sufficient, and authority, for NSW Fair Trading to commence recovery actions against the builder, directors and any relevant related corporate entities.

Consideration should also be given to enhancing s 94(1)⁸ to include suspension of any relevant licenses for the Builder who failed to meet s 92(1) and where the conduct is repeated consideration should be given to a ban on re-licensing for a relevant period of time.

⁷ HBA (n 3) s 92(1).

⁸ HBA (n 3) s 94(1).

Reform idea 2 – Allow claims earlier in the building dispute process

Where a business continues to trade, but has failed to comply with rectification orders properly made by a court or NSW Fair Trading, the matter should remain outside of the HBCF regime. Homeowners have various mechanisms to enforce contractual obligations and rectification orders granted. To provide compensation via the HBCF scheme before all reasonable avenues of recovery have been exhausted would create an unsustainable claims ratio for the scheme and would create a significant moral hazard with respect to compliance with government directions.

However, Sedgwick considers that in instances where contractual enforcement measures have been pursued and reasonable steps exhausted, that at the discretion of the regulator an expedited claimant management process should be available to meet the residual needs of the consumer.

Reform idea 3 – Increase minimum insurance coverage

Sedgwick supports the proposed reform to increase minimum coverage offered by the scheme to \$400,000, for policies covering the construction phase and policies covering the defects liability period.

The need to balance increased coverage with maintaining affordable premiums is acknowledged. Coverage of \$400,000 for Building costs is, for a point of comparison, equivalent to the average sum-insured for residential buildings in NSW in 2019. Residential building costs are presently increasing at 4.9% per quarter.⁹ Failure to keep pace with changes to building costs could erode the purpose of the HBCF and therefore coverage levels for the HBCF should be reviewed more frequently. A minimum of 3 years is recommended.

Adopting a maximum entitlement of \$400,000 could increase consumer confidence noting the inflation occurring across the industry.

Reform idea 4 – Increase cover for non-completion claims

Sedgwick Response: Sedgwick understands that the 20% max entitlement was established prior to 2012 and was calculated based on second Builder set-up and mobilisation costs, plus application of second round preliminaries and margin equaling or close to 20% of the original contract value.

In our experience the 20% often fails to recognise that progress payments of the original building contract were front end loaded to assist with cashflow of the project. Nonlinear payment distribution is a common scenario with building contracts, if not the norm. Where a contract is abandoned towards the middle or back end of the project a disproportionate amount of capital has

⁹ ABS March 2022 Construction output costs

often been exhausted. Reliance on 20% of the value of the work is therefore ineffective with respect to completion.

A more fundamental challenge exists. A benchmark of 20% relies upon the contract entered into being achievable in the first instance for the agreed value of the work. Our observations of claims arising in 2022, for building contracts commenced in the preceding two years, is that the contracts are typically undervalued by approximately 30% measured against 2022 prices, the year in which rebuilding services must be engaged to undertake the contracted works.

Sedgwick consider that an entitlement of 30% is more appropriate to cover the extra cost of a second Builder completing the abandoned project.

Further, we recommend special dispensation be applied to claims that are lodged during the current industry pricing and supply challenges – Refer to Annexure – Sedgwick Q2 – 2022 Building Activity

Reform idea 5 - Publish exemptions granted by SIRA

The application of exemptions to regulations is a matter of public interest. Sedgwick strongly endorses any measures that would make the exemptions more transparent to industry and consumers.

Reform idea 6 – Should the threshold for requiring insurance be raised.

It would be premature to consider elevating the threshold without first analyzing the average building contract value across the defect portfolio. For example, do projects in the \$20-\$50k band result in a high volume of claims? Or are defects more typically occurring on larger projects such as \$200k renovations or new builds.

Reform idea 7 – Opt-outs or premium caps for high value projects

No, opt-out provisions should not be considered. Mandatory participation drives positive behaviors and provides a layer of governance and accountability. Allowing builders to opt-out from providing those community benefits would be poor policy. A segmented approach to opt-out would cause similar issues.

Sedgwick's observation over some 3,500 claims is that high value projects are not immune from defects, disputes, and non-completion issues.

If high value projects are able to opt-out, the underwriting burden disproportionately shifts to low value contracts. Over time this will threaten sustainability of the scheme. From an equity perspective, if the scheme is to be made optional based on value of the works, ie more expensive

construction can forgo insurance coverage, it will only penalize (through costs) others. If parties to high value contracts can opt-out then why not others.

If intent to allow opting out from providing consumer protection persists, Government should consider amendment of s 92 to include:

S92(1)(c) All parties to the residential building contract have agreed, as a condition precedent, to forgo obtaining a contract of insurance with respect to the works to be undertaken.

Reform idea 8 – Broader insurance exemptions for high rise buildings

Sedgwick is supportive of legislative reform that has occurred in Class 2 construction, specifically the DBP Act and RAB Act.

Sedgwick’s observation is that these reforms are already having a positive impact on the quality of construction and are driving measurable behavioural improvements across the sector.

Contracts for remedial or renovation building works for existing Class 2 structures are now required to be performed under the DBP requirements. This additional level of design requirement and accountability will cause improvement over time to the quality of these works and will compress defect and dispute rates.

However, Sedgwick’s expertise in Class 2 structures leads us to caution against any relaxation of risk mitigation policies for this type of construction. A high degree of builder and project management experience is required in order to avoid poor outcomes for building owners.

Sedgwick recommend the industry continues to drive accountability and governance in all forms of construction and therefore maintain the cover for renovations and remedial projects of high rise buildings. This will continue to support the momentum of the legislation reforms.

Reform idea 9, 10, 11 – Insurance exemptions

Any expansion to exemption to the s92 requirement for insurance should be considered carefully and only applied in circumstances where there is no opportunity for the property to acquire a beneficiary before expiration of statutory defects liability and warranty periods.

Section 18D(1) extends the benefit of warranties under the HBA to ‘successors in title’.¹⁰ The HBA also requires that a contract for insurance in relation to residential building work must insure ‘a person on whose behalf work was done’ and their ‘successors in title’.¹¹

¹⁰ HBA (n 3) s 18D.

¹¹ HBA (n 3) s99.

These are not idle considerations. In *Gardez*¹² *Hammerschlag J* held that a plaintiff was a ‘successor in title’, having purchased a building from the original party to a residential building contract, and was therefore entitled to the benefit of the warranties and insurance coverage important aspects of ownership.

If exemptions for certain property uses are to be countenanced, then it is recommended that s97 be amended to include restrictions on the transfer of the property to others, who would not qualify for the exemption, until the period of protection that would have been available under a contract for insurance has expired.

Reform idea 12 – Repeal provisions that regulate former scheme insurers

Sedgwick supports this reform in principle.

Reform idea 13 - Provision for ‘alternative indemnity products’

Sedgwick believes that alternative indemnity products are currently challenging to sustain for home building liabilities. However, the option for future commercial manufacture of alternative capacity should not be discounted or prevented. Statutory support for the development of alternatives should remain in the HBA.¹³

With respect to concerns about the consumer protections available under alternative indemnity products, it is not possible to quantify the risk unless a product is developed and presented for approval. Consumer protections are a matter of design of such products. Theoretical opposition to alternative products, before a product is designed and approval sought, may be perceived by some as an attempt to simply maintain the status quo.

The HBA contains provisions for the regulator to issue guidelines on insurance products concerning a range of performance matters. If concerns persist over consumer protections in possible future indemnity product an expansion to the regulators powers to provide guidance in s103EC to also provide guidance on alternative indemnity products under Part 6 should be considered.

The Regulator has sufficient powers to allow or disallow use of an alternative products based on a view that the product will or will not cover relevant losses. If not satisfied the Regulator has the power to not approve a product or approve conditional use. An expansion of these powers is unnecessary.

¹² *Gardez Nominees Pty Ltd v NSW Self Insurance Corporation* [2016] NSWSC 1916

¹³ HBA (n 3) Part 6.

Reform idea 14 – Legislatively amend SIRA’s functions to regulate icare HBCF

Sedgwick considers it a matter of good public policy and governance that icare HBCF activity be subject to relevant regulatory scrutiny and where necessary directions. Sedgwick would welcome any opportunity to provide views, based on experience in Queensland and Victoria, on regulatory changes proposed to

Reform idea 15 - Single, State-insurer model

Monopolies should be avoided where there is a current, or future appetite, for competitive underwriting. There are few measures that need to be taken by government to run the icare model efficiently, and none that require the exclusion of future competitive underwriting solutions to achieve. Therefore, government could do both, require and regulate efficient delivery of services by icare, and leave the door open for competitive underwriting to be considered. There is, in other markets, a strong correlation between efficiency of government services and the availability of competitive commercial solutions.

CONCLUSION

Complaints regarding home buildings are escalating and based on the experience of other States the risk of builder collapse is growing. Claims for compensation, when lodged, are growing in forensic complexity, a trajectory matched by the increasing expectations of consumers in NSW.

Government has established a track record of innovating, through digitisation and data, improving government services to the great benefit of business and consumers. In most respects, the HBCF is already a competent consumer protection for NSW residents who contract with a builder.

However, with some reform of the Home Building Act and performance of the schemes operation, in particular a renewed focus on claims management, the HBCF will become best practice in the Federation.

Sedgwick would welcome an opportunity to expand on these comments. Further information and engagement with Sedgwick can be requested through [REDACTED], Sedgwick’s Executive General Manager, Home Claims & Building Services at [REDACTED]

Yours faithfully,

[REDACTED]

Chief Executive Officer
Sedgwick Australia