Submission

NSW Home Building Compensation Reform

15 August 2022

About QBE

QBE Insurance Group Limited is an international insurer with insurance products covering a diverse portfolio including property, crop, energy, marine and aviation. Headquartered in Sydney and listed on the Australian Securities Exchange, we employ more than 11,700 people in 27 countries around the world.

QBE Insurance (Australia) Ltd (QBE) has offices in all Australian states and territories and provides a broad range of general insurance products to personal, business, corporate and institutional customers.

QBE has a major presence in Australian statutory insurance schemes, providing insurance and specialist agency services in most jurisdictions throughout the country.

Since its origins in Queensland over 130 years ago, QBE has been an integral part of the Australian business landscape, providing peace of mind to Australians during normal business and times of crises.

QBE is proud of its heritage and the support that it has provided to our customers and policy holders during this time. Our purpose – enabling a more resilient future.

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Overview

In February 2020, the NSW Government asked the Independent Pricing and Regulatory Tribunal (***IPART***) to review the effectiveness and efficiency of the home building compensation (***HBC***) scheme in protecting consumers who are covered under the scheme. IPART published its findings and recommendations in December 2020 (***IPART Review***), suggesting a range of reforms to how the HBC scheme is regulated and operated. The State Insurance Regulatory Authority (***SIRA***), the regulator of the HBC scheme, is seeking feedback to help inform the design of regulatory reforms to the HBC scheme flowing from the IPART Review.

On 4 July 2022, SIRA released the *Home building compensation reform Discussion Paper* (***Discussion Paper***) for consultation. The Discussion Paper outlines a range of reform ideas falling under three themes: expand some aspects of the scheme to better support some homeowners; narrow some aspects of the scheme to lower the cost of some work on homes and reduce regulatory burdens or costs; and reconsider who should provide cover in the scheme and how they should be regulated.

QBE welcomes the opportunity to provide feedback on the Discussion Paper and would be happy to discuss and provide any further information to support this response.

General observations

As outlined in the IPART Review, home building warranty insurance in NSW has undergone significant changes in its operation and coverage since it was first introduced as a government scheme in 1972. The scheme was originally introduced by the government to provide protection for consumers given the importance of the home to individuals and families. The scheme was privatised in 1997, however the NSW Government re-entered the market as the monopoly provider in 2010 after the collapse of a major insurer provider (HIH Insurance) and the gradual withdrawal of private insurers from the scheme. The scheme was re-opened to competition in 2018 after certain reforms to the scheme were made aimed at improving its sustainability, however the NSW Government-operated NSW Self Insurance Corporation (***icare***) currently remains the only insurer offering insurance under the scheme today.

The IPART Review investigated whether there are any impediments to private sector participation in the market. IPART found:

> *… new entrants have been discouraged from entering because the risks of defects is uncertain and the costs are high, with icare's HBCF continuing to make losses each year (as premiums were previously set below breakeven levels). In addition, the regulatory regime is also overly prescriptive and duplicative.*

IPART recommended changes intended to provide greater flexibility for private providers, however noted that:

> *… it is still likely to take a number of years to achieve a workable level of competition in the HBC market. This is especially the case in the current economic environment. The COVID-19 pandemic is likely to lead to a number of insolvencies as construction activity falls, increasing the number of claims, which would further discourage entry in the short-term.*

Currently, insurance under the HBC scheme compensates homeowners for losses arising from defective and incomplete work where the builder or tradesperson becomes insolvent, dies, disappears or has their building licence suspended (in certain circumstances). The insurance must provide cover for loss arising from a failure to commence or complete work, claimable for up to 12 months from the failure to commence or cessation of the work. It must also provide cover for losses arising from defective work for at least 6 years after completion of the work (major defects) and 2 years after completion of the work (non-major defects).

It is important to note that under the current model, a one-off premium is paid for the insurance coverage before building work commences. This one-off premium is then required to cover operating costs, claims costs and also capital requirements for insurers for what can be a very long period of time. The nature of the coverage is also intrinsically sensitive to economic cycles. In times of significant downturn, or in the event of failure of one or more major builders, there can be issues of contagion which can create ripple effects for the rest of the building industry. As foreshadowed in the IPART Review, over recent months there have been several building companies placed into administration and liquidation, with many homes left unfinished and debts to subcontractors, suppliers and workers outstanding. We understand that the increasing price of construction materials, supply chain delays and COVID-related labour shortages continue to impact the profitability of building companies across Australia.

As the premium for HBC cover is paid up-front, there is no ability to reprice during the long-term nature of the cover, as economic conditions and potentially a builder's viability change. As such, private insurers and state governments have experienced significant losses and deficits when providing home indemnity insurance in NSW and other states in Australia. Additionally, even if insurers were able to reprice for this risk, there is a question as to whether the premiums required to fund the current coverage would be affordable for consumers.

QBE supports the aim of the Discussion Paper to consider options for reform. QBE believes that further reforms to the HBC scheme may be needed in order to underpin a competitive, viable and sustainable commercial scheme. For instance, consideration could be given to potentially limiting defect cover to major defects only.

More broadly, QBE believes the effectiveness of building industry regulation, including compliance and enforcement, also plays a key role in the supporting the viability of the HBC scheme. QBE notes the NSW Government has embarked on a range of reforms related to the residential construction sector. However, as noted in the IPART Review, many of the changes underway are focused on the multi-story segment of the residential market. We support the suggestion made by IPART that these should also apply more broadly to the low-rise building sector in the future. In addition, we support recommendation 2 of the IPART Review that "[NSW] Fair Trading develop a program of proactive investigations and audits of building work in the low rise residential sector, similar to the approach being taken by the Building Commissioner in relation to apartment buildings."

QBE is also supportive of IPART's recommended changes to the rules on how much building businesses can be paid at the beginning of a project and as it progresses to minimise homeowners' out of pocket costs when projects are not completed. Specifically:

- Recommendation 4: That the NSW Government amend section 8 of the Home Building Act to cap the deposits for residential works over $20,000 at 5%.
- Recommendation 5: That the NSW amend section 8A (2)(a) of the Home Building Act so that the value of progress payments paid upon the completion of specified stage of work (as a proportion of the total value of the contract) must reflects the costs of completing that stage of work (as a proportion of total costs).

While there is potential for the HBC scheme to facilitate private market participation and competition in the future, there are a range of broader factors to be considered in this context. This includes the nature and scope of the coverage, the correlation with economic cycles, the effectiveness of building industry regulation, capitalisation/financial stability of the building industry and affordability of the product.

Feedback on consultation questions

This section outlines QBE's comments on the questions set out in the Discussion Paper.

Theme 1 – Better supporting homeowners	
Reform idea 1 – Cover victims of unlawfully uninsured home construction	
Questions 1 - 4	QBE suggests that the scheme should not provide cover in circumstances where a business unlawfully fails to take out insurance, consistent with the current approach. We are concerned the proposal may have unintended outcomes by potentially providing an incentive for a business not to take out insurance with the knowledge there is a safety net available for homeowners. This in turn may place additional pressures on the existing premium pool. In addition, whilst supporting the need for adequate consumer protections, QBE does not consider that the features outlined in the Discussion Paper to facilitate the provision of coverage in these circumstances would adequately mitigate the likely costs and pressures placed on the premium pool. In our experience, businesses and developers that have avoided complying with their insurance obligations are typically already under financial distress. In these circumstances, attempts to recover costs from them are unlikely to be successful.

Reform idea 2 – Allow claims earlier in the building dispute process	
Questions 5 – 7	QBE does not have specific views on these questions.
Reform idea 3 – Update the minimum insurance cover	
Questions 8 – 10	QBE considers that an increase in the minimum amount of cover offered by the scheme from $340,000 to $400,000 is appropriate. We also suggest this should be reviewed once every three years to ensure the threshold keeps pace with inflation and other factors. In respect of 'split cover' insurance contracts (i.e. one covering the construction period and the other covering the post-warranty period), QBE is of the view that the split covers should still be provided under a single insurance policy by a single provider/insurer with a total coverage limit of $400,000 (assuming the proposal to increase the amount of cover proceed). If the covers are split and are able to be provided by separate insurers, we believe there are a range of additional complexities and inefficiencies that are likely to result that would require careful consideration. As noted in the Discussion Paper, an increase in cover would better reflect typical building costs but it would also need to be reflected in future premium pricing. Although the quantitative impacts of this proposal have not been estimated at this stage, insurers seeking to enter the market would need to carefully consider the implications of providing an increased minimum amount of cover when setting premium rates.
Reform idea 4 – Increase cover for non-completion claims	
Question 11	QBE considers that increasing non-completion cover to 30% of the value of the insured work (option c) would be appropriate. QBE recognises however that this is likely to flow through to an increase in insurance premiums, noting the Discussion Paper estimates an increase of 4.9%. However, given a majority of claimants reach or exceed the current cover amount, the increase would provide the benefit of improved consumer protection.
Reform idea 5 – Publish exemptions granted by SIRA	
Question 12	QBE agrees the proposal for SIRA to publish a register of projects that are exempted from insurance would promote greater transparency.
Theme 2 – Housing affordability and regulatory burdens	
Reform idea 6 – Update the threshold for requiring insurance	
Questions 13 - 14	QBE agrees that an increase to the threshold above which work must be insured to $26,000 is appropriate in the context of the average value of work undertaken and inflationary considerations. As outlined in the Discussion Paper, the proposed threshold should also provide the opportunity to minimise costs being passed on to homeowners and to provide greater choice when contracting for smaller projects. Consistent with our previous comments on Reform idea 3, QBE also suggests that this threshold amount should be reviewed once every three years, to ensure the threshold remains suitable.
Reform idea 7 – Opt-outs or premium caps for high value projects	
Questions 15 – 16	QBE does not believe that homeowners and building businesses should be able to agree to opt-out of insurance for work of over $2 million to a single dwelling. We consider that consumer protections should continue to be available in these circumstances. As such, we agree with the alternative proposal to cap premium prices for work over $2 million in line with the example set out in the Discussion Paper (i.e. premium calculated based on the value of the construction up to a specified value). We note that in the case of a non-completion claim, the homeowner would have access to insurance cover of 20% of the amount of cover (or 25-30% should reform idea 4 proceed).

Reform idea 8 – Broader insurance exemptions for high rise buildings	
Question 17	QBE does not support the proposal to expand the insurance exemption for renovations and alterations to multi-dwelling buildings over 3 storeys. We are concerned this will result in a reduction in consumer protection. We would however support limiting the scope of the cover provided to rectification works of a structural nature. Non-structural defects should preferably be resolved with the developer and Body Corporate. This is based on the reasoning that the HBC scheme should be a scheme of last resort for major defects and not used as a remedy for issues that have possibly resulted from inadequate quality of work during construction.
Reform idea 9 – Insurance exemptions for some housing services	
Questions 18 – 20	QBE, in principle, supports the proposed insurance exemptions in circumstances where there will be no beneficiary, where it is limited to building work done on behalf of charities that provide housing services, and for work where the conditions of planning consent or restrictions on the use of the land require that the homes must be used for housing services. QBE, however, suggests that these continue to be subject to individual application (not automatically exempt as proposed) to ensure an appropriate level of rigour around the assessment is maintained and potential misuse of the exemption is minimised.
Reform idea 10 – Insurance exemptions for local government	
Question 21	QBE does not have a specific view on this question.
Reform idea 11 – Premium refunds or exemptions for 'build-to-rent' schemes	
Questions 22 – 23	QBE does not have specific views on these questions.
Reform idea 12 – Repeal provisions that regulate former scheme insurers	
Question 24	QBE does not have a specific view on this question.
Theme 3 – Providers and how they are regulated	
Reform idea 13 - Reform or repeal provision for 'alternative indemnity products'	
Questions 25 – 26	QBE does not support a proposal that would allow discretionary fidelity funds to operate in the scheme. QBE believes this would reduce consumer protections and agrees with SIRA's assessment in the Discussion Paper that potential ways to mitigate the risks to homeowners arising from the discretionary nature of a fidelity fund are not feasible. As such, QBE supports removal of the provision for 'alternative indemnity products' from the scheme to ensure that homeowners receive the protections derived from insurance and the regulatory regime applicable to insurers.
Reform idea 14 – Legislatively amend SIRA's functions to regulate icare HBCF	
Questions 28 – 29	QBE supports the proposals outlined in the Discussion Paper to strengthen SIRA's regulatory powers relating to icare's eligibility and claims handling models. Given the absence of competitive pressures to improve products and services, as noted in the IPART Review, we agree changes to strengthen regulatory oversight of icare are important to ensure ongoing accountability and transparency that will assist to underpin consumer protections.

Reform idea 15 - Refocus of the regulatory regime to a single, State-insurer model	
Question 30	QBE believes that competition is key to driving efficient pricing, innovative products and services and value for businesses, communities and governments. Competition is an important factor in the effective functioning of the economy. In this context, we support models that facilitate effective competition for the provision of sustainable insurance products and services. It is important however to recognise that private insurers and state governments have historically experienced significant losses and deficits when providing HBC in several states across in Australia. As such, private sector participation in the NSW HBC scheme remains dependent on the viability and sustainability of the insurance product. While there is potential for the HBC scheme to facilitate private market participation and competition in the future, there are a range of broader factors to be considered in this context. This includes the nature and scope of the coverage, the correlation with economic cycles, the effectiveness of building industry regulation, capitalisation/financial stability of the building industry and affordability of the product.
Question 31	As outlined above, a competitive and sustainable insurance market is desirable for an efficiently functioning economy and one that is generally thought preferable to a government monopoly. As such, we support retaining the option for private participation in the HBC scheme as the scheme develops. Until such time as there is a viable and sustainable competitive market, we also support measures that may assist with efficiency, innovation and provide support for consumers. For example, consideration could be given to facilitating a multiple agent model for the delivery of underwriting and claims management services. This would enable the experience and expertise of the private insurance market to be leveraged, encouraging further innovation and efficiencies.

Conclusion

QBE appreciates the opportunity to participate in the consultation on proposed regulatory reforms to the HBC scheme and would be pleased to discuss and provide any further information to support this response.

If you have any questions or require further clarification or information, please do not hesitate to contact [redacted], Head of Underwriting, Financial & Professional Services - Specialty ([redacted]) or [redacted] General Manager Government Relations & Industry Affairs ([redacted]).

QBE