

Tuesday 16th August

State Insurance Regulatory Authority

231 Elizabeth Street

Sydney NSW 2000

Via email: HBCreform@sira.nsw.gov.au

NIBA Submission: Home Building Compensation reform consultation

Introduction

The National Insurance Brokers Association (NIBA) welcomes the opportunity to provide feedback on the State Insurance Regulatory Authority's proposed reforms to the New South Wales home building compensation scheme.

NIBA notes the lack of actuarial data accompanying the proposed changes makes it difficult to assess the impact of the proposed reforms. This is especially significant where the proposed reforms would result in a reduction in the size of the pool or an increase in claims costs. NIBA is concerned that reforms that could lead to an increase in the number of claims or a reduction in the size of the pool could further exacerbate the uncertainty surrounding the long-term economic viability of icare HBCF.

About NIBA

NIBA is the peak representative body for the intermediated general insurance industry. NIBA represents approximately 450 member firms and 15,000 individual brokers including large, multinational insurance brokers, Australian broker networks, and small to medium-sized businesses located in cities and regional areas right around Australia.

NIBA aims to promote the role of insurance brokers and the role they play in supporting and advising their clients on risk and insurance matters. NIBA provides this knowledge and expertise to governments and government agencies to promote understanding of the operation of general insurance markets.

NIBA member firms all hold an Australian financial services licence (**AFSL**), issued by the Australian Securities and Investments Commission (**ASIC**) under the *Corporations Act 2001 (Cth)*, which enables them to deal in and/or advise on risk insurance products.

Insurance brokers represent the interests of the purchasers of insurance, the policyholders, and not those of insurance companies. Consequently, comments made by NIBA and its members are made on behalf of its members and the public that purchases insurance, not on behalf of insurance companies.

Question 1: Should victims of unlawfully uninsured work be able to claim on the home building compensation scheme in some circumstances?

NIBA does not support the proposal for owners whose contractors/ builders fail to take out insurance under the home building compensation scheme to be eligible to make a claim under the home building compensation scheme due to the significant impact this proposal

would have on the underlying risk of the pool and the upward pressure this reform would have on insurance premiums.

Extending the scheme to allow for uninsured homeowners to make a claim under the scheme would result in an increase in the number of claims, as well as higher premiums for responsible businesses. This increase in costs is ultimately borne by consumers through increased building costs.

Allowing uninsured homeowners to make a claim under the scheme would also create a moral hazard by providing an incentive for businesses to not obtain insurance knowing that the homeowner would be covered regardless.

Homeowners are responsible for ensuring their home is adequately insured. The Consumer Building Guide states *“HBC cover is required where work is worth more than \$20,000 (including labour and materials). The builder or tradesperson must give you evidence of HBC cover before they start work on your project or you pay them any money, including a deposit”*.

SIRA has indicated that this reform is intended to protect homeowners if their builder or contractor illegally failed to insure the work. In NIBA’s view protections to homeowners could be increased through education of homeowners as to the requirement for contractors to take out home warranty insurance and the ability for homeowners to verify details of insurance to prevent unlicensed contractors from providing fraudulent insurance documents.

NIBA also notes that the proposed approach would likely result in prolonged claims processes as homeowners will have to prove they were not aware the property was uninsured. This would add unnecessary complexity and costs to the already embattled scheme.

Question 3: *If adopted, should homeowners be required to diligently pursue the responsible business for a remedy first, if they want to claim for uninsured loss?*

The home building compensation scheme is intended to be a last-resort scheme where traditional means of seeking compensation have been exhausted or are not available due to insolvency. NIBA supports the retention of the home building compensation scheme as a last-resort scheme. If adopted, homeowners should be required to pursue the responsible business and the business given an opportunity to remediate/rectify any defect prior to a claim for an uninsured loss being made under the scheme.

Question 4: *Should unpaid premiums and claim costs for uninsured work be recovered from building businesses and developers that have not complied with their insurance obligations, including culpable directors?*

Yes, the home building compensation scheme should be able to recover claims costs and unpaid premiums from developers and contractors who have failed to comply with their insurance obligations.

Question 5: Should homeowners be able to make an insurance claim if the business that worked on their home fails to comply with a rectification order issued by NSW Fair Trading (whereas currently claims are only accepted if the business is no longer trading)?

This proposal seems suggest a move towards a first-resort scheme. NIBA does not support any changes that would result in the home building compensation scheme becoming a first-resort scheme.

A move towards a first-resort scheme would significantly increase claims and insurance premiums and result in higher building costs at a time when supply chain issues have already resulted in a dramatic increase in building costs across NSW. The previous

NIBA notes that the New South Wales first-resort scheme proved to be unsustainable with loss ratios in excess of 300%. The Queensland model features a number of key differences that reduce costs including a narrower definition of structural defect and incentivizing contractors to rectify works regardless of responsibility. Additionally, the maximum claim value of the Queensland scheme is significantly lower than New South Wales scheme.

Question 8: Should the maximum amount of cover offered by the scheme be increased from \$340,000 to \$400,000 to reflect the increase in the average cost of building a new single dwelling since the cover amount was last updated in 2012?

NIBA notes that SIRA has not provided any actuarial data on the impact to premiums should the maximum claim value be increased. In NIBA's view a cost assessment should be carried out prior to any decision to increase the amount of cover available under the scheme. NIBA also notes that the New South Wales home building compensation scheme already has the highest maximum claim value of all home warranty schemes in Australia (see table below).

	Maximum claim value	Median Capital house price
NSW	340000	1,120,836
ACT	85000	940,026
VIC	300000	806,196
QLD	200,000	779,895
SA	150,000	628,744
WA	100,000	555,538
TAS	200,000	738,399

Any increase to the maximum claim value is likely to result in an increase to premiums. NIBA encourages SIRA to investigate opportunities to reduce costs to the scheme prior to making any changes to the current caps and limits.

Question 12: Should SIRA publish a register of projects that SIRA has exempted from insurance, so that a person with an interest in the property may check whether work was lawfully done without insurance under an exemption granted by SIRA?

NIBA supports this proposal.

Question 15: Should homeowners and building businesses be able to agree to opt-out of insurance for work of over \$2 million to a single dwelling?

NIBA supports this proposal, due to the relatively low return-on-investment for high-value properties. However, NIBA believes that any uninsured works should be disclosed in the contract of sale or section 32 notice so that future homebuyers are able to make an informed decision prior to purchasing.

Question 18: Should building work be exempt from insurance if there will be no beneficiary, because the homes will be used to provide social or affordable housing or specialist disability accommodation?

NIBA supports this proposal, provided the exemption is limited to charities and not-for-profit organisations that provide housing services and where restrictions prevent the homes from being used for any purposes other than housing services.

Question 21: Should councils be exempt from insurance to develop housing on council-owned land?

NIBA supports this proposal.

Question 22: Given there is no beneficiary to claim insurance, should Build-to-Rent scheme developers be able to cancel the policy and claim a refund for the insurance premium?

Yes, Build-to-Rent scheme developers should be able to cancel the policy and claim a refund of paid premiums.

Question 23: Should the renovation or alteration of a Build-to-Rent building be exempt from insurance, given the homes are intended to be used for long-term lease over 15 years and there will be no person able to claim on insurance during that time?

Renovation or alteration of a Build-to-Rent property should be exempt from insurance where the insurance period for any home warranty claim is within the 15-year lease period. Any work carried out where the insurance period would extend past this period should require insurance to protect potential future property owners.

Question 25: Should fidelity funds be allowed to operate in the scheme that are not legally obliged to compensate homeowners, and instead have the discretion whether and how much to pay?

In NIBA's view, fidelity funds should not be able to operate in the home building compensation scheme due to the lack of consumer protection such funds provide. Fidelity funds are also not subject to the same regulatory oversight as other APRA-regulated insurance products. Concerns have previously been raised over the lack of adequate risk

management systems present within many of these funds and a lack of capital to satisfy APRA's prudential standards.

Question 27: Should the NSW Government instead remove provision for 'alternative indemnity products' such as fidelity funds from the scheme, given that IPART has found it is unlikely that any such product could be offered that would have the same consumer protections as insurance?

In light of the unsuitability of alternative indemnity products, NIBA supports this proposal.

Question 28: Should SIRA have the power to make icare HBCF amend and resubmit its eligibility or claims handling models and to adopt specific changes, if SIRA finds the models do not comply with legislation or guidelines?

Yes, NIBA supports greater oversight of icare HBCF by SIRA, including powers to adopt specific changes where the scheme does not comply with legislation and/or previously established guidelines.

Question 29: Should the law require that SIRA must publish a statement about its assessment and decision each time icare HBCF's lodges a new eligibility or claims handling model?

NIBA supports this proposal.

Question 30: Do you think it is commercially viable for multiple insurers and providers to operate in the NSW home-building scheme?

In NIBA's view, it is unlikely a commercial insurer will enter the NSW home warranty market in its current state. Prior to 2010, private insurers participated in the home building compensation scheme. However, these insurers exited the scheme due to the low profitability and high risk of the fund. The financial position of the incumbent provider highlights the financial difficulties insurers face under the current framework. If private insurers are to return to the scheme, significant steps must be taken to reduce the underlying risk of the pool.

Currently, the underwriting process uses historical financial records when determining a builders' risk. This means that the financial position of the builder at the time of assessment may be vastly different to the position indicated by their financial records. It is important for the long term of the scheme that the underwriting process is able to identify these risks as accurately as possible.

By switching from historical tax records to real-time financial information, such as Business Activity Statements, underwriters will have a more accurate view of a builder's financial position at the time of application.

This data may also assist underwriters to identify warning signs of potential illegal phoenixing activity and prevent these businesses from undertaking any further work. By identifying these businesses early and preventing them from participating in the scheme the overall risk of the pool can be reduced.

Question 31: If relaxing the regulation of private insurers' pricing and eligibility practices fails to achieve new market entrants, should the NSW Government reinstate icare's monopoly and focus on running a sole insurer model as efficiently as possible?

NIBA strongly opposes any moves to reinstate the icare as the monopoly insurer. As previously stated, the NSW Government should focus on reforms that reduce the underlying risk of the pool as a way to make the home building compensation scheme more attractive to private insurers.

NIBA believes that a competitive home building compensation market can deliver positive outcomes for NSW homeowners provided an appropriate regulatory framework is in place. NIBA encourages the NSW Government to work with industry to reform the existing regulatory framework and product design so as to encourage private participants.

Should you have any queries or wish to discuss any aspect of this submission please don't hesitate to contact me or my office.

Yours sincerely,



Chief Executive Officer
National Insurance Brokers Association