

Consultation on Home Building Compensation Scheme Reforms Discussion Paper – icare submission

Executive Summary

1. Insurance and Care NSW (**icare**) thanks the State Insurance Regulatory Authority (**SIRA**) for the opportunity to respond to the *Home building compensation reform Discussion Paper (Discussion Paper)*.
2. icare is uniquely placed to provide insights into the impacts of SIRA's reform ideas because it has been managing the Home Building Compensation Fund (**HBCF**) since icare's inception (with its underlying scheme entity, the NSW Self Insurance Corporation, managing the fund since the Government took over the product in 2010). As a result, icare has a deep understanding of home building compensation (**HBC**) insurance in NSW and a great appreciation of its role in providing a safety net for homeowners when other consumer protection safeguards fail.
3. icare believes that while consumer and homeowner protections must support residential construction activity in NSW to thrive, any reforms should not detract from the ultimate goal of protecting NSW homeowners.
4. To further the HBC scheme's purpose, icare considers the aims of the scheme should be to:
 - a. guarantee quality where the accountable builder is unable or unwilling to do so;
 - b. allocate costs of consumer protection on a fair basis between builders;
 - c. set the risk appetite for builder activity so that it supports a competitive and vibrant residential building industry, without undue barriers to entry or adverse selection against builders, while still maintaining prudent and reasonable controls against insuring high-risk builders; and
 - d. ensure consumer protection is provided in a sustainable and affordable manner.
5. The Discussion Paper includes a number of reform ideas arising from the findings and recommendations of the Independent Regulatory Tribunal (**IPART**) *Review of the Efficiency and Effectiveness of the NSW Home Building Compensation Fund (IPART Review)*. While icare supports many of the reform ideas in the Discussion Paper, consideration needs to be given to the cumulative impact of those changes on premium pricing. Although any one reform may have a limited impact, the overarching concern is to ensure that the combined effect of the reforms on premium pricing is financially sustainable and that the benefit of reforms collectively is not outweighed by their pricing impact.
6. Apart from the overall impact on premium pricing, icare's key concerns in response to the Discussion Paper relate to the following:
 - a. **Early claims** - while icare recognises the consumer benefit proposal under Reform Idea 2 to modify the HBC scheme to from a 'last-resort' option to allow claims at an earlier stage, the detrimental impacts for insurers, builders and the legal and commercial dispute resolution system outweigh the potential benefit. It would likely lead to increased litigation, further complexity in claims management and premium cost, and place icare in an invidious position of inherent legal tension between the interests of homeowners,

builders and the regulator, which may reduce the efficiency and consistency of the scheme and hamper confidence in icare's ability to manage claims.

- b. **Increasing SIRA's regulatory power** – while supportive in principle of the proposal to increase the regulatory power of SIRA under Reform Idea 14, icare does not agree with the specific proposal of enabling the regulator to override risk selection as it would undermine icare's ability to manage the interaction of risk selection and premium pricing.
- c. **Changing the competitive market** - the proposed modification of the competitive HBC market model:
 - i. removing the provisions which allow for competitors in the form of 'alternative indemnity products' providers in Reform Idea 13 is supported by icare for the reasons outlined in the Discussion Paper.
 - ii. reverting to a State-insurer model under Reform Idea 15 - whilst ultimately a policy decision of the Government, it is icare's view that the current arrangements of a competitive framework without any actual competition fails to deliver the intended benefit to consumers of a competitive market, as the arrangements are inefficient, expensive and administratively complex. Before determining that, though, icare suggests that SIRA play a stronger role in determining the desired long-term outcome (governmental delivery of the insurance or otherwise) and then in leading reforms to achieve that outcome.

Background

- 7. In the Discussion Paper, SIRA raises 15 regulatory reform ideas (**Reform Ideas**) resulting from the findings and recommendations of the IPART Review. This document provides icare's response to those reform ideas.
- 8. icare provides its response to these Reform Ideas by adopting the headings used in the Discussion Paper.
- 9. icare welcomes the opportunity to participate in further meetings with SIRA to discuss the matters raised in this response or any other matter arising from the consultation, including in progressing any proposed legislative amendments.

Response to SIRA's Reform Ideas

Reform Idea 1 – Cover victims of unlawfully uninsured home construction

- 10. SIRA proposes to change the HBC scheme to allow these uninsured homeowners to make claims through the HBCF. The proposed reform being considered by SIRA includes a range of limitations, exclusions and other mitigating measures to reduce the impact of the change, such as limiting the scope of cover, excluding complicit homeowners, and giving SIRA recovery rights against businesses and culpable directors analogous to arrangements under the workers compensation scheme.
- 11. icare supports an arrangement to protect victims of unlawfully uninsured construction, but not in the nature of direct cover through the HBCF.
- 12. In icare's view, the outcome intended by this proposal, namely the protection of homeowners where a builder has not met their legal obligations to arrange insurance, is essential for achieving the proper objective of the ultimate goal of the scheme. In icare's experience, it has historically been difficult to deal with builder

insolvencies where a failure to insure has occurred, and these situations typically lead to poor consumer outcomes.

13. The critical question is how to deliver this consistent consumer protection outcome without undermining the character of the current general protection of HBCF as insurance, or providing perverse incentives for homeowners to not scrutinise builder insurance obligation compliance so as to avoid premium impacts.
14. In icare's view, it is unsuitable for the protections to be characterised as "insuring" or "covering" the victims of unlawfully uninsured home construction, as this is a public policy outcome not connected to the intended role of icare as a commercial insurer. The role of covering this gap would be more appropriately characterised as government indemnity, benefit or entitlement equivalent to the insurance benefit, rather than an assumption of insurance.
15. A shift in the responsibility to cover uninsured losses without a contract of insurance or commensurate premium to icare effectively moves the costs of covering this gap to the insurance providers and their responsible customers and appears to conflict with the intent of icare to effectively operate as a commercial insurer. Funding by levy, either on HBC insurance or on building contracts, is more appropriate under principles of contract, but there is still the issue of making honest builders cover the cost of dishonest builders. It may be more appropriate to consider funding this protection from the Government directly.
16. icare recognises that, in determining the characterisation of this benefit, there is a public policy interest in it being formalised and its funding mechanism clarified prospectively. Where there is a large builder collapse, it has been the historic experience across jurisdictions that governments commit to compensation, bailouts, grants and other interventions to prevent adverse outcomes. However, where there are smaller insolvencies, victims suffering equivalent harm are not as likely to receive intervention without an established government power and pre-funding mechanism.
17. Regardless of the form and funding mechanism ultimately preferred, however, icare notes that there are potential practical and cost-related efficiencies of managing uninsured claims alongside insured claims. In particular, managing claims arising from warranty failures is a specialist activity, and there would be limited opportunity for scale while icare is the sole or dominant HBC insurance provider.
18. Due to the uncertainty in the volume of uninsured work in NSW, icare is not in a position to reliably estimate the cost impact of this proposal, however, icare considers that it is unlikely to be substantial.
19. Should this reform, or any equivalent reform, be introduced to provide protection to victims of unlawfully uninsured residential building work, icare agrees with the limitations proposed in the Discussion Paper, including measures whereby homeowners would first have to pursue the usual remedies against the builder and for related entities, owner-builders, and complicit homeowners to be excluded.

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

20. The HBC scheme is a 'last resort' option and requires, in order to trigger coverage, the death, disappearance, insolvency or licence suspension of a builder for failure to pay the relevant claimant. The Discussion Paper seeks input on a proposal to allow claims to be made at an earlier stage, where builders fail to comply with a rectification order made by NSW Fair Trading, a court or Tribunal.

21. In icare's view, this is the most fundamental of all changes raised in SIRA's Discussion Paper, and the detrimental impact of such a substantive change outweighs the potential benefit. The central issue is not the transition of cost or consumer risk, but the likely increased litigation, further complexity in claims management, and additional premium cost associated with the reform. icare anticipates the reform would reduce the efficiency and consistency of the scheme and hamper builder and homeowner confidence in icare's ability to manage claims.
22. This reform would effectively require insurers to:
- a. generally accept NSW Fair Trading rectification orders as binding and recover the content of an administrative determination through civil legal action against builders on a regular basis; or
 - b. engage in disputes with NSW Fair Trading in place of the builder where there is serious disagreement.
- This would likely require much closer integration and alignment between the insurer and NSW Fair Trading, whereby decisions of the building regulator, which remain open to challenge and are made without consideration of commercial impacts, would in effect serve as the insurance liability determination. This interdependency would not be a proper or appealing position for any commercial insurer. In a market that is already unattractive to new entrants, care should be taken to avoid making the HBC insurance market less appealing to potential competitors unless there is a positive determination to adopt a policy of single Government insurer.
23. The reform also requires icare's direct and material involvement at an early stage in building disputes and in court and administrative appeals. This leads to significant additional complexity in claims management, shifting the emphasis from cost-effective construction procurement to litigation and dispute management.
24. The reform may also impose a near-fiduciary duty for icare to publicly dispute with the building regulator in situations where there is a difference of assessment between insurance loss and the regulatory approach to construction issues. Increased complexity and disputes will ultimately decrease confidence in icare's ability to manage claims, and possibly NSW Fair Trading's ability to manage complaints.
25. In any dispute about entitlement to cover, therefore, this option could see icare proceeding adversarially against at least one of the homeowner, the builder or the building regulator. None are ideal, as:
- (a) there are strong fairness considerations in icare acting against the homeowner, even relative to the current position of possible contest between builder and homeowner;
 - (b) there are fairness considerations, commercial considerations (builders are also insurer customers), and insurance considerations (insurers generally do not proceed against their insured parties) in acting against a builder; and
 - (c) there are integrity, public confidence and reputational considerations for icare as a public sector entity proceeding against the building regulator.
26. Noting the Government legislative reforms for building regulation already undertaken through the *Design and Building Practitioners Act 2020* and *Residential Apartment Buildings (Compliance and Enforcement Powers) Act 2020* and any further reforms to the *Home Building Act 1989* or NSW construction legislation

generally, it is important to consider that any shift here would occur in parallel to the courts and tribunals already being required to settle novel law and questions of duty and liability. It may be unsuitable to introduce further scheme complexity at the same time.

27. This change will also materially impact premium pricing, although this is difficult to quantify at this stage. Some of the additional costs may be defrayed by recoveries from builders, but the value or certainty of these recoveries is not known. The potential drivers of cost reductions contemplated in the Discussion Paper may rely on the recovering insurer having the authority of a combined insurance-regulatory entity.
28. While the Discussion Paper draws a comparison with the equivalent scheme in Queensland, it is important to be mindful of the differences in NSW. In Queensland, the model of the Queensland Building and Construction Commission (**QBCC**) is a combined insurance-regulatory structure, whereas in NSW the model is to have independent and regulated insurance providers. This comparison may therefore be unreliable.

Reform Idea 3 – Update the minimum insurance cover

29. The Discussion Paper considers increasing the current minimum insurance cover offered by HBCF from \$340,000 to \$400,000.
30. Subject to the overarching concern in relation to the cumulative impact of reforms on premium rates, icare supports this proposed change to the minimum cover, as any uninsured losses place a significant burden on affected homeowners. Although the impact of this reform is not yet certain, icare's initial assessment indicates that this adjustment to the minimum insurance cover is likely to lead to an estimated premium increase of 3 to 6 per cent.
31. icare also suggests that, rather than setting a fixed increase in the minimum insurance cover, an index be applied instead, perhaps pegged to a periodic analysis of building cost growth.

Reform Idea 4 – Increase the cover for non-completion claims

32. SIRA proposes to increase the sub-limit for non-completion claims (being the cost of finishing unfinished building work) from 20 per cent of the building contract cost to 25 or 30 per cent.
33. icare supports this reform, subject to the impact that it, together with other reforms, will have on premiums. icare's view is that 25 per cent would be largely adequate for present purposes, but 30 per cent may better deal with the apparent trend of increasing uninsured losses.
34. As indicated in the Discussion Paper, increasing the sub-limit to 25 or 30 per cent of the building contract cost is expected to have the following impact on premiums:
 - a. 5 per cent increase (that is, extending the sub-limit from 20 to 25 per cent of the contract cost) will add an estimated 2.4 per cent to overall premiums; and
 - b. 10 per cent increase (that is, extending the sub-limit from 20 to 30 per cent of the contract cost) will add an estimated 4.9 per cent to overall premiums.
35. Between 2015 and 2020, it appears that an average of 56 per cent of non-completion claims have reached the 20 per cent cap, meaning the majority of non-completion claims are not fully covered despite being well

below the \$340,000 limit of liability. More significantly, icare's analysis suggests that the trend of uninsured losses is increasing. Uninsured losses that exceed the maximum cover for non-completion claims are similar to uninsured projects and place a large burden on affected homeowners. This reform would deliver better outcomes for the majority of customers who are exceeding the non-completion claims limit.

Reform Idea 5 – Publish exemptions granted by SIRA

36. Currently, there is no public register where an interested person can check whether property works were done without insurance on the basis of a granted exemption. The Discussion Paper suggests that SIRA be required to publish details of insurance exemptions that it has granted. Creating a register would enable the public to see if there is an exemption in place; for example, due to special circumstances, if full compliance is impossible, or if it would cause undue hardship.
37. Given that the proposal aligns with the objective of open, transparent and accountable Government decision making, icare agrees that SIRA should publish details of insurance exemptions granted in a public register. The benefits of greater accountability and transparency outweigh the costs of publishing (which, as indicated in the Discussion Paper, SIRA considers are unlikely to be material).
38. icare suggests that, in addition to publishing the details of the exemption, SIRA should consider including the rationale behind the grant.

Reform Idea 6 – Update the threshold for requiring insurance

39. The \$20,000 threshold for a building project to require HBC insurance has remained the same since 2012. While this threshold has not changed, increasing inflation leading to higher average building costs means that more projects are meeting this threshold and requiring HBC insurance. The reform idea raised is to increase the threshold to \$26,000 or another figure to be determined by consultation.
40. In icare's view, the threshold should remain the same because it is already comparatively high, with NSW having the highest threshold for HBC insurance in Australia. While the costs of construction have increased, meaning a greater proportion of projects are captured than in 2013, there is significant risk to small projects relative to the premium paid should the threshold be increased.
41. In relation to the impact on premium pricing, icare preliminarily estimates that the premium impact of this change would be less than \$1 million per year in premiums foregone and therefore less than 1 per cent of premiums retained by homeowners. This reform also requires one-off technology and eligibility process changes, the costs of which will need to be factored into premiums and should be considered against the potentially limited benefit.

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

42. The premiums paid by building business (and ultimately homeowners) are calculated by multiplying the building contract amount by the applicable rate. This means that the higher the value of the building project, the higher the premium will be. Regardless of the premium paid, however, the insurance cover has the same fixed cap. Accordingly, when compared to lower value projects, particularly high value projects receive disproportionately less value for their premium. IPART has recommended shifting to voluntary cover where

a single-dwelling project exceeds \$2 million, through a system that allows homeowners to opt-out. Alternative options being considered by SIRA to ensure premiums remain proportionate to benefits are to cap premiums, or provide optional additional cover for high value projects.

43. While icare recognises that the premium paid for HBC insurance for high-value single dwellings may be disproportionate to benefit, the proposal for an opt-out system has many disadvantages. An opt-out scheme would be complex for icare to administer, SIRA to enforce and disadvantage successor purchasers, and does not reflect the fact that claims arise on high-value projects as frequently as on other projects.
44. Instead, icare supports alternative options to ensure premiums remain proportionate and considers premium caps indexed against the policy limit of liability to be the best solution. These caps can ensure that benefits and premiums remain proportionate, maintain the protections for successors in title, and have less premium impact on the overall scheme. The total estimated portfolio impact of a premium cap is a reduction of \$3 million per year compared to \$6 million for an opt-out scheme.
45. The alternative of introducing premium caps for high value work, which can be indexed depending on the value of the project, would achieve the same goal of ensuring proportionality of premium and benefit, without the disadvantages of an opt-out system.

Reform Idea 8 – Broader insurance exemptions for high rise buildings

46. While not always understood, the exemption from the requirement to obtain HBC insurance for multi-storey (high rise) buildings does not extend to repair, renovation, or rectification work and only covers their original construction. The IPART Review found there was a lack of clarity regarding the requirements for insurance for multi-dwelling buildings over three storeys high. To give better clarity, the Discussion Paper raises expanding the exemption to include any work (including, for instance, repair work done for strata owners corporations) on new or existing multi-dwelling buildings over three storeys.
47. In the form currently proposed, icare considers the positive and negative impacts of a broader exemption are relatively balanced. Removing coverage of multi-storey repair/renovation/rectification would bring NSW in line with the scope of the mandatory product in other jurisdictions, however, it would reduce protection for some consumers and create a greater disparity between house and apartment owners.
48. If this reform was combined with sustainable, robust Latent Defects Insurance in the commercial market (as recommended by the taskforce of the Office of the Building Commissioner), or some other consumer protection mechanism, icare would support this reform as it would clarify and simplify the insurance process without material downsides for consumers.

Reform Idea 9 – Insurance exemptions for some housing services

49. For some social and affordable housing or specialist disability accommodation, insurance must be purchased, but there is in many cases no beneficiary. SIRA has requested feedback as to whether the existing exemptions from buying HBC insurance should be broadened to automatically exempt work done for the purpose of social and affordable housing, and self-contained specialist disability accommodation, on the basis that there are unlikely to ever be beneficiaries to lodge a claim.

50. As this would have marginal impact on premiums and is in line with existing exemptions, icare supports this reform. It is understood that SIRA's reasoning is that the housing services are developers and at law are not policy beneficiaries; and that consequently, limited if any consumer benefits would be forgone. icare notes that in some limited cases, specialist disability accommodation may be resold to individual people with disabilities. Before adopting this reform, therefore, an abundance of caution should be exercised to ensure that broadening the exemption does not create a gap for vulnerable people.

Reform Idea 10 – Insurance exemptions for local government

51. Under the NSW Department of Planning and Environment's *Housing 2041: NSW Housing Strategy*, the NSW Government plans to support the use of council land for housing where it is deemed appropriate. SIRA has sought feedback as to whether the exemption from buying HBC insurance (which already exists for public sector agencies doing residential building work) should be extended to include house building work undertaken for local councils in development initiatives. The underlying rationale is that if the work is ever sold, the council will always be available as a recovery target and the risk that exists in private construction does not exist.

52. As adopting this reform would have marginal impact and is in line with the position on exemptions for State Government, icare supports the exemption being broadened in this way.

Reform Idea 11 – Premium refunds or exemptions for 'build-to-rent' schemes

53. The NSW Government encourages large scale build-to-rent (**BTR**) developments through certain tax concessions. BTR is a relatively new housing model for NSW, where a developer retains ownership of a residential building and offers homes for long-term lease. To further support the BTR model, the Discussion Paper proposes that refunds of premium be provided for developments once the project is registered under the BTR scheme, as well as exempting repair, renovation, and alteration work done on existing BTR buildings.

54. icare opposes this reform proposal, at least in relation to premium refunds, due to the legal inconsistency involved. Whether exemptions are granted is a matter for the Government, but icare does not anticipate a material premium impact.

55. Unlike the other proposed exemptions supported by icare, the refunds-based approach would put the HBCF on risk for non-completion of work (subject to any developer exclusion), and give an entitlement to the builder for premium recovery at completion, generally to the benefit of the developer. This would create undue benefit (protection without cost to the beneficiary) and thwart basic principles of contract.

56. icare is also concerned about the administrative impact of dealing with exemptions, not only in terms of the application/refund process itself, but in maintaining accurate accounts despite annual uncertainty about how much premium may need to be refunded in BTR matters.

Reform Idea 12 – Repeal provisions that regulate former scheme insurers

57. This reform proposes repealing provisions regarding 'run-off' home warranty insurers once all claims are closed, because by that time the warranty period within which homeowners can put the insurers on notice would have passed, and the policies issued under the old scheme would have expired.

58. Given the benefits identified in the Discussion Paper of removing this remaining regulatory burden, icare supports this reform, but considers it would be prudent for SIRA to ensure thorough analysis be undertaken and work in close consultation with affected insurers to avoid any unintended consequences.

Reform Idea 13 – Reform or repeal provision for ‘alternative indemnity products’

59. To enable competition in the HBC market, the legislation allows for providers to apply to SIRA for a licence to be a provider under the HBC scheme, either as a private sector insurer or as an ‘alternative indemnity product’ (AIP) provider. AIPs (such as fidelity funds or mutual funds) vary from prudential insurers in that they do not have equivalent contractual or statutory obligations to pay claims. Since the avenue for new providers was introduced in 2018, there have been no AIP new market entrants, as only two licence applications have been received and both were unsuccessful.

60. While IPART recommended reforms to assist AIP market entry, SIRA has indicated it does not believe reforms are feasible, and this view is backed by industry associations. The Discussion Paper proposes either removing the provisions for AIPs or, if kept (being the less preferred option), allowing AIPs to operate with a discretion as to whether to pay claims and accepting the risk that poses to consumers.

61. For the reasons outlined by SIRA in the Discussion Paper and given the longstanding concern about the suitability of such models in NSW, icare wholly agrees that the provisions enabling new AIP provider market entrants should be removed. icare supports the position that the HBC insurance product be limited to insurance providers who are prudentially regulated (either by the Australian Prudential Regulation Authority or SIRA).

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

62. Under the current regime for the HBCF, icare must submit an eligibility model, claims handling model and premium filing annually to SIRA. Once in place, icare is bound to follow each of these. While SIRA is able to reject an eligibility or claims handling model, in the event that it does not accept some aspect of these models, it cannot require modification or approve with certain conditions.

63. IPART has recommended that HBCF premiums be determined by IPART or SIRA, however, the NSW Government did not accept that recommendation. IPART also recommended that icare should continue to propose models, but that ultimately, SIRA should determine the model to be adopted. The Discussion Paper proposes that SIRA be given the power to issue directions to icare to change a model or, if icare does not do so, to deem a change to the model (which icare would then be bound to follow).

64. While icare does not oppose the regulatory changes in principle, icare does not agree with the specific reform proposed. The proposal in its current form, which enables the regulator to override risk selection aspects in isolation, would undermine icare’s ability to holistically manage risk selection and premium pricing. This could result in a scenario where the regulator insists on a risk acceptance without allowing for full premium recovery, as is required by icare’s obligations.

65. icare considers the existing regulatory mechanisms (such as pre-filing meetings, a rejection power and a guideline-making power to specify the content and purpose of models) provide an effective means for SIRA

to regulate premiums, claims handling, eligibility, and so on. SIRA already has the power to include specific eligibility requirements or restrictions, which requires icare to design and submit a compliant model. icare believes that further reform is unnecessary and could unreasonably interfere with icare's functions.

66. There may be opportunities for other regulatory changes in line with the IPART recommendations that do not have this issue. For example, the power to approve, rather than not reject, a combined eligibility and premium submission, may enable SIRA to require that models be submitted in line with any guideline or objective, without creating opportunity for mismatch between premium and risk.
67. Further, icare notes that the IPART recommendations that this reform is intended to address are predicated on assumptions regarding the outcome of the Discussion Paper's Reform Idea 15. SIRA has noted that some elements of the current regulatory environment are required due to the nominally competitive environment. As such, in line with its submission on Reform Idea 15 below, icare believes that positive decisions regarding the position on scheme competition should be made prior to further amending regulation.
68. Should the proposed change proceed, the reform (and any subsequent exercise of new powers) should be done in consultation with icare's Minister and NSW Treasury, since the cost of the risk selection ultimately flows into the NSW balance sheet, and because the change would reduce the powers of icare's Minister and Board to balance risk and premium.

Reform Idea 15 – Refocus of the regulatory regime to a single, State-insurer model

69. Due the costs of maintaining a notionally competitive market in circumstances where there is an ongoing lack of interest for private market entrants, SIRA proposes that unless their current attempt to facilitate market entry is successful (through reduced regulatory burden in guidelines for private entrants), the NSW model revert to a single State-insurer model.
70. icare recognises the current position is untenable. While competition could yield positive outcomes for consumers, the current situation of an operational and regulatory environment geared for non-existent competition does not deliver the intended benefit to consumers. Instead, it is expensive, inefficient, administratively complex and necessarily involves redundant resources across icare and SIRA. The current competitive market arrangements (including the competitive neutrality price loading, data reporting requirements that are redundant without competitors, and other regulatory resources) come with costs which are ultimately borne by homeowners, builders and the State. Where these arrangements remain unable to secure a competitive entrant, the framework should be amended to remove those costs in the interest of maximising the efficiency of the scheme.
71. icare says, though, that the decision on reform should be based on the ultimate long-term goal for the scheme and that further policy work is needed to elicit that goal.
72. Looking at other jurisdictions for comparison, while Victoria has commercial insurance competition, it is unlikely that the introduction of such niche competitors will fundamentally alter the NSW Government's exposure to the market or change the dynamics of risk selection for builders. Following recent builder insolvencies, Tasmania is looking to establish a home building compensation fund without competition.

Further, the current volatility of the residential construction environment makes medium-term commercial competition less likely.

73. icare notes that the HBCF has only been pricing at the full operational break-even rates since 2021 and that technical pricing for the final category of duplex and triplex dwellings is only scheduled for October 2022. Industry consideration of SIRA’s shift to more flexible and principles-based prudential requirements for eligibility and premiums have only been in place since December 2021. Accordingly, as noted in the Discussion Paper, it may be that competition will eventuate in the current environment over time and that patience is the appropriate course.

74. icare is of the view, however, that these changes are likely to be insufficient to incentivise entry into the market on their own. To attract private market entrants, icare anticipates that the market would need to offer a greater chance at sustainable profitability or greater underwriting flexibility for private insurers. icare agrees with IPART that, despite the intent of the existing framework, icare is almost certain to remain the dominant, if not sole, provider for the medium-term. The barriers to a commercial insurer entering the market on a for-profit basis are considerable:

- a. Even after material premium increases driven by the transition to technical pricing and the increase in NSW residential construction contract values, the premium pool is small relative to insurance products of similar complexity and volatility risk.
- b. The long-tail nature of the product requires significant commitment of capital relative to potential revenue.
- c. The specialist nature of HBC underwriting makes insuring warranty risks labour-intensive and limits available economies of scale.
- d. The regulatory regime imposes unusual objectives, such as encouraging a vibrant residential building industry on a commercial insurer. Future regulatory and legislative objectives may require the insurer to coordinate, or even effectively subordinate, decision-making to the regulatory bodies such as NSW Fair Trading or the Office of the Building Commissioner.

75. Considering these barriers, it may be reasonable to anticipate that further material changes that would allow greater profitability or reduced underwriting effort may be required. Methods to achieve higher profitability and greater flexibility, however, are likely to have negative effects for homeowners, such as higher premiums or reduced cover. This can be seen in the history of Government interventions that attempted to retain private market participation in 2002 (the original transition from the first resort benefits that had been in place for homeowners since 1972), and 2003 (the exclusion of new construction high rise buildings from the legislative scope that had been covered since 1972).

76. The below table summarises the history of the NSW HBC Scheme.

1. Government run 'first resort' scheme	2. Privately run 'first resort' scheme	3. Privately run 'last resort' scheme	4. Government run 'last resort' scheme	5. Nominally competitive 'last resort' scheme
1972: Scheme established	<ul style="list-style-type: none"> • 1997: Private Home Warranty Insurance Scheme commenced 	<ul style="list-style-type: none"> • 2002: Scheme moved from 'first resort' to 'last resort' 	<ul style="list-style-type: none"> • 2010: Government entered the market with new premium structure 	<ul style="list-style-type: none"> • 2019: icare began staging transition to sustainable

<p>1992-1993: Royal Commission into the Building Industry and Building Services Corporation report released, which recommended moving towards private underwriting</p>	<ul style="list-style-type: none"> • 2001: HIH collapsed (40% of market) • BIG Corp established for affected policy owners 	<ul style="list-style-type: none"> • 2003: High-rise buildings removed from the scheme • November 2009: NSW Government announced it will enter the market, managed by the NSW Self Insurance Corporation, as private insurers flag plans to exit the market 	<p>and became the sole underwriter of home warranty insurance in NSW</p> <ul style="list-style-type: none"> • 2015: Renamed to HBCF and icare established • 2017: SIRA appointed regulator • 2018: Private competitors permitted to seek license 	<p>pricing</p> <ul style="list-style-type: none"> • 2020: IPART Review undertaken • 2021: SIRA delivered regulatory reform to encourage commercial competitive • 2021: icare delivered operational reform based on IPART findings. • October 2022: icare reaches full HBCF technical pricing
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77. The question of competition is thus a difficult issue, which needs a clearer Government policy position on the intended long-term outcome. Various consequences, such as consumer cost, consumer protection, consumer responsibility and appropriateness of Government balance sheet exposure, can only be evaluated in the context of a clear public policy position. icare can advise on different initiatives and provide input on policy concepts, but ultimately these need to be determined by reference to a desired end-state. icare does not believe that has been sufficiently articulated.

78. icare, with complete respect, challenges SIRA to bring forward the arguments for a policy position reflecting the desired end-state, whether this be government monopoly, mixed government/commercial arrangements or otherwise.

79. As a matter of policy, the NSW Government should make a decision on whether the priority is to achieve a truly competitive market, even at anticipated consumer impost, to formally reverse the policy position adopted in 1993 of moving to private underwriting and recognise the consumer benefit objective as ultimately a Government obligation, or otherwise adopt a deliberate position such as hybrid delivery.

80. icare does note that when the HBCF was first formed (as the Home Warranty Insurance Fund) through the *NSW Self Insurance Corporation Amendment (Home Warranty Insurance) Act 2010*, the following intended benefits of the arrangements were espoused to the NSW Parliament:

- a. "A single Government insurer will allow premiums to be priced consistently across the State."
- b. "There will be one set of eligibility conditions for all builders, as opposed to the current arrangements where different rules apply depending on the insurer."
- c. "These new arrangements will increase transparency for builders and consumers and provide greater certainty."

icare believes that it has delivered on those imperatives, but that the current reforms in place to encourage competition, including the recent regulatory changes, logically encourage departure from these objectives.