

Executive Summary

Inquiry Reference (Chapter 1)

The Home Building Amendment (Insurance) Legislation Bill 2002 was passed by the Legislative Council on 9 May 2002. The Legislative Council also resolved to refer the provisions of the bill, as passed, to the Standing Committee on Law and Justice for inquiry. The terms of reference for the inquiry were straightforward: the Committee was charged with examining the impact of the *Home Building Amendment (Insurance) Act 2002* on home warranty insurance, home builders and consumers. The Committee received 23 submissions and heard evidence from 16 witnesses.

New South Wales Home Warranty Insurance Scheme (Chapter 2)

The Home Warranty Insurance Scheme was established under Part 6 of the *Home Building Act 1989* and Part 5 of the *Home Building Regulation 1997* to provide insurance cover for home owners against losses of up to \$200,000 arising from defective and incomplete building work. The scheme commenced on 1 May 1997. Insurance is provided by private insurers approved by the Minister for Fair Trading. Contractors are required to take out an insurance policy in the name of the home owner before the contractor is able to commence work. The requirement to obtain insurance is compulsory and is linked to the licensing system for contractors undertaking residential building work.

Pressure for Reform (Chapter 2)

Following the commencement of the scheme, the home warranty insurance market experienced a relatively calm initial period. However, like other insurance markets, it was badly affected by the collapse of HIH Insurance in March 2001 and the events of 11 September 2001. By the end of 2001 the media was reporting a crisis in home warranty insurance and it became clear that the long-term viability of the market was under threat. In response, the New South Wales and Victorian Governments undertook negotiations with the insurance industry and other interested parties to find a solution and subsequently announced uniform reforms to their home warranty schemes on 13 March 2002. Some of the reforms were implemented administratively and the remainder were realised through the passage of the *Home Building Amendment (Insurance) Act 2002*. Despite the announcement of the reforms, the State's second largest provider of home warranty insurance, Dexta Corporation Ltd, announced in April 2002 that it was withdrawing from the home warranty insurance market because it was unable to secure a re-insurer. It was only after the New South Wales and Victorian Governments put in place arrangements for the necessary reinsurance that Dexta was able to re-open for business two weeks later.

The Home Building Amendment (Insurance) Act 2002 (Chapter 3)

The *Home Building Amendment (Insurance) Act 2002* was assented to on 16 May 2002 and came into force on 1 July 2002. The Act amended the *Home Building Act 1989* and the *Home Building Regulation 1997* to make further provisions with respect to insurance for residential building work, owner-builder work and the supply of kit homes; and for other purposes. The Amendment Act aimed to ensure the long-term viability of the home warranty insurance scheme and implemented five main reforms. First, it provided that home warranty insurance for residential building work, the supply of kit homes and for certain other work, is *last resort* insurance. This means that insurance only covers losses that arise where the builder or supplier is insolvent or dead or has disappeared. In all other circumstances a consumer must pursue a

contractor through other means such as the processes of the Consumer, Trader and Tenancy Tribunal. Second, with regard to losses arising from defects, the Amendment Act creates two separate types of loss with different periods of cover. In regard to a *structural defect*, the period of insurance cover is six years after the completion of the work, the supply of the kit home, or the end of the contract relating to the work or supply, whichever is the later. In regard to loss arising from a *non-structural defect*, the period of cover is two years. Third, the Amendment Act enables the Minister for Fair Trading to approve alternative home building indemnity schemes or arrangements in New South Wales. Fourth, it also provides that the losses indemnified by an insurance contract include any legal or other reasonable costs incurred by a beneficiary in seeking to recover compensation from the contractor or supplier for the loss or damage or in taking action to rectify the loss or damage. Finally, the Act enables insurers to limit liability for losses arising from the non-completion of building work to 20% of the contract price.

Impact of the Amendment Act on Home Warranty Insurance (Chapter 4)

The main aim of the Amendment Act was to ensure the long-term viability of the Home Warranty Insurance Scheme, which had been threatened by instability in the insurance market. The Amendment Act was also a direct response to the lobbying efforts of insurers which indicated that, without the reforms, their presence in the market was tenuous. All indications from participants in the Inquiry from the insurance sector are that the reforms have, at this stage, been successful in stabilising the market and thereby enhancing the long-term viability of the scheme. The reforms have reduced the overall extent of insurers' liability and thereby their overall risk. The major insurer in the market, Royal & SunAlliance, has predicted that its premiums could drop by as much as 20% as a result of the reforms. The insurance sector was generally optimistic that additional insurers may now consider entering the market as a result of the reforms and the Committee is aware of at least one insurer that is actively considering this option. The Committee is also aware of at least two industry associations that are exploring the possibility of establishing new alternative indemnity arrangements pursuant to the new provisions.

Impact of the Amendment Act on Home Builders (Chapter 4)

The evidence examined by the Committee throughout the Inquiry indicated that the Amendment Act is perceived as having both positive and negative impacts on home builders. Negative impacts include: uncertainty about the nature of the reforms among builders; a reduction in cash flow that may be caused by the 20% liability cap for non-completion claims; and delays in dispute resolution processes that may be caused by the last resort reform. The last resort reform was also identified as having a positive impact on builders because it locates responsibility for defective work in the hands of builders rather than insurers, with an emphasis on dispute resolution. Any new alternative indemnity arrangements established pursuant to the new provisions will provide builders with much needed choice and may also contribute to a reduction in premiums. In so far as the impact of the Amendment Act on home builders could be identified at this stage, the extent of the impact was largely speculative. None of the negative impacts were identified as being particularly onerous.

Impact of the Amendment Act on Consumers (Chapter 4)

The Committee acknowledges the view of Building Action Reform Group that the Amendment Act will have a negative impact on the consumer protection afforded by the Home Warranty Insurance Scheme. In doing so, however, the Committee notes that this view must be tempered with an understanding of the background and purpose of the Amendment Act as a means of

preventing insurers from withdrawing from the home warranty insurance market, and conflicting opinions that the reforms will have minimal impact on consumers. The Committee also identified that some of the reforms will clearly have a positive impact on consumers.