

Standing Committee on Law and Justice

**Report on the *Home  
Building Amendment  
(Insurance) Act 2002***

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## **Terms of Reference**

*That the Standing Committee on Law and Justice investigate the impact of the Home Building Amendment (Insurance) Act 2002 on:*

*home warranty insurance;*

*home builder; and*

*consumers.*

*The Committee is to report by 5 September 2002.*

These terms of reference were referred to the Committee by the House on 9 May 2002.

## **Committee Membership**

**The Hon Ron Dyer, MLC**, Australian Labor Party, Chair

**The Hon John Ryan, MLC**, Liberal Party, Deputy Chair

**The Hon Peter Breen, MLC**, Reform the Legal System

**The Hon John Hatzistergos, MLC**, Australian Labor Party

**The Hon Janelle Saffin, MLC**, Australian Labor Party

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## Chair's Foreword

In this report, the Standing Committee on Law and Justice has endeavoured to carry out a thorough and comprehensive examination of the impact of the *Home Building Amendment (Insurance) Act 2002* on home warranty insurance, home builders and consumers.

The Committee has noted that the move to a 'last resort' home warranty insurance scheme implemented by the Amendment Act aligns New South Wales with the schemes in South Australia, Victoria, Western Australia, the Australian Capital Territory and the Northern Territory. This reform and other reforms in the Amendment Act are in line with the recent findings of the National Review of Home Builders Warranty Insurance and Consumer Protection, conducted for the Ministerial Council on Consumer Affairs by Professor Percy Allan AM. The last resort reform rids New South Wales of what Professor Allan described as the 'cruel hoax' of the first resort schemes.

Most significantly, the Committee has found that the Amendment Act has been successful in achieving its aim of stabilising the home warranty insurance market, which had been in crisis following the collapse of HIH and the events of 11 September 2001. However, the Committee has asked that the Government consider some issues relating to the manner in which the Amendment Act impacts on builders and consumers.

I would like to thank my colleagues on the Committee for their participation in the Inquiry, and their bi-partisan approach to the report and its findings and recommendations. I would also like to thank the Committee Secretariat for their assistance. In particular, Ms Rachel Callinan, the Senior Project Officer for this Inquiry, provided comprehensive research and valuable assistance in drafting this report. Thanks are also due to the participants in the Inquiry who made submissions and appeared as witnesses at hearings.

**The Hon Ron Dyer MLC**

**Committee Chair**

## **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.

## Summary of Recommendations

### **Recommendation 1      Page 17**

The Committee recommends that the New South Wales Government should continue with the implementation of a data collection procedure for the home warranty insurance market. The Minister for Fair Trading should specify, as part of the Conditions for Approval of insurers, that insurers must supply the Government with detailed market data concerning home warranty insurance premiums, claims and payouts.

### **Recommendation 2      Page 24**

The Committee recommends that the Minister for Fair Trading consider, as a matter of priority, the recommendations of the National Review of Home Builders Warranty Insurance and Consumer Protection, with a view to promoting the consumer protection aims of the New South Wales Home Warranty Insurance Scheme as well as a competitive and viable home warranty insurance market.

### **Recommendation 3      Page 40**

The Committee recommends that the Department of Fair Trading, in collaboration with insurers and industry associations, develop information for consumers clearly explaining the nature of home warranty insurance, with particular emphasis on its last resort nature.

### **Recommendation 4      Page 44**

The Committee recommends that the Department of Fair Trading work with home building industry associations to develop information that clearly sets out the obligations of builders in relation to home warranty insurance and statutory warranties.

### **Recommendation 5      Page 45**

The Committee recommends that the Department of Fair Trading provide advice to the Swimming Pool & Spa Association of NSW Limited as to how the definition of 'structural defect' in section 57AC the *Home Building Regulation 1997* applies to all aspects of the construction of swimming pools and spas.

### **Recommendation 6      Page 45**

The Committee also recommends that the particular characteristics of swimming pool and spa construction be incorporated into the proposed guideline document suggested in Recommendation 7.

### **Recommendation 7      Page 48**

The Committee recommends that the Department of Fair Trading develop a guide for use in New South Wales along the lines of the Victorian Guide to Standards and Tolerances. The Committee also recommends that the guide should identify which defects fall within the definition of structural defects and which fall into the residual category of non-structural defects.

### **Recommendation 8      Page 49**

The Committee recommends that the Minister for Fair Trading ensure that an appropriate regulatory framework is imposed on new alternative indemnity arrangements that it approves under s 192A of the *Home Building Act 1989*.

**Recommendation 9 Page 54**

The Committee recommends that the New South Wales Government consider examining the 20% limitation on liability for non-completion of work with a view to determining the impact of this reform on consumers.

**Recommendation 10 Page 54**

The Committee further recommends that the New South Wales Government give consideration to amending the *Home Building Regulation 1997* to provide that, instead of limiting liability resulting from non-completion of building work to 20% of the contract price, a contract of insurance may limit liability resulting for non-completion of building work to an amount that is '20% of the sum insured or 20% of the contract price, whichever is greater.'

**Recommendation 11 Page 61**

The Committee recommends that after the *Home Building Amendment (Insurance) Act 2002* has been operational for six months, the Minister for Fair Trading should consider the impact that the reforms have had on dispute resolution resources with a view to meeting any additional demands on the Consumer Trader and Tenancy Tribunal and the Building Conciliation Service.

**Recommendation 12 Page 64**

The Committee recommends that the Department of Fair Trading investigate allegations that some builders are working without obtaining insurance required by legislation and engaging in practices such as contract splitting to avoid insurance obligations.

**Recommendation 13 Page 64**

The Committee recommends that the New South Wales Government take the issues raised in relation to the experiences of builders in relation to the New South Wales Home Warranty Scheme, as set out in paragraphs 4.92-4.98 of this report, into consideration as part of any future review of the scheme that it may undertake.

**Recommendation 14 Page 68**

The Committee recommends that the New South Wales Government examine the possibility of a supplementary catastrophic fund to consider claims from consumers who had received full payment of \$200,000 from a home warranty insurance policy and still require additional funds to demolish/rectify or reinstate a building that was constructed for the purpose of being their principal residence.

**Recommendation 15 Page 69**

The Committee recommends that the New South Wales Government take the issues raised in relation to the experiences of consumers of the New South Wales Home Warranty Scheme, as set out in paragraphs 4.110-4.118 of this report, into consideration as part of any future review of the scheme that it may undertake.

**Recommendation 16 Page 69**

The Committee recommends that the Minister for Fair Trading consider implementing a 'Builder's Choice Award' in New South Wales, along the lines of that operating in Alberta, Canada.

# Chapter 1 Introduction

## Reference from the Legislative Council

- 1.1** The Home Building Amendment (Insurance) Legislation Bill 2002 was introduced into the Legislative Assembly on 7 May 2002 by the Hon John Aquilina MP, Minister for Fair Trading. The bill was passed without amendment the following day and was subsequently introduced into the Legislative Council by the Hon John Della Bosca MLC, on 9 May 2002. The bill passed through all stages on that day and the House also resolved to refer the provisions of the bill, as passed, to the Standing Committee on Law and Justice for Inquiry.<sup>1</sup> The terms of reference were:

*That the Standing Committee on Law and Justice investigate the impact of the Act on:*

*home warranty insurance;*

*home builders; and*

*consumers.*

- 1.2** The motion to refer the bill requires the Committee to report by 5 September 2002 and states that '[t]he reference of this bill to the Standing Committee on Law and Justice is in no way intended to constrain the commencement of the bill at an earlier date'.<sup>2</sup>
- 1.3** The bill was assented to on 16 May 2002 and commenced on 1 July 2002. A copy of the *Home Building Amendment (Insurance) Act 2002* (the Amendment Act) is reproduced as Appendix 1.

## Conduct of this Inquiry

- 1.4** The Committee placed advertisements in newspapers on 18 May 2002 calling for written submissions. The Committee Chair also wrote directly to 29 individuals and organisations advising them of the inquiry and inviting them to make submissions. The Committee received 23 submissions. A list of the individuals and organisations that made submissions is contained in Appendix 2.

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<sup>1</sup> NSWPD (LC), 9 May 2002, p 1887.

<sup>2</sup> *ibid.*

- 1.5** The Committee held five days of public hearings on 11, 22, 25 and 31 July 2002 and 8 August 2002, at which 16 witnesses gave evidence. A list of witnesses is reproduced as Appendix 3.
- 1.6** The Chair's draft report was prepared in August and was circulated for consideration at a deliberative meeting on 26 August 2002. Relevant minutes of proceedings are set out as Appendix 4.

### **Structure of this Report**

- 1.7** This report is divided into four chapters. **Chapter 1** contains introductory information about the Inquiry and this report.
- 1.8** **Chapter 2** provides background information in relation to the Amendment Act including: an overview of the New South Wales home warranty insurance scheme; an overview of the home warranty insurance market in New South Wales; and an analysis of the pressure on the home warranty insurance market which lead to the reforms.
- 1.9** **Chapter 3** examines the Amendment Act, exploring the nature of the various reforms contained in it.
- 1.10** **Chapter 4** examines the impact of the reforms contained in the Amendment Act on home warranty insurance, home builders and consumers.



## Chapter 2 The Amendment Act in Context

By way of background to the *Home Building Amendment (Insurance) Act 2002* (the Amendment Act) and the Inquiry, this chapter provides an overview of the New South Wales Home Warranty Insurance Scheme, as it stood prior to the reforms implemented by the Amendment Act. The aspects of the scheme that have been reformed by the passage of the Amendment Act are noted in this chapter and are described in detail in Chapter 3. This chapter also sets out the nature of the home warranty insurance market and provides an analysis of the pressures on the market that led to the implementation of the Amendment Act. Firstly, however, this chapter briefly examines the government insurance scheme that existed in New South Wales prior to the current scheme, and the transition to the current scheme.

### Pre May 1997 – Government Insurance Scheme

- 2.1** The Builders Licensing Board was established in 1971, to protect consumers from loss in the event of a builder performing unsatisfactory work or becoming insolvent, to guard against the failure of builders to pay employees or to pay for goods and materials and to encourage apprenticeships in the industry. The basis of the system was compulsory licensing for all residential builders.<sup>3</sup> The licensing of builders commenced in April 1972 and the insurance scheme for consumers commenced in April 1973. Insurance was provided by the government until 1 May 1997 when the private scheme was established.<sup>4</sup>
- 2.2** The Building Services Corporation (BSC) was established in 1987, amalgamating the licensing functions of the Builders Licensing Board, the Plumbers, Gasfitter and Drainers Board, and the Department of Minerals and Energy. The BSC was a ‘one-stop-approach’, assuming responsibility for providing education, advice, rectification orders, dispute resolution, the regulation of building contracts, the licensing and disciplining of builders and insurance.<sup>5</sup>
- 2.3** Under the BSC scheme, any home-owner or purchaser who contracted with a ‘Gold Licence’ holder was covered by one of the BSC’s two insurance schemes. The BSC Comprehensive Scheme covered building work approved by a Council under the *Local Government Act*, costing more than \$1,000 and undertaken by an appropriately licensed contractor. Bathroom, kitchen and laundry renovations were also covered, even though a building approval may not be required. A premium was paid before plans were released by Council. Claims were generally made following failure to resolve a complaint after investigation by the BSC. For contracts entered into after the BSC regulation was introduced in 1990, the maximum payment on any one claim was \$100,000. Prior to that the maximum payment was \$60,000. No premium was required for coverage by the BSC

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<sup>3</sup> Commissioner Dodd, *Inquiry into the New South Wales Building Services Corporation*, 28 February 1993, p 13.

<sup>4</sup> *History and background to the operation of building, licensing and insurance in New South Wales*, tendered by Mr John Schmidt, Department of Fair Trading, 11 July 2002, Part 1, p 1.

<sup>5</sup> *ibid*, Part 1, p 2.

Special Scheme, as this scheme was funded from licensing fees. In general terms, Special Insurance covered all areas of work not covered by the Comprehensive Scheme. Owner-builders were also covered under the Special Scheme against any defective work done by a licensed contractor.<sup>6</sup>

**2.4** On 18 September 1995, Cabinet gave approval in principle to a range of reforms for the home building industry, including the introduction of a private insurance scheme. The reforms followed reports on the operations of the BSC by the Royal Commission into Productivity in the Building Industry (May 1992) and the Inquiry into the New South Wales Building Services Corporation by Dr Peter Dodd (March 1993).<sup>7</sup>

**2.5** In particular, the Dodd Report recommended comprehensive reform and deregulation of the licensing system. Commissioner Dodd's recommendation included replacing the existing licensing system with a registration system supported by private indemnity insurance.<sup>8</sup> In regard to insurance, Commissioner Dodd concluded that:

...there is no reason for the Government to continue its monopoly of the insurance market in the residential building industry. The monopoly aspects are not in the best interests of the consumers or builders and the holding of insurance risk is not in the best interests of the citizens of New South Wales.<sup>9</sup>

**2.6** Legislation was passed during the 1996 Spring session introducing the new scheme and the old government run scheme was carried over in transitional and savings provisions, in the now *Home Building Act 1989*.<sup>10</sup>

## **Post May 1997 – The Home Warranty Insurance Scheme**

**2.7** The private insurance scheme commenced on 1 May 1997 and has since become known as the Home Warranty Insurance Scheme. The 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 defective and incomplete building work. The Department of Fair Trading (the Department) is responsible for administering the scheme.

**2.8** The scheme has been amended in several ways since its introduction. In 1999 it was decided that licensing should be linked to the requirement for home warranty insurance. Accordingly, the *Home Building Amendment Act 1999*, which commenced in November of that year, was enacted to require licence applicants in the building and 'certain other work'

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<sup>6</sup> This information is paraphrased from Dodd, op cit, pp 16-17.

<sup>7</sup> Commissioner Gyles, RV, *Royal Commission into Productivity in the Building Industry in New South Wales. Final report, related papers and appendices*, 1992 and Dodd, op cit.

<sup>8</sup> Dodd, op cit, p 5.

<sup>9</sup> Dodd, op cit, p 6.

<sup>10</sup> Department of Fair Trading, op cit, Part 7, p 1.

categories to submit evidence of their eligibility for insurance cover when applying for a licence (as well as evidence of technical qualifications and experience).<sup>11</sup>

- 2.9** In November 1999, following a review of licensing, and in response to concerns raised by home owners, consumers, industry associations, builders and others, the Government announced a comprehensive package of reforms for the home building industry that included some changes to the insurance scheme.<sup>12</sup> The *Home Building Legislation Amendment Act 2001* therefore provided for a number of reforms relating to licensing, dispute resolution, contracts and insurance. The Act was assented to on 17 July 2001. The Department has advised that most of the provisions commenced on 10 August 2001, 30 November 2001 or 1 January 2002 and that work is proceeding on the remainder of the reforms.<sup>13</sup> A review of the various reforms and their implementation stages, provided to the Committee by the Department is set out as Appendix 5.

### **Insurance and licences**

- 2.10** In order to obtain a licence authorising the holder to contract to do residential building work, applicants need to show the Department that they have the fitness, ability and capacity to carry out the contracts for which the licence is required.<sup>14</sup> Applicants must also satisfy the Department that they have complied with, or are able to comply with, any insurance requirements under the *Home Building Act 1989* in relation to the work.<sup>15</sup> The Department must cancel licences under certain circumstances including where the licence holder has not or cannot comply with insurance requirements.<sup>16</sup>

### **Who is required to take out home warranty insurance?**

- 2.11** *Builders and suppliers of kit homes.* All builders, including suppliers of kit homes to consumers, and tradespeople who are contracting directly with their customers (including consumers who are owner-builders) or carrying on residential building work on their own property for resale, must take out insurance *prior* to commencing work or supplying the kit *if* the work requires a licence and the work costs over \$5,000.<sup>17</sup> This threshold has recently been increased to \$12,000, as discussed in paragraph 2.66. Builders or tradespeople who work as sub-contractors to a licensed head contractor are not required to take out insurance.

<sup>11</sup> Department of Fair Trading, *op cit*, Part 2, p 3.

<sup>12</sup> *ibid.*

<sup>13</sup> Department of Fair Trading, *op cit*, Part 3, p 1.

<sup>14</sup> *Home Building Act 1989*, s 19(1) and (2).

<sup>15</sup> *Home Building Act 1989*, s 19(2A).

<sup>16</sup> *Home Building Act 1989*, ss 22 and 22A.

<sup>17</sup> *Home Building Act 1989*, ss 92 and 93.

- 2.12** 'Residential building work' is essentially considered to be the building, alteration or repair of a dwelling. A 'dwelling' includes a detached or semi-detached house, transportable house, terrace or town house, duplex, villa-home, strata or company title home unit or residential flat, and extends to include swimming pools and spas and other structures relating to the dwelling.<sup>18</sup> A 'kit home' is a set of building components which, when offered for sale, is represented as sufficient for the construction of a dwelling according to a plan or instructions furnished by the supplier.<sup>19</sup>
- 2.13** *Owner-builders*: must arrange insurance if and when they sell the building within seven years of its completion.<sup>20</sup> Note that completion of owner-builder work is deemed to be at the date of final inspection by council, or if no inspection, six months after the issue of the permit.<sup>21</sup>
- 2.14** If a person who is required to take out a contract of insurance fails to do so there are a range of consequences. For example, if a contract of insurance that is required for residential building work is not in force in the name of the person who contracted to do the work, in relation to any residential building work done under a contract, the contractor who did the work is not entitled to damages or to enforce any other remedy in respect of a breach of the contract committed by any other party to the contract in relation to that work.<sup>22</sup> A person who fails to satisfy insurance requirements is also liable to pay a fine.<sup>23</sup>

### **Proof of insurance**

- 2.15** A certificate of insurance in the prescribed form must be given to the customer before commencement of the work or the supply of the kit home.<sup>24</sup> The contractor is not entitled to receive any payment (including a deposit) until insurance is in place and a certificate of that insurance is given to the customer. Where new dwellings are sold by builders or developers a certificate of insurance must be attached to the sale contract.<sup>25</sup> In the case of off-plan sales, a certificate of insurance must be given to the purchaser within 14 days of the insurance being taken out by the builder.<sup>26</sup>

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<sup>18</sup> *Home Building Act 1989*, s 3.

<sup>19</sup> *ibid.*

<sup>20</sup> *Home Building Act 1989*, s 95.

<sup>21</sup> *Home Building Regulation 1997*, cl 48(3).

<sup>22</sup> *Home Building Act 1989*, ss 94.

<sup>23</sup> *Home Building Act 1989*, ss 94A, 95 and 96.

<sup>24</sup> *Home Building Act 1989*, ss 92 and 93 and *Home Building Regulation 1997*, cl 54.

<sup>25</sup> *Home Building Act 1989*, s 96A.

<sup>26</sup> *Home Building Regulation 1977*, cl 14.

### Approval of insurance providers

- 2.16** Home warranty insurance can only be provided by insurance companies that have been approved by the Minister for Fair Trading.<sup>27</sup> The Department informed the Committee that in order to obtain approval, an insurer must be approved by the Australian Prudential Regulatory Authority, have adequate dispute resolution mechanisms that are transparent and available to the consumer, and offer an approved type of insurance.<sup>28</sup> Insurers currently approved to sell home warranty insurance are identified in paragraph 2.40.
- 2.17** The Committee understands that a guideline document on the conditions of approval, titled 'Conditions of Approval of Approved Private Providers of Insurance', is currently being revised by the Department and is likely to be approved by the end of the year.<sup>29</sup> The Committee is also aware that the most significant changes to the document, in regard to concerns that builders and consumers have about the scheme, are the establishment of service standards for the eligibility criteria for builders to obtain insurance and for the processing of builders' applications for insurance and the claims handling process.

### Losses indemnified

- 2.18** *Residential building work* The contract of insurance for residential building work must insure the person on whose behalf the work is being done against the risk of loss resulting from:
- non-completion of the work because of the insolvency or death of the contractor or because of the fact that, after due search and inquiry, the contractor cannot be found; and
  - a breach of a statutory warranty (explained below) in respect of the work.<sup>30</sup>
- 2.19** *Supply of a kit home* A contract of insurance for the supply of a kit home must insure the person to whom the kit home is supplied against the risk of loss resulting from:
- non-supply of the kit home because of the insolvency or death of the supplier or because of the fact that, after due search and inquiry, the supplier cannot be found;
  - materials and components used in the kit home not being good and suitable for the purpose for which they were used; and

<sup>27</sup> *Home Building Act 1989*, s 102(2). Note that approval may be unconditional or subject to conditions and the Minister may revoke or vary an approval.

<sup>28</sup> Department of Fair Trading, *op cit*, Part 7, p 2.

<sup>29</sup> Department of Fair Trading, *Home Building Warranty Insurance, Conditions of Approval of Approved Private Providers of Insurance*, July 1998. These conditions were made and approved by the former Minister for Fair Trading, the Hon Jeff Shaw QC MLC, pursuant to the *Home Building Act 1989*, s 103A and are effective from 10 July 1998.

<sup>30</sup> *Home Building Act 1989*, s 99.

- faulty design of the kit home.<sup>31</sup>

**2.20** Note that the Amendment Act substitutes the phrase ‘disappearance of’ for the following phrase in the above paragraphs: ‘or because of the fact that, after due search and inquiry, the [contractor or supplier] cannot be found’. This reform is examined in Chapter 3, paragraph 3.23.

**2.21** The losses that *must* be indemnified by a home warranty insurance contract for residential building work, or the supply of a kit home, are expanded upon in the *Regulation* which states that a contract of insurance must indemnify the holder of the insurance for loss or damage arising from the following:<sup>32</sup>

- a breach of a statutory warranty (see below);
- a faulty design provided by a contractor or supplier;
- the cost of alternative accommodation, removal and storage costs reasonably and necessarily incurred;
- the loss of deposit or progress payment;
- materials or components used in kit homes that were not good or suitable for purpose;
- the faulty design of kit home; and
- non-completion of work due to early termination of the building contract because the contractor or supplier failed or refused to complete the work.

**2.22** Note that the Amendment Act inserts another type of loss into this list - the ‘legal and other reasonable costs’ incurred by a claimant in seeking to recover compensation. The Amendment Act also provides that indemnification for *all* of these losses (and not just for non-completion claims) will only occur as a *last resort* (ie when the builder or supplier is insolvent, dead or has disappeared). These reforms are discussed in Chapter 3, in paragraphs 3.15-3.16 and 3.1-3.5.

### **Statutory warranties**

**2.23** The holder of a builder’s licence, or a person required to hold a licence before entering into a contract, has the following warranties implied in every contract for residential building work:

- the work will be performed in a proper and workmanlike manner and in accordance with the plans and specifications set out in the contract;

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<sup>31</sup> *Home Building Act 1989*, s 100.

<sup>32</sup> *Home Building Regulation 1997*, cl 43.

- all materials supplied will be suitable for the purpose for which they are used and that, unless otherwise stated, those materials will be new;
- the work will be done in accordance with, and will comply with, the *Home Building Act*, or any other law;
- the work will be done with due diligence and within the time stipulated in the contract and if no time is stipulated, within a reasonable time;
- if the work consists of the construction of a dwelling, the making of alternations or additions to a dwelling, or the repairing, renovation, decoration or protective treatment of a dwelling, the work will result in a dwelling that is reasonably fit for occupation as a dwelling; and
- the work and any materials used in doing the work will be reasonably fit for the specified purpose or the result that the owner desires the work to achieve.<sup>33</sup>

**2.24** A person must make notification of a breach of a statutory warranty within six months after becoming aware, or after she or he ought reasonably to be aware, of the circumstances of the claim.<sup>34</sup> Proceedings for a breach of a statutory warranty must be commenced within seven years after the completion of the work to which it relates or if the work is not completed the date for completion in the contract, or if there is no such date, the date of the contract.<sup>35</sup> Note also that warranties extend to immediate successors in title.<sup>36</sup>

### **Limitations on liability**

**2.25** Any limitations on liability under a contract of insurance must comply with the requirements of the *Home Building Regulation 1997*.<sup>37</sup> Relevantly, the *Regulation* provides that an insurance contract *may* contain certain limitations on liability under the contract including:

- damage due to or made worse by the failure of any beneficiary to take reasonable and timely action to minimise the damage;
- damage to work or materials that is made outside the reasonable lifetime of the work or materials; and

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<sup>33</sup> *Home Building Act 1989*, s 18B.

<sup>34</sup> *Home Building Regulation 1997*, cl 54.

<sup>35</sup> *Home Building Act 1989*, s 18E.

<sup>36</sup> *Home Building Act 1989*, s 18D.

<sup>37</sup> *Home Building Act 1989*, s 102(4).

- and loss or damage as could be reasonably expected to result from fair wear and tear of the building work.<sup>38</sup>

**2.26** The Amendment Act introduces another limit on liability that can be included in a contract of insurance, in the form of limit on liability for non-completion claims to 20% of the contract price. This reform is explained in more detail in Chapter 3, paragraphs 3.17-3.22.

### **Minimum cover**

**2.27** The minimum cover that must be provided by a contract of insurance is \$200,000 in relation to each dwelling to which the insurance relates.<sup>39</sup> While this provision is couched in terms of a minimum, it effectively operates as the maximum amount that consumers are insured for since insurers do not tend to provide any more cover than this level.

### **Period of cover**

**2.28** In regard to non-completion of work, an insurance contract provides cover for not less than 12 months after the failure to commence or the cessation of work.<sup>40</sup>

**2.29** Until recently, the period of cover for all other types of loss (as set out in paragraphs 2.18-2.21) was not less than seven years from the completion of work.<sup>41</sup> The Amendment Act has changed this period to *six* years from completion of work for loss arising from structural defects and *two* years from completion of work for loss arising from non-structural defects, as examined in Chapter 3, paragraphs 3.6-3.10.

### **'Completion' of work**

**2.30** For the purposes of determining the period of cover, the *Home Building Act 1989* defines the *completion* of work or the supply of a kit home as follows:

**2.31** *Residential building work:* For the purposes of determining the period of cover to be provided by an insurance contract in relation to residential building work, work is taken to be complete:

- (a) on the date that the work is completed within the meaning of the contract under which the work was done, or

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<sup>38</sup> *Home Building Regulation 1997*, cl 45.

<sup>39</sup> *Home Building Act 1989*, s 102(3). Note that this is subject to limitations relating to deposits and progress payments and other limitations specified in the policy. This amount may also be prescribed by the *Regulation*.

<sup>40</sup> *Home Building Act 1989*, s 103B(1).

<sup>41</sup> *Home Building Act 1989*, s 103B(2).



- (b) if the contract does not provide for when work is completed or there is no contract, on the date of the final inspection of the work by the applicable council, or
- (c) in any other case, on the latest date that the contractor attends the site to complete the work or hand over possession to the owner or if the contractor does not do so, on the latest date the contractor attends the site to carry out work.<sup>42</sup>

**2.32** *Kit homes:* For the purposes of determining the period of cover to be provided by an insurance contract in relation to the supply of a kit home, the supply is taken to be complete:

- (a) on the date that the supply is completed within the meaning of the contract under which the kit home is supplied, or
- (b) in any other case, on the latest date that the contractor attends the site to complete the supply or hand over possession to the owner or if the contractor does not do so, on the latest date the contractor attends the site in relation to the supply.<sup>43</sup>

**2.33** *Owner-builder:* For the purposes of determining the period of cover to be provided by an insurance contract in relation to owner-builder work, the work is taken to be complete:

- (a) on the date of the final inspection of the work by the applicable Council; or
- (b) if there is no final inspection by the council, on the date that is six months after the issue of the permit for the owner-builder work.<sup>44</sup>

### **Claims on insurance**

**2.34** The insurer must be notified of the claim or potential claim within six months after the claimant first becomes aware, or ought reasonably to be aware, of the circumstances of the claim. However, in relation to a claim for incomplete work, the insurer must be notified of the claim or potential claim within 12 months after the contract date, the date provided for commencement or the date work ceased, whichever is the latest.<sup>45</sup> An excess of up to \$500 on claims may be imposed by the insurer.<sup>46</sup>

<sup>42</sup> *Home Building Regulation 1997*, cl 43(1).

<sup>43</sup> *Home Building Regulation 1997*, cl 48(2).

<sup>44</sup> *Home Building Regulation 1997*, cl 48(3).

<sup>45</sup> *Home Building Regulation 1997*, cl 53.

<sup>46</sup> *Home Building Act 1989*, s 102(6).

### **Dispute resolution of insurance claims**

- 2.35** If an insurer gives a written decision on a claim and the claimant disagrees with it, the claimant has 45 days in which to lodge an appeal against the decision with the Consumer Trader and Tenancy Tribunal (CTTT).<sup>47</sup> If the insurer *does not* give a written decision within 45 days of the claim being lodged, unless the claimant has agreed to extend the time, it will be deemed by law to be a refusal of the claim.<sup>48</sup> The claimant may then lodge an appeal against the insurer with the CTTT without any time limitations.
- 2.36** The CTTT was established on 25 February 2002 when the Fair Trading Tribunal and the Residential Tribunal were merged to form a single specialist dispute resolution forum for consumer, trader and tenancy matters in New South Wales. The CTTT is also the forum for resolving disputes between builders and consumers involving up to \$500,000. All home building disputes must be considered for resolution by the Building Conciliation Service (BCS) before being accepted for a formal hearing by the CTTT. The BCS was established on 1 January 2002 and its role is to assist both customers and contractors to resolve their disputes without the need for costly and time consuming litigation.

### **Home Warranty Insurance In Other Australian Jurisdictions**

- 2.37** All Australian States and Territories have legislated for mandatory home warranty insurance. All jurisdictions except Queensland have private competitive insurance models that operate within a legislative framework. In Queensland, the government-owned Queensland Building Services Authority is the only provider of insurance and it also has licensing and consumer protection functions. A description of the Queensland scheme by the Insurance Council of Australia is included as Appendix 6.
- 2.38** A comparative table of the features of the various home warranty insurance schemes in Australia, compiled by Professor Percy Allan AM, as part of his recent National Review of Home Builders Warranty Insurance and Consumer Protection, is set out as Appendix 7.<sup>49</sup> Professor Allan's review, referred to throughout this report as 'the Allan Review', is examined in paragraphs 2.74-2.75 of this chapter.

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<sup>47</sup> *Home Building Regulation 1997*, cl 55.

<sup>48</sup> *Home Building Regulation 1997*, cl 54.

<sup>49</sup> Professor Percy Allan AM, Principal, Percy Alan & Associates Pty Ltd, *National Review of Home Builders Warranty Insurance and Consumer Protection*, Report prepared for the Ministerial Council on Consumer Affairs, June 2002.

## The Home Warranty Insurance Market

**2.39** The Committee notes that the Allan Review ‘guesstimated’ that the total size of the Australian home warranty market is \$157 million, with over 90% of this concentrated in New South Wales, Victoria and Queensland.<sup>50</sup> The following description of the ‘unique’ home warranty insurance market is extracted from the Allan Review report:

The HBWI market in Australia is unique, not only in respect to non-insurance markets, but also to other insurance markets, including those specialising in long tail liabilities (for example, life, public liability and professional indemnity including medical indemnity)...

The main thing that stands out is that except for the supply and price of HBWI (which for all intents and purposes are not officially restricted), every other aspect of HBWI in Australia is different to a normal market situation.

Essentially governments have freed up the supply of insurance, but regulated the content and made the demand obligatory. Complicating the equation is that HBWI is taken out by a different entity (the builder) to the beneficiary (the home buyer). Hence, the consumer has no choice over which policy is chosen. In most cases it is not until they make a claim that the true nature of the insurance becomes apparent to them.

Also the costs to the seller (the insurer) are not known in advance. Indeed with building defects (as opposed to non-completion) it is normally not until the seventh year of the policy that insurers can be confident of the final cost of the claims. With governments regularly changing the insurance conditions, past claims patterns are no guide to the future. Given these difficulties and past losses, it is not surprising that few insurers are interested in this market. This makes the market less competitive than it should be.<sup>51</sup>

### Insurers

**2.40** There are currently four approved insurance providers offering policies for building contractors, tradespeople and owner-builders in New South Wales, as listed below.<sup>52</sup>

*Royal & SunAlliance Insurance Australia Ltd.* Royal & SunAlliance’s agent is HIA Insurance Services Pty Ltd. HIA Insurance is the endorsed provider of insurance products to the Housing Industry Association. Royal & SunAlliance advised the

<sup>50</sup> *ibid*, p 18. Note that the guesstimate is based on partial information about the industry provided by Royal & SunAlliance and the Building Services Authority (Qld). The other two insurers, Dexta and Reward, failed to provide the Allan Review with relevant statistics.

<sup>51</sup> Allan, *op cit*, p 10.

<sup>52</sup> Department of Fair Trading, *Brochure: Home Warranty Insurance*, July 2002.

Committee that as at March 2002 it held 55% of the market share for home warranty insurance in New South Wales and a 53% share nationally.<sup>53</sup>

*Allianz Australia Insurance Ltd.* Allianz's agent is Dexta Corporation Ltd. Dexta claims to hold 'about half' the home warranty insurance market in New South Wales and Victoria.<sup>54</sup>

*Reward Insurance Ltd* is an Australian owned insurer and became the third provider of home warranty insurance in New South Wales on 17 January 2002.<sup>55</sup> Reward's agent is its subsidiary, Australia Home Warranty Pty Ltd.

*Key Insurance* is an underwriter for owner-builder insurance only. Key Insurance was bought in late 2001-early 2002 by Australian Unity Insurance but retained the name of Key Insurance for the Department's approval list.<sup>56</sup>

**2.41** The Committee notes that the Housing Industry Association (HIA) has close links with HIA Insurance Services, as stated by the Executive Director of HIA New South Wales:

The first is that we licence our name to Aon to use the brand HIA Insurance Services. We also provide information technology and other builder assessment software to assist the insurer in making a decision about builders and their performance. The other important issue is that we provide them with direct policy advice.<sup>57</sup>

**2.42** The Committee also notes that it was advised by the MBA that it does not have *formal* relationships with any insurer:

The Master Builders Association of NSW has never had any relationship with HIH. The MBA had a joint venture agreement with Jardine Thompson Insurance Brokers (Jardines) to provide the MBA with brokerage services across a wide range of insurance products. Jardines had arrangements with HIH in respect of home warranty insurance and prior to the collapse of HIH, were also providing home warranty insurance on behalf of Dexta Corporation<sup>58</sup>

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<sup>53</sup> Submission 9, 21 June 2002, p 3.

<sup>54</sup> Dexta Corporation Limited, 'Dexta to Continue Providing Home Warranty', *Media Release*, 20 June 2002.

<sup>55</sup> Aquilina J, Minister for Fair Trading, 'Minister welcomes new home warranty insurer', *Media Release*, 17 January 2002.

<sup>56</sup> Department of Fair Trading, *op cit*, Part 7, p 1.

<sup>57</sup> Crouch, Evidence, 22 July 2002, p 17.

<sup>58</sup> Submission 11, Supplementary Submission, 6 August 2002, p 5.

## Premiums

- 2.43** Premiums are set by the insurance market and are not regulated. Insurers set premiums after rating the risks of each builder. The Committee has been unable to obtain sufficient data to present a detailed picture of home warranty insurance premiums in New South Wales in comparison with other jurisdictions since the introduction of the scheme in 1997. The limited information made available to the Committee is presented here.
- 2.44** Royal & SunAlliance advised the Committee that in February 2002 it increased its premiums substantially in New South Wales by an average of 170%. The increase was described as being ‘...necessary in the prevailing environment...’<sup>59</sup> The Committee also notes that there has been a steady overall increase in Royal & SunAlliance premiums since 1998. In this regard the National Manager of Warranty and Construction for Royal & SunAlliance, Mr Michael Huntly advised the Committee as follows:
- Mr HUNTLY:**...I have figures from 1998, which is when Royal and SunAlliance started measuring. In New South Wales in 1998 the average premium was \$140. At the end of 2001 it was \$288. As at June 2002 it was \$471 and we anticipate that it will be \$770 by the end of this year.
- The Hon. JOHN RYAN:** That suggests that premiums are about to increase.
- Mr HUNTLY:** No. It is working through. This is a rolling 12-month number so a lot of the old premiums from the end of last year are still included in this figure.
- Mr TURNER:** They are affecting the average.
- CHAIR:** So there is a lag effect.
- Mr HUNTLY:** Yes. The increases from February that are just starting to flow through.
- The Hon. JOHN RYAN:** So a person paying insurance now would pay an average of \$770.
- Mr HUNTLY:** Yes, in New South Wales.<sup>60</sup>
- 2.45** Royal & SunAlliance also provided the Committee with details of its average premiums charged since 1998 in the Australian jurisdictions in which it operates, reproduced as Appendix 8. The information shows a steady increase in premiums in New South Wales over the five years, with a marked increase in the last year. The table also shows New South Wales to have the highest premium for 2002 compared to other jurisdictions.
- 2.46** Premium statistics gathered by Professor Allan for the financial year 2000-2001, for all States and Territories except the Northern Territory, show that during that time New

<sup>59</sup> Submission 9, 21 June 2002, p 5.

<sup>60</sup> Evidence, 25 July 2002, p7.

South Wales ranked in the middle range of premiums. These statistics are reproduced as Appendix 9. The Committee notes the following finding of the Allan Review:

There is no current or historical data collected at either a state or national level on [home warranty insurance] claims that could be used by governments to judge the comparative effectiveness of their regulatory regimes and accessed by prospective insurers to realistically price their policies.<sup>61</sup>

- 2.47** The Allan Review therefore identified as a 'high priority' that the Australian Prudential Regulation Authority should be requested to collect and publish separate data on home warranty insurance premiums, claims and payouts.<sup>62</sup> The Federal Parliamentary Secretary to the Treasurer, Senator Ian Campbell, has since stated that '...the Government would examine ways to centrally collect and publish market data concerning home builder's warranty insurance premiums, claims and payouts, as recommended in the report.'<sup>63</sup>
- 2.48** Under the Conditions of Approval (see paragraph 2.17) approved home warranty insurance providers are obliged to provide certain information to the Department, including details of: claims paid and the value of those claims; claims that were not paid for reasons such as that they were not within the scope of cover; and average premiums charged for average cost of works for annual policies. There is no requirement for insurers to report the total value of premiums paid under the scheme. The Minister for Fair Trading reported to the Parliament in June 2000 that insurers in the scheme at that time had been 'inconsistent' in providing relevant information to the Government.<sup>64</sup>
- 2.49** The Department supplied the Committee with a summary of the statistics that it had collected with regard to the home warranty insurance market in New South Wales for the years 1997-1998 to 2000 – 2001. The statistics have been included as Appendix 10.
- 2.50** Royal & SunAlliance provided the Committee with details with regard to its claims and profits experience in New South Wales. These details have been included as Appendix 11. The Committee was not provided with the raw figures on which these estimates of profitability were calculated. Additionally, Royal & SunAlliance were the only insurer to provide any detail in this regard. The figures supplied were also limited to the profit and claims experience for the period 1997-2000 because, according to Royal & SunAlliance, '...the 2000 and 2001 years were too underdeveloped to provide any meaningful insight.'<sup>65</sup> The statistics given to the New South Wales Government for the years 1997-2000 were not adequate to determine whether the home warranty insurance market in this state was

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<sup>61</sup> Allan, op cit, p 32.

<sup>62</sup> Allan, op cit, p 55.

<sup>63</sup> Senator Ian Campbell, Parliamentary Secretary to the Treasurer, 'Government welcomes Allan review into home builder's warranty insurance and consumer protection', *Media Release*, 2 August 2002.

<sup>64</sup> General Purpose Standing Committee No. 3, 2000-2001 Budget Estimates, Questions Placed on Notice at/after Hearing, Question 35.

<sup>65</sup> Submission 9, 21 June 2002, p 5.

profitable or unprofitable in those years. These statistics do not, however, suggest that it was unprofitable.

- 2.51** The Committee recognises that the Government is significantly disadvantaged in assessing claims by insurers for changes to the scheme if they do not have adequate, accurate and timely details from insurers about the insurance market. It is imperative that the New South Wales Government pursue its current initiatives to obtain more detailed and timely information about the scheme's profitability and claims experience. The Government should seek and publish annually appropriate information about the scheme similar to the practice of the Motor Accidents Authority in relation to the motor accident insurance scheme.
- 2.52** The Committee agrees that, as a matter of priority, comprehensive data collection on home warranty insurance premiums, claims and payouts should be undertaken and made public. The Committee recommends that the New South Wales Government should continue to undertake its own data collection. In this regard, the Committee notes that the Conditions for Approval for insurance providers include some reporting requirements that relate to claims and premiums. The Department has advised that it is currently reviewing the Conditions of Approval to include a new reporting framework (see paragraph 2.72). The Committee suggests that one way that the New South Wales Government could collect its own data is to include more detailed reporting requirements in the Conditions of Approval with regard to premiums, claims and payouts.

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### **Recommendation 1**

The Committee recommends that the New South Wales Government should continue with the implementation of a data collection procedure for the home warranty insurance market. The Minister for Fair Trading should specify, as part of the Conditions for Approval of insurers, that insurers must supply the Government with detailed market data concerning home warranty insurance premiums, claims and payouts.

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### **Criteria for judging eligibility for insurance**

- 2.53** The eligibility criteria used by insurers to determine whether to provide insurance cover to a particular builder are not regulated. The eligibility criteria are therefore determined by each insurer. The Committee notes that the criteria used by insurers are far from clear to the building industry, a point that was raised several times in submissions and in evidence given to the Inquiry. This issue is discussed further in Chapter 4, paragraph 4.93.

## Pressure for Reform

- 2.54** As noted above, private home warranty insurance was introduced in New South Wales in May 1997. After experiencing a relatively calm initial period, the home warranty insurance market, like other insurance markets, was badly affected by the collapse of HIH Insurance in March 2001 and the events of 11 September 2001.
- 2.55** The collapse of HIH left only two insurers in the market, namely Royal & SunAlliance and Dexta. As HIH covered a large proportion of the home warranty insurance market in Australia, its collapse resulted in a significant reduction in industry capacity to provide cover. The Insurance Council of Australia (ICA) estimates that HIH controlled 50 to 60% of the private sector market (excluding Queensland and the Northern Territory) in builders warranty insurance.<sup>66</sup> And according to the ICA, the collapse of HIH ‘...left many builders exposed and immediately put pressure on the availability and cost of cover’.<sup>67</sup>
- 2.56** The impact of the events of September 11 on Australia’s insurance market has been described by the ICA as follows:
- While most insurers in Australia had little or no direct exposure to the attacks, they are part of a global industry that is now reassessing the cost of insurance and reinsurance, the extent of cover and the basis of continued profitability. And after several years of excess capacity and poor financial returns, the impact on reinsurance rates in particular inevitability put pressure on premiums in Australia.<sup>68</sup>
- 2.57** In relation to home warranty insurance specifically, the Department informed the Committee that: ‘[e]ven though they were overseas events and home warranty insurance is a small product in the insurance field, it was not immune to the impacts.’<sup>69</sup>
- 2.58** The Committee acknowledges the submission of the Builders for Active Industry Reform which argues that there were pre-existing difficulties with the home warranty insurance scheme that were exacerbated, rather than caused, by these events and that these also contributed to the increasing pressure on the market.<sup>70</sup> Some of these difficulties are noted in Chapter 4 of this report.
- 2.59** Despite the fact that a new insurer, Reward, entered the market in December 2001, the media began to report a ‘crisis’ in home building insurance, with builders reportedly finding

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<sup>66</sup> Insurance Council of Australia, *Annual Review 2001/2002*, p 27.

<sup>67</sup> *ibid.* See also: ‘Up to 1,000 trapped in home insurance wreckage’, *The Sydney Morning Herald*, 26 March 2001, p 5.

<sup>68</sup> *ibid.*, p 18.

<sup>69</sup> Schmidt, Evidence, 11 July 2002, p 3.

<sup>70</sup> Submission 2, 27 May 2002, p 3.



that insurance was becoming harder and more costly to obtain.<sup>71</sup> Early this year, both Dexta and Royal & SunAlliance advised the Government that they could no longer provide cover for high-rise due to withdrawal of reinsurance support. Reinsurers also expressed the view that the scheme, as currently constituted, was becoming unviable.<sup>72</sup>

**2.60** In response to these developments and other concerns raised by the insurers and building industry, the New South Wales and Victorian Governments undertook negotiations with the insurance industry and other interested parties to find a solution.<sup>73</sup> The New South Wales and Victorian Governments subsequently announced, on 13 March 2002, uniform reforms to their home warranty schemes, as set out in the following section.

**2.61** The announcement of the reforms and their partial implementation did not, however, prevent Dexta from revealing, on 10 April 2002, that it was withdrawing from the home insurance market because it was unable to secure a re-insurer. The Department advised the Committee that, in response, ‘...it was essential that the Government move quickly so that there was minimal disruption to the robust building industry and to ensure that consumer protection was maintained.’<sup>74</sup> Therefore, on 16 April 2002, the Government announced that, in conjunction with the Victorian Government, it had put in place arrangements for the necessary reinsurance for Allianz so that Dexta could re-open for business. Dexta resumed issuing home warranty insurance in New South Wales and Victoria on 24 April 2002.<sup>75</sup> In June 2002, the Government revealed that it intends to continue to underwrite Dexta until 31 December 2002.<sup>76</sup>

## **New South Wales and Victorian Governments Uniform Reforms**

**2.62** The reforms announced by the New South Wales and Victorian Governments on 13 March 2002 were designed to ‘...provide substantial protection for home buyers, a healthy building industry and a viable market for insurers and were a direct response by the two Governments to the lobbying efforts of insurers.’<sup>77</sup> In this regard, the reforms were said to

<sup>71</sup> See, for example, ‘Builders’ insurance crisis starts to hit home’, *The Sydney Morning Herald*, 3 December 2001, p 1.

<sup>72</sup> Submission 18, 2 July 2002, p 1.

<sup>73</sup> Submission 18, 2 July 2002, p 1. See also, New South Wales Department of Fair Trading, ‘States to jointly reform home warranty insurance’, *Media Release*, 28 February 2002.

<sup>74</sup> Submission 18, 2 July 2002, p 2. See also, New South Wales Department of Fair Trading, ‘Successful outcome on Home Warranty Insurance negotiations’, *Media Release*, 16 April 2002.

<sup>75</sup> Dexta Corporation, ‘Important notice’, *Media Release*, 1 May 2002.

<sup>76</sup> Aquilina J, Minister for Fair Trading, ‘Government brings further stability to home warranty insurance’, *Media Release*, 20 June 2002 and Dexta, ‘Dexta to continue providing home warranty’, *Media Release*, 20 June 2002.

<sup>77</sup> *ibid.* See also Schmidt, Department of Fair Trading, Evidence, 11 July 2002, p 4.

address ‘...the major problems that have impacted on the Home Warranty Insurance market in Australia arising from the global issues confronting the insurance industry.’<sup>78</sup>

**2.63** The key reforms were stated as follows:

- the threshold for works requiring insurance will rise to \$12,000 bringing NSW and Victoria into line with South Australia and Western Australia;
- insurance will cover structural defects for 6 years and non-structural works for 2 years;
- high-rise multi-developments will not be required to carry this form of domestic dwelling insurance. Similar limitations on high-rise developments apply in Queensland, Tasmania and the ACT;
- owners of high-rise units will have access to a last resort fund;
- the establishment of a catastrophe fund, funded by contributions from insurers and builders, capable of supporting claims above \$10m arising from the death, disappearance or insolvency of any single builder;
- home owners will be able to make a claim against their policy as a last resort, that is where the builder is dead, disappeared or insolvent; and
- the minimum amount that an insurer can specify as the limit of its liability will double in Victoria to \$200,000. This is equivalent to NSW, but significantly greater than in other states.<sup>79</sup>

**2.64** The reform relating to structural and non-structural works, and the last resort reform, were implemented through the passage of the *Home Building Amendment (Insurance Act) 2002*, which is the subject of this report. The remaining reforms have been implemented through amendments to the *Home Building Regulation 1997* and are described briefly below.

**2.65** The Committee notes that the Victorian Government implemented the reforms to its scheme by means of a Ministerial Order made under section 135 of the *Building Act 1993* (Vic) on 20 May 2002.<sup>80</sup>

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<sup>78</sup> Aquilina J, Minister for Fair Trading, ‘Uniform scheme to provide viable home warranty insurance’, *Media Release*, 13 March 2002.

<sup>79</sup> *ibid.*

<sup>80</sup> Domestic Building Insurance Ministerial Order, *Victorian Government Gazette*, No S 82, Monday 20 May 2002, p 1-15.

### **Raising the threshold for work requiring insurance**

**2.66** The threshold for home building work that requires insurance was raised from \$5,000 to \$12,000 on 2 April 2002 by an amendment to the *Home Building Regulation 1997*.<sup>81</sup> The increase in the threshold brings New South Wales and Victoria into line with South Australia and Western Australia. In announcing the increase, the Minister made the following comments about its purpose:

It provides improved flexibility for small builders. The threshold has been raised to relieve consumers and builders from the high insurance premiums that often now apply to small jobs. Consumers with small jobs valued at less than \$12,000 have access to the Building Conciliation Service of the Consumer Trader and Tenancy Tribunal for low cost resolution of any disputes that arise.<sup>82</sup>

### **High-rise multi developments**

**2.67** This reform was to involve the removal of the requirement for high-rise multi-developments to carry home warranty insurance and would have aligned New South Wales with the schemes in Queensland, Tasmania and the Australian Capital Territory (and now Victoria) where high-rise multi-developments are not required to carry home warranty insurance.

**2.68** The New South Wales Government subsequently decided, however, *not* to implement this reform. In this regard, the Department advised the Committee that:

Instead [the Government] implemented a reinsurance arrangement to ensure home warranty cover remained available. As a result builders are now able to get cover for high-rise from the three insurers. This ensures that owners of high-rise apartments received the same level of consumer protection as owners of other dwellings.<sup>83</sup>

**2.69** The Department expanded on this issue in evidence before the Committee:

In relation to high-rise, despite the other reforms being acceptable to the players, the Royal and Sun and the Dexta-Allianz entities could not find reinsurers who would be willing to take on the high-rise risk. So in New South Wales the Government has maintained 100 per cent coverage of the high-rise cover, which those entities are writing. In Victoria they have taken a different approach: they

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<sup>81</sup> Department of Fair Trading, 'Home Warranty insurance Threshold raised to \$12,000', *Media Release*, 2 April, 2002. Note that the coverage provided under certificates of insurance issues between 1 May 1997 and 30 June 2002 is not affected by the increase.

<sup>82</sup> Department of Fair Trading, 'Home Warranty insurance Threshold raised to \$12,000', *Media Release*, 2 April 2002.

<sup>83</sup> Submission 18, 2 July 2002, p 2. See also Schmidt, Evidence, 11 July 2002, p 6.

have taken away the mandatory requirement for high-rise cover for consumers in that State and are implementing a catastrophe fund to provide a level of cover.<sup>84</sup>

### **Catastrophe fund**

- 2.70** The Committee understands that negotiations for the establishment of the catastrophe fund in New South Wales are underway.

### **Future Reform**

- 2.71** In response to a question from the Committee regarding further refinement of the scheme, Mr Schmidt, the former Assistant Director-General of the Department, stated:

As you would be aware, it seems that in almost every session a home building amendment bill is introduced. I have already referred to the work of Professor Allan. I hope that that will be a major catalyst for ongoing reform, regardless of what happens at a national level. It is very clear that the Government will continue to examine the operation of this scheme to see whether it can be further improved and enhanced. So the work has not stopped at all.<sup>85</sup>

- 2.72** The Department subsequently provided the Committee with a list of activities it is currently undertaking in relation to home building, some of which are to be introduced by the end of this year. The activities specific to home warranty insurance are as follows:

insurers to introduce service standards for claims handling and ensure appropriate access for consumers to claims personnel to discuss issues. The aim of this initiative is to improve claims management and customer service;

insurers to develop and publicise their eligibility criteria for builder assessments. The aim to ensure that builders have access to plain English information about eligibility requirements and to improve the quality of builder applications to hasten processing times;

insurers to establish service standards for processing builder applications to encourage faster processing of builder applications and improved customer service;

exclusion of demolition and other inappropriate work from insurance requirements; and

introduce revamped Conditions of Approval, including a new reporting framework. The aim of this initiative is to make the conditions more relevant and transparent and to make them reviewable by Parliament.<sup>86</sup>

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<sup>84</sup> Schmidt, Evidence, 11 July 2002, p 4.

<sup>85</sup> Schmidt, Evidence, 11 July 2002, p 24.

<sup>86</sup> Submission 23, Supplementary submissions, 9 August 2002 and 22 August 2002.

- 2.73** The Department also advised that it is working with the Department of Planning, in consultation with consumer, building and insurance representatives, to examine and address the recommendations of the Joint Select Committee on the Quality of Buildings and the Allan Review.<sup>87</sup>

### **National Review of Home Builders Warranty Insurance and Consumer Protection – The Allan Review**

- 2.74** In concluding this chapter, the Committee notes that in July 2001 the Ministerial Council on Consumer Affairs agreed to a National Review of Home Builders Warranty Insurance and Consumer Protection. An independent consultant, Professor Percy Allan, AM, undertook the review. The purpose of the review was to explore systemic issues in the home warranty insurance market with a view to identifying changes that could be made to the existing arrangements to ensure a viable scheme that provides an appropriate level of protection for consumers.<sup>88</sup> The terms of reference were to:

identify and analyse the appropriateness of the current home warranty insurance schemes in providing appropriate consumer protection by an adequate number of providers in an efficient competitive market;

analyse the long term sustainability of the current home warranty insurance schemes (including a comparative analysis of the various States and Territories schemes and other models);

identify those aspects of home warranty insurance which are common to State and Territory based schemes; and

suggest any potential reforms and their costs and benefits which may lead to appropriate consumer protection and greater national uniformity or consistency.<sup>89</sup>

- 2.75** Professor Allan's report was released on 2 August 2002. Findings relevant to the terms of reference for this inquiry are identified in Chapter 4. The Committee also notes that in response to the report the Federal government has encouraged the States and Territories '...to act quickly to consider the review's recommendations which aim to achieve a competitive and viable home builder's warranty insurance market.'<sup>90</sup> The Committee supports this response and recommends that the New South Wales Government consider the recommendations of the Allan Review with a view to promoting the consumer

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<sup>87</sup> *ibid.*

<sup>88</sup> Watkins J, Minister for Fair Trading and Hockey J, Minister for Financial Services and Regulation, 'National Review of Builders Warranty Insurance', *Media Release*, 4 October 2001.

<sup>89</sup> *ibid.*

<sup>90</sup> Senator Ian Campbell, Parliamentary Secretary to the Treasurer, 'Government welcomes Allan review into home builder's warranty insurance and consumer protection', *Media Release*, 2 August 2002.

protection aims of the Home Warranty Insurance Scheme as well as a competitive and viable home warranty insurance market.

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**Recommendation 2**

The Committee recommends that the Minister for Fair Trading consider, as a matter of priority, the recommendations of the National Review of Home Builders Warranty Insurance and Consumer Protection, with a view to promoting the consumer protection aims of the New South Wales Home Warranty Insurance Scheme as well as a competitive and viable home warranty insurance market.

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

The long title of the *Home Building Amendment (Insurance) Act 2002* (the Amendment Act) is:

An Act to amend 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 was assented to on 16 May 2002 and came into force on 1 July 2002. The amendments do not apply to existing contracts of insurance.<sup>91</sup> The reforms implemented by the Amendment Act are explained in the following paragraphs. The Department of Fair Trading (the Department) advised the Committee that the reforms are ‘...aimed at ensuring the long term viability of the home warranty scheme and the building industry while providing both reasonable and realistic cover for consumers.’<sup>92</sup>

### **Move to a Last Resort Scheme**

- 3.1**        One of the main objectives of the Amendment Act is to provide that the home warranty insurance required to be provided under the *Home Building Act 1989* for residential building work, the supply of kit homes and for certain other work is *last resort* insurance.
- 3.2**        According to the Explanatory Note to the bill, ‘last resort insurance’ means that a consumer is covered under a home warranty insurance policy *only if* the person cannot enforce or recover against the builder or supplier because the builder or supplier is insolvent or dead or has disappeared.
- 3.3**        The Committee notes that part of the New South Wales Home Warranty Insurance Scheme was already ‘last resort’, prior to the amendments, and that this remains unchanged by the Amendment Act. In this regard, the *Home Building Act 1989* provides that the insurance cover for *non-completion* of residential building work or *non-supply* of a kit home is ‘last resort’ insurance cover (as explained further in Chapter 2, paragraph 2.18). The Amendment Act provides that, as well as in relation to non-completion of residential building work and the non-supply of kit homes, insurance for other aspects of residential

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<sup>91</sup> Schedule 1[16] of the Amendment Act inserts a new Part 10, cl 68 into Schedule 4 of the *Home Building Act 1989*. The new clause provides that, subject to the *Home Building Regulation 1997*, an amendment to a provision of the *Home Building Act 1989* made by the Amendment Act does not apply to an insurance contract that is in force at the time the amendment commences (ie 1 July 2002). Schedule 2[11] of the Amendment Act makes the same provision with regard to certain amendments to the *Home Building Regulation 1997*. Note also that Schedule 1[15] of the Amendment Act provides for the making of savings and transitional regulations consequent on its enactment.

<sup>92</sup> Submission 18, 2 July 2002, p 4.

building work, the supply of kit homes, and for certain other work is also to be last resort insurance.<sup>93</sup>

- 3.4** Therefore, a home warranty insurance policy now applies only to the death, insolvency and disappearance of a contractor or supplier and for all other cases, such as a failure to complete work where the contractor is solvent, the consumer must pursue other avenues. The Department explained how the reform will work with respect to consumers who are in dispute with a contractor who is neither insolvent, dead nor disappeared:

For consumers who are in dispute with their contractor, and the contractor is still in business, the scheme will operate differently. In this situation the consumer will have to pursue the matter with the contractor. If the consumer is unable to recover compensation or have the contractor rectify the problem due to the insolvency, death or disappearance of the contractor the consumer may lodge a claim. Consumers will be encouraged to use the services of the Building Conciliation Service (BCS) that is part of the Consumer, Trader and Tenancy Tribunal.<sup>94</sup>

- 3.5** This amendment was one of the uniform reforms agreed to by the New South Wales and Victorian Governments earlier this year, as discussed in Chapter 2, paragraph 2.63. Mr John Schmidt, the former Assistant Director-General of the Department, advised the Committee in evidence that this amendment was one of the reforms for which the major insurer in the market, Royal & SunAlliance, had lobbied the New South Wales Government:

Shortly thereafter the Government had approaches from both the French reinsurer, SCOR, and the other major insurer in the market, Royal and Sun Alliance, which indicated clearly to the Government that, if it was to continue in this particular field, it was looking for significant reforms to the operation of the market. It wanted the introduction of a distinction between structural and non-structural defects; it wanted the Government to remove the requirement for high-rise insurance; it wanted the Government to move to a last resort scheme based on existing models in South Australia and Western Australia; and it raised some other issues. Basically, the company put a log of claims to the Government.<sup>95</sup>

## **Insurance Cover for Structural and Non-Structural Defects**

- 3.6** Prior to the implementation of the Amendment Act, the *Home Building Act 1989* required that a contract of insurance must provide insurance cover for *any loss* (other than for non-completion<sup>96</sup>) for a period of not less than *seven years* after the completion of the work, the

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<sup>93</sup> *Home Building Amendment (Insurance) Act 2002*, Schedule 1[3] – [7] and Schedule 2[1]-[6].

<sup>94</sup> Submission 18, 2 July 2002, p 2.

<sup>95</sup> Evidence, 11 July 2002, p 4.

<sup>96</sup> A contract of insurance must provide insurance cover for loss arising from *non-completion* of work for a period or not less than 12 months after the failure to commence, or cessation of, the work the subject of the cover: *Home Building Act 1989*, s 103B(1). This has not been changed by the *Home Building Amendment (Insurance) Act 2002*.



supply of the kit home, or the end of the contract relating to the work or supply, whichever is the later.<sup>97</sup>

**3.7** The Amendment Act creates two separate types of loss that must be covered by insurance and each has a different period of cover.<sup>98</sup> In regard to a *structural defect*, a contract of insurance must provide cover for a period of not less than 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 any other defect, generally referred to as a *non-structural defect*, the period of cover will be two years. The amendments mean an overall decrease in the period of cover and a decrease of one year with regard to structural defects, and decrease of 5 years for non-structural defects.

**3.8** The distinction between structural and non-structural defects is a new feature of the New South Wales scheme. The term 'structural defect' was not previously used or defined. The Amendment Act inserts a new section 57AC the *Home Building Regulation 1997* to define 'structural defect' as follows:<sup>99</sup>

**structural defect** means any defect in a structural element of a building that is attributable to defective design, defective or faulty workmanship or defective materials (or any combination of these) and that:

- (a) results in, or is likely to result in, the building or any part of the building being required by or under any law to be closed or prohibited from being used, or
- (b) prevents, or is likely to prevent, the continued practical use of the building or any part of the building, or
- (c) results in, or is likely to result in:
  - (i) the destruction of the building or any part of the building, or
  - (ii) physical damage to the building or any part of the building, or
  - (d) results in, or is likely to result in, a threat of imminent collapse that may reasonably be considered to cause destruction of the building or physical damage to the building or any part of the building.

**structural element** of a building means:

- (a) any internal or external load-bearing component of the building that is essential to the stability of the building or any part of it, including things such as foundations, floors, walls, roofs, columns and beams, and
- (b) any component (including weatherproofing) that forms part of the external walls or roof of the building.

**3.9** This amendment was one of the uniform reforms agreed to by the New South Wales and Victorian Governments earlier this year, as discussed in Chapter 2, paragraph 2.63. The Victorian Government incorporated the distinction between structural and non-structural defects into its scheme, with the same periods of cover as New South Wales, in May 2002. The Committee also notes that Mr Schmidt, from the Department, advised the Committee

<sup>97</sup> S 103B(2).

<sup>98</sup> *Home Building Amendment (Insurance) Act 2002*, Schedule 1[9]. The Amendment Act also provides that the period for which insurance cover must be provided can be varied by the *Home Building Regulation 1997*: Schedule 1[10]. Schedule 1[10] is a consequential amendment.

<sup>99</sup> *Home Building Amendment (Insurance) Act 2002*, Schedule 2[10].

that this amendment was one of the reforms for which the major insurer in the market, Royal & SunAlliance, had lobbied the Government, as quoted above.<sup>100</sup> The Committee observes that there is a discrepancy between Mr Schmidt's evidence and the evidence of Mr Huntly, the National Manager Warranty and Construction for Royal & SunAlliance, Warranty and Construction, who advised the Committee in evidence that this reform was not one that Royal & SunAlliance lobbied for.<sup>101</sup>

**3.10** The Committee notes that this distinction is comparable to a distinction that existed in the pre-1997 Government scheme and the current Queensland scheme, as pointed out to the Committee by the Department:

Under the closed government scheme there was 7 years cover for major structural defects and 3 years cover for other defects. However, this period of cover ran from commencement of the work not completion. Under the Queensland Government insurance scheme there is 6 1/2 years cover (from payment of the premium) for category 1 defects and 6 months after practical completion for category 2 defects. Category 2 defects described are those that result from the failure of the contractor to meet reasonable standards of construction and finish or are of a kind that commonly occurs during the settling in period of a new building.<sup>102</sup>

### **Approval of Alternative Home Building Indemnity Schemes or Arrangements**

**3.11** The Amendment Act inserts a new section 102A into the *Home Building Act 1989* to enable the Minister to approve alternative home building indemnity schemes or arrangements in New South Wales.<sup>103</sup> Such approval can be subject to any conditions prescribed by the *Home Building Regulation 1997* or imposed by the Minister.

**3.12** More specifically, the Amendment Act provides that the requirements in relation to contracts of insurance for home building work do not apply if the relevant work or supply is covered by a home building indemnity scheme, or other arrangement, approved by the Minister.<sup>104</sup> The Amendment Act also provides that the *Home Building Regulation 1997* may make provision for, or with respect to, such an approved scheme or arrangement, including provision for the functions of the Guarantee Corporation in relation to the administration of an approved scheme or arrangement. Additionally, the Amendment Act made

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<sup>100</sup> Evidence, 11 July 2002, p 4.

<sup>101</sup> Evidence, 25 July 2002, p 2.

<sup>102</sup> Submission 18, 2 July 2002, pp 3-4.

<sup>103</sup> *Home Building Amendment (Insurance) Act 2002*, Schedule 1[8].

<sup>104</sup> *ibid.*

amendments to facilitate the administration by the Guarantee Corporation of any such approved scheme or arrangement.<sup>105</sup>

**3.13** The type of alternative home building indemnity schemes or arrangements envisaged by the Government include an industry-based indemnity scheme or a similar scheme that could be administered by the Building Insurers' Guarantee Corporation.

**3.14** In its submission to the Inquiry, the Department pointed out that this reform implements *enabling* provisions only and was enacted in response to expressions of interest from industry groups to establish an industry operated indemnity scheme.<sup>106</sup> In this regard, the Minister made the following statement in his second reading speech on the bill:

Because of the difficulties that the home warranty market has experienced, a number of industry bodies have been examining the feasibility of setting up alternative indemnity schemes to cover work. Provided such schemes deliver equal or better cover to the home warranty insurance scheme, they have the potential to benefit both industry and consumers. The problems relating to reinsurance to which I referred earlier also make it important for the Government to be able to act quickly to put in place arrangements to avoid dislocation to the building industry. The Bill therefore provides that the Minister may approve alternative home building indemnity schemes or similar arrangements.<sup>107</sup>

## Legal or Other Reasonable Costs

**3.15** Clause 43 of the *Home Building Regulation 1997* sets out the losses that must be indemnified by a contract of home warranty insurance, as described in Chapter 2, paragraph 2.21. The Amendment Act provides that the losses or damages that must be indemnified are also to 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.'<sup>108</sup> A 'beneficiary' means a person entitled to claim a benefit provided under an insurance contract.<sup>109</sup> The term 'other reasonable costs' is not defined in the legislation.

**3.16** In its submission to the Inquiry, the Department placed this reform in the context of the move to last resort insurance, stating that:

Recognising that consumers may incur cost in pursuing a contractor the Act provides that the insurance policy must cover the consumer against legal or other

<sup>105</sup> *ibid.* Note that Schedule 1[11]-[14] of the Amendment Act makes consequential amendments to facilitate the administration by the Guarantee Corporation of any such approved scheme or arrangement.

<sup>106</sup> Submission 18, 2 July 2002, p 4.

<sup>107</sup> NSWPD (LA) 7 May 2002, pp 1641-1642.

<sup>108</sup> *Home Building Amendment (Insurance) Act 2002*, Schedule 2[7].

<sup>109</sup> *Home Building Regulation 1997*, cl 39.

reasonable costs incurred in seeking to recover compensation from the contractor or in taking action to rectify the damage or loss.<sup>110</sup>

### **Ability to Limit Liability for Non-Completion to 20% of Contract Price**

- 3.17** As described in Chapter 2, paragraph 2.25, the *Home Building Regulation 1997* provides that an insurance contract may contain certain limitations on liability. The limitations are set out in the *Regulation* and include such things as loss or damage caused by fair wear and tear, damage due to a failure by a beneficiary under the contract to take reasonable and timely action to minimise the damage and claims in relation to an appliance or apparatus if the claim is made after the expiry of the manufacturers warranty.<sup>111</sup>
- 3.18** The Amendment Act amends the *Regulation* to provide that home building insurance contracts may *also* limit liability resulting from *non-completion* of building work to an amount that is 20% of the contract price for the work.<sup>112</sup> As set out in Chapter 2, paragraph 2.18, home warranty insurance covers loss arising from the non-completion of the work due to insolvency, death or, disappearance of the contractor.
- 3.19** In the Committee's view, insurers are likely to take up this reform immediately so that insurance contracts entered into from 1 July 2002 will only cover non-completion claims for 20% of the contract price.<sup>113</sup>
- 3.20** The Department advised the Committee that the purpose of the amendment is:
- ...to ensure that non-completion claims are reasonable. Under the current scheme there is no incentive for a consumer to assess whether a contract price is reasonable. They can accept an unreasonably low quote knowing that if the builder fails the insurance scheme will cover them for \$200,000. The consumer is then in the position of potentially making a windfall gain by getting building work to a value in excess of the original contract.<sup>114</sup>
- 3.21** This amendment brings New South Wales in line with Victoria where the ability for insurers to limit liability for non-completion to 20% of the contract price was introduced in 1998.<sup>115</sup> Mr David Turner, the National Manager Warranty for HIA Insurance Services, explained the 20% limitation in relation to Victoria, in response to a question from the Hon John Ryan MLC:

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<sup>110</sup> Submission 18, 2 July 2002, p 3.

<sup>111</sup> *Home Building Regulation 1997*, cl 45.

<sup>112</sup> *Home Building Amendment (Insurance) Act 2002*, Schedule 2[8].

<sup>113</sup> As indirectly acknowledged by HIA Insurance Services: Submission 17, 26 June 2002, p 3.

<sup>114</sup> Submission 18, 2 July 2002, p 3.

<sup>115</sup> *ibid.*

**The Hon. JOHN RYAN:** Why is the amount capped at the amount of the contract price which, in some respects, is accidental. Why should it not be capped at the value of what the consumer is ultimately paying for, the sum insured, 20 per cent of the sum insured? It is a modest difference but I take the view that if I am paying a premium for \$200,000 worth of cover, I should at least be entitled to 20 per cent of \$200,000 rather than 20 per cent of what might accidentally be the contract price, which may be \$150,000 to \$160,000?

**Mr TURNER:** I think you will find that that came from the Victorian position, which was largely what was deemed an acceptable level for non-completion outside of what the contract was that the client entered into. In other words, there was a responsibility on the clients to ensure that the contract they were entering into was a fair and reasonable price that they were paying and not one that was unjustly discounted by the builder for whatever reason. The 20 per cent was struck because it appeared that was a reasonable differential. If anybody was underpricing competitors by 20 per cent or more than 20 per cent, there was probably a responsibility on the consumers to make sure that the price they were paying initially was a real price.<sup>116</sup>

- 3.22** Other jurisdictions do not have a 20% liability limit, but rather limit liability for non-completion to set amounts, as listed below (except the Northern Territory where there is no ceiling on non-completion claims):<sup>117</sup>

|                              |           |
|------------------------------|-----------|
| Queensland                   | \$200,000 |
| South Australia              | \$ 80,000 |
| Western Australia            | \$100,000 |
| Tasmania                     | \$ 50,000 |
| Australian Capital Territory | \$ 85,000 |

## Other Amendments

- 3.23** In relation to home warranty insurance, the *Home Building Act 1989* makes several references to the insolvency or death of a contractor or kit home supplier, or the situation where, *after due search and inquiry*, the contractor or supplier *cannot be found*.<sup>118</sup> The Amendment Act substitutes the word 'disappearance' for this rather unwieldy reference to the situation where a contractor or supplier can't be found. The definition section (*Home Building Act 1989*, s 90) is also amended to state that that a reference to the 'disappearance' of a contractor, supplier or owner builder 'includes a reference to the fact that after due search and inquiry, the contractor, supplier or owner-builder cannot be found'.<sup>119</sup>
- 3.24** Schedule 2[9] of the Amendment Act, requires that '\$12,000' be substituted for '\$5,000' wherever occurring in the *Home Building Act 1989*. This amendment is consequential on the

<sup>116</sup> Evidence, 25 July 2002, p 20.

<sup>117</sup> Allan, op cit, p78.

<sup>118</sup> *Home Building Act 1989*, ss 99, 100 and 101.

<sup>119</sup> *Home Building Amendment (Insurance) Act 2002*, Schedule 1[1].

recent increase, from \$5,000 to \$12,000, to the threshold for works requiring home building insurance, as discussed in Chapter 2, paragraph 2.66.

**3.25** Schedule 3 of the Amendment Act makes various miscellaneous amendments as set out below.

Clarification that the definition of ‘building claim’ in section 48 of the *Home Building Act 1989* includes an appeal against a decision of an insurer under a contract of insurance.<sup>120</sup>

Removal of superfluous words in relation to the making of applications to the Consumer, Trader and Tenancy Tribunal for the determination of building claims.<sup>121</sup>

Clarification that, if the Building Insurers’ Guarantee Corporation pays an amount to a beneficiary under the indemnity provided by Part 6A of the *Home Building Act 1989*, and the beneficiary’s rights in respect of the matter covered by the indemnity are assigned to the Guarantee Corporation, the assignment includes the assignment of any rights that the beneficiary may have against a developer or any other person in respect of the matter.<sup>122</sup>

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<sup>120</sup> *Home Building Amendment (Insurance) Act 2002*, Schedule 3.1[1].

<sup>121</sup> *Home Building Amendment (Insurance) Act 2002*, Schedule 3.1[2]. Note that Schedule 3.2[1] and [2] contain amendments consequential on the amendment made by Schedule 3.1[2].

<sup>122</sup> *Home Building Amendment (Insurance) Act 2002*, Schedule 3.1[3].

## Chapter 4 Impact of the Reforms

This chapter examines the impact of the *Home Building Amendment (Insurance) Act 2002* (the Amendment Act) on home warranty insurance, home builders and consumers. First, an analysis of the views expressed in submissions and in evidence regarding the impact of each of the reforms contained in the Amendment Act is undertaken. Mindful that the reforms must be viewed as a package, this chapter then sets out a concluding review of the impact of the Amendment Act on home warranty insurance, home builders and consumers.<sup>123</sup>

### Preliminary Remarks

- 4.1** The Amendment Act commenced on 1 July 2002. The reforms therefore had only been in place for approximately six weeks at the time the Committee concluded this Inquiry. The Committee observes that this renders an evaluation of the impact of the Amendment Act largely a speculative exercise.
- 4.2** The Committee received 23 submissions and of those only nine addressed the terms of reference (and some only very briefly). Instead, many submissions focused on other issues and concerns about the Home Warranty Insurance Scheme. The paucity of information specifically relating to the Amendment Act made it difficult for the Committee to effectively assess the impact of the reforms. However, with the aid of the pertinent submissions, and the evidence given to the Committee in hearings, some conclusions have been drawn and are set out in this chapter.
- 4.3** The Committee regrets that there was only minimal contribution from consumers and that therefore it did not have the opportunity to canvass more views held by consumers regarding the impact of the Amendment Act. The Committee received one submission from a consumer and heard evidence from one group representing the interests of consumers.<sup>124</sup> Here the Committee would like to acknowledge the work of the Building Action Reform Group (BARG) in representing consumer interests by providing oral evidence to the Inquiry. It is the Committee's view that the limited response from consumers is due to the fact that consumers are a disparate group of people linked by isolated experiences with builders and home warranty insurance, rather than an indication that the Amendment Act will have limited impact on consumers, or that there is a lack of interest in this issue among consumers.
- 4.4** The Committee notes also that while it received submissions and heard evidence from the largest insurer in the market, Royal & SunAlliance, and its agent HIA Insurance Services, it did not receive submissions from Dexta/Allianz or Reward, although invitations to participate in the Inquiry were extended. The Committee identifies a parallel in this regard

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<sup>123</sup> The 'Other Amendments' explained in Chapter 3, paragraphs 3.23-3.25, are not examined in this chapter as they are consequential amendments.

<sup>124</sup> Submission 7, 6 June 2002 and Onorati and Russo, Evidence, 8 August 2002.

to the participation of insurers in the Allan Review.<sup>125</sup> The Committee's comments about the views of insurers are therefore based on the views of Royal & SunAlliance and its agent (except where noted) and do not claim to reflect the views of the other insurers.

## **Impact of the Last Resort Reform**

**4.5** The nature of the last resort reform was set out in Chapter 3, paragraphs 3.1-3.5. This reform has proven to be the most controversial of those implemented by the Amendment Act; not in terms of whether it has achieved, or is likely to achieve, its aim but rather in terms of its impact on consumers. The Committee notes in this regard that Royal & SunAlliance has indicated that the reform has already had the desired effect of stabilising the insurance market and will contribute to a reduction in premiums in the future. On the other hand, BARG has strongly criticised the reform as having a detrimental impact on the level of cover that home warranty insurance provides consumers.

**4.6** Confounding an assessment of the impact of this reform is the view of the Department of Fair Trading (the Department) that it is likely to have 'limited impact', and the view of Professor Allan who strongly supports the reform and argues that it will have little impact on consumers due to what he calls the 'cruel hoax' of the previous 'first resort' scheme.

### **New South Wales Government view**

**4.7** The Department has advised the Committee that this reform will have *limited* impact, because the majority of insurance claims concern builder insolvency anyway:

As the bulk of insurance claims are paid as a consequence of builder insolvency, the change to a last resort scheme will have limited impact. This is particularly the case where there are complex contractual disputes between the consumer and the contractor. Where such disputes do arise the insurer may be unable to determine which party is in the right and will often refer the claimant to the Tribunal in order to have the legal position resolved.<sup>126</sup>

**4.8** The former Assistant Director-General of the Department, Mr John Schmidt, identified the positive impact that this reform will have for *builders*:

...One of the concerns we have often had expressed by builders is that prior to a move to last resort when an insurance claim could be made when a contract was still on foot, they felt they had lost some of the relationship with the consumers in that it was theoretically possible for a consumer to walk away from a contract, lodge a claim with an insurer who might then pay it out, yet the builder not be given adequate opportunity to respond to that claim. That area has now been resolved by the clarity of the move to last resort.

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<sup>125</sup> Allan, op cit, p 18.

<sup>126</sup> Submission 18, 2 July 2002, p 3.



For builders it should also significantly alter the risk profiles that are used by insurers in basing their assessment criteria and their premiums, so we expect to see improvements there.<sup>127</sup>

### **Insurers' views**

#### **4.9** Royal & SunAlliance described this reform as one of the 'key' amendments for insurers, and identified its likely impacts:

We welcome the change and believe it has the following impacts:

- Increase the degree of responsibility that contractors accept for their own workmanship;
- Improve communication between contractor and home owner;
- As soon as a downward trend in claims experience can be detected and quantified, insurers will reduce premiums. (A permanent shift in claims experiences may begin to emerge some 12 to 18 months after the changes are effected)
- Reduce the volatility in the claims experience, in turn reducing insurer's risk, capital employed and premiums.
- No deleterious impact on consumers.<sup>128</sup>

#### **4.10** HIA Insurance Services identified this reform as having a beneficial impact on insurers, consumers and builders, emphasising that the last resort model places responsibility for contractual disputes in the hands of the builder and the consumer with reliance on dispute resolution processes rather than the insurers:

The last resort approach provides a more predictable operating environment for builders, consumers and private sector warranty underwriters as contractual disputes are handled in a more appropriate forum rather than through an insurance company. Consumers can be protected where a contractual dispute is followed by the failure of a builder. It's the responsibility of the regulatory agency and or the courts to enforce the outcomes of contractual disputes rather than making it an issue for the insurers. Essentially, consumers are paying for disputes to be resolved by insurers rather than through appropriate avenues such as the regulator eg DFT, CTTT.<sup>129</sup>

#### **4.11** The Insurance Australia Group (IAG) endorsed this reform but flagged a concern regarding the use of insolvency to trigger insurance claims:

<sup>127</sup> Evidence, 11 July 2002, p 8.

<sup>128</sup> Submission 9, 21 June 2002, p 7.

<sup>129</sup> Submission 17, 26 June 2002, pp 3, 4 and 5.

This [reform] is important to maintain premiums at an affordable level and to make sure that builders perform their duties in accordance with the building contracts which consumers have entered into in good faith. However, we are concerned about the use of insolvency to trigger claims and the practice within the building trade for a builder to hold multiple licenses in the names of different corporate entities. We believe that the fact that one licensed corporate entity owned by the builder becomes insolvent should not absolve the builder of responsibility in performing his contractual obligations if the builder is still licensed and carrying on business under other legal entities. In other words, indemnity under the home warranty insurance policy should not be invoked unless and until the builder is unable to carry on business at all. It is the builder as an individual who ought to retain primary responsibility for the activities under the licence, rather than the legal entity.<sup>130</sup>

- 4.12** The Insurance Council of Australia (ICA) identifies the positive impact of this reform on home warranty insurance:

The other concern for insurers is the credit risk that this insurance requires. With the new amendments in the [Amendment] Act this puts the insurers in the position of last resort for the protection of consumer rights, after all other avenues have been exhausted between the builder and consumer. This provides some certainty for insurers as a result of the amendments.<sup>131</sup>

### **Builders' views**

- 4.13** The Housing Industry Association (HIA) expressed the view that the last resort reform is a beneficial one for builders, consumers and home warranty insurance alike. According to the HIA, the strength of the reform lies in the fact that it will create 'a more predictable operating environment for builders, consumers and private sector warranty underwriters.'<sup>132</sup>
- 4.14** The MBA also expressed support for this reform although it was critical that the reform may increase delays in resolving contractual disputes between builders and consumers:

The Act changes the scheme to a scheme of last resort, which will lockout many claims that are essentially contractual disputes where the contract has been subsequently terminated and an insurance claim made. These matters will not have to be dealt with through the [CTTT]. The concern the MBA raises is that through amendment legislation in 2002, the CTTT now has jurisdiction over all residential disputes and therefore the insurance amendment legislation could compound current delays. Subsequently additional pressure will be placed upon the new Builders Conciliation Services attached to the CTTT.<sup>133</sup>

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<sup>130</sup> Submission 14, 25 June 2002, p 2.

<sup>131</sup> Submission 12, 24 June 2002, p 2.

<sup>132</sup> Submission 8, 24 June 2002, p 4.

<sup>133</sup> Submission 19, June 2002, p 4.

- 4.15** Mr Paul Delahunty, General Manager of the Swimming Pool & Spa Association of NSW Limited (SPASA), described the negative effect that the last resort reform will have on consumers who cannot recover from a builder and cannot access insurance because the builder is neither insolvent, dead or has disappeared:

The old BSC system provided coverage whether or not the builder was available, even in situations where the builder had not taken out insurance. So the consumer was extremely well protected under the old system. On television the other night there was coverage about a builder who still argues that he is around and will fix the problems. Yet people have been waiting in excess of 18 months for him to do the work....So the insurer does not have to pay: the consumer does not have the benefit of insurance because the builder is not insolvent, dead or missing. The poor old consumer is left trying to get his house finished, rebuilt or whatever and he cannot because this guy is still saying, "Yes, yes, yes, I'll do the work". But the consumer does not have access to the insurance.<sup>134</sup>

### **Consumers' views**

- 4.16** The President of BARG, Mrs Irene Onorati, argued that this reform leaves consumers 'seriously disadvantaged' because, among other matters, they are left with the difficult task of pursuing builders who are not insolvent or dead or who have not disappeared:

Under the last resort scheme consumers can only make an insurance claim if their home has not been completed or has defects, if the builder dies, disappears or becomes insolvent. Consumers are seriously disadvantaged, as (a) consumers are on their own to pursue the builder to fix the defects; (b) this puts too much power in the hands of the builder, as the builder can threaten to walk off the job knowing that the home owner will have to go to a court or a tribunal to obtain an order against him; (c) protracted delays - the builder knows that nothing will be ordered immediately - in BARG's experience it can take from two to three years; cost - inequality of bargaining power; the builder has more money; consumers are financially stretched; the builder is in the position that the longer he delays, then it is more likely the consumer will succumb to his demands; home owners need to get expensive consultants' reports and solicitors costs, plus the cost associated with being out of their home and paying rent and the mortgage; (d) no insurance redress for contract being legitimately terminated due to the breaches or misconduct by the builder; (f) home owners have no cover if the builder loses his licence, unless the builder becomes insolvent; this change leaves the home owner almost completely exposed to the whims of the builder. How and who is appropriately protecting consumers?<sup>135</sup>

- 4.17** Mr Salvatore Russo, the pro bono solicitor for BARG, referred to this reform as a 'disaster' for consumers noting that under the previous scheme, the existence of insurance, and the presence of an insurer as an interested party to a dispute, was beneficial for consumers, as it placed pressure on a builder to settle contractual disputes:

<sup>134</sup> Evidence, 31 July 2002, pp 23 and 24. See also Submission 20, 4 July 2002, p 6.

<sup>135</sup> Evidence, 8 August 2002, p 2.

**Mr RUSSO:** That is a disaster for consumers...The reason is this: The consumer is now put to a position where insurance being their last resort, he has no-one who intervenes and plays at least some form of role as a mediator. What we have seen with the insurance companies up until now is that when insurers come into the arithmetic, at least the builder becomes slightly more sensitive to settling because he is under some pressure from his insurer as to whether or not he has actually undertaken the work properly. The insurer appoints an expert and actually independently sometimes goes out and inspects the works. Where that inspection reveals that the work in fact is substantially defective or consistent with the claims made by the consumer, the insurers sometimes, in the experience that I have had, take a pretty strong position against the builder. That we see as at least a little bit of control over the builder.

Putting it as last resort means that the consumer now has to go through virtually the entire process of litigation and dispute resolution before he can get to the insurer. That means that he has to spend money that he does not have in obtaining reports, in obtaining legal representation and in trying to deal with a builder who may have done this many times before, and for a consumer it is the first time. So the consumer is just completely prejudiced by creating a last resort system because they no longer have someone that they can actually turn to, even at the preliminary stages of a dispute, to assist in its resolution.<sup>136</sup>

### **Other views**

**4.18** The Law Society of New South Wales (the Law Society) believes that this reform will have a negative impact on consumers:

In principle, the move towards the concept of home warranty insurance being a 'fund of last resort' will add to the expense and uncertainty for consumers already facing the trauma of defective or incomplete building works.<sup>137</sup>

**4.19** In evidence Professor Allan stated that this reform (as well as others in the Amendment Act) has already had the desired effect of 'calming' down the insurers.<sup>138</sup> The Committee notes that in his review Professor Allan was very supportive of last resort schemes over first resort schemes, rating last resort as a 'very high' priority.<sup>139</sup> Professor Allan identified the pros and cons of adopting a last resort scheme as follows:

**Pro:** Recognises reality that private insurers refuse to accept HBWI as a 'first resort' measure anywhere in Australia. As such mandating 'last resort' insurance

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<sup>136</sup> Evidence, 8 August 2002, p 2.

<sup>137</sup> Submission 16, 21 June 2002, p 1.

<sup>138</sup> Evidence, 8 August 2002, p 27.

<sup>139</sup> Note that Professor Allan's report canvassed many options that were raised in submissions and interviews to address the problems of home warranty insurance nationally. It presented '...a core set of "high" and "very high" priority measures that should be undertaken to restore confidence in home building warranty insurance and the homebuilding process more generally. Options assigned a "medium" score should also be given serious consideration': Allan, op cit, p vii.

would accept what happens in practice and end the false expectations generated by 'first resort' legislation. Even in Queensland, where a government agency (BSA) provides HBWI, genuine 'first resort' insurance does not apply since a homebuyer is expected to seek restitution from their builder before claiming on insurance. Nevertheless in Queensland the BSA uses its licensing powers to discipline builders who do not rectify work ordered by the BSA. Where a builder refuses to obey such orders the BSA compensates the homebuyer.

**Con:** See comment in previous option.<sup>140</sup> Would require better building safeguards (as canvassed under consumer justice options) to minimise those risks no longer insured, such as incomplete or defective work that a practicing builder refuses to remedy.

**Priority:** Very High (since private insurers refuse to underwrite 'first resort' insurance).<sup>141</sup>

**4.20** In contrast to the views of BARG and the Law Society, Professor Allan described this reform as having limited impact on consumers because of what he calls 'the cruel hoax' that the pre-existing insurance arrangements were not last resort. Professor Allan explains this claim as follows:

In states with 'first resort' HBWI schemes the insurer is theoretically obliged to not only compensate for loss of deposit on, non-completion of or defects to a building if the builder dies, becomes insolvent or disappears, but also to do so if the builder is still trading. In practice however, insurers expect a homebuyer to exhaust all other avenues of appeal before claiming on their insurance policy. Effectively 'first resort' is little different to 'last resort' except that it results in home buyers having false expectations about their insurance rights.<sup>142</sup>

**4.21** The Department acknowledged the 'cruel hoax', stating in its submission that:

In other words, if a contractual dispute arises between a consumer and a builder (who is still on foot), the very complexities of building disputes effectively means that the insurance claims will generally not be resolved in advance of resolution of the contractual dispute.<sup>143</sup>

**4.22** Professor Allan also argued that this reform will actually have a *positive* impact on consumers because consumers will not have false expectations about their insurance rights:

The sooner some governments end the cruel hoax of 'first resort' insurance the sooner consumers will come to accept that homebuilding is not insured in the

<sup>140</sup> This is a reference to the following comment: 'This could eventually precipitate a consumer backlash, unless there is an improvement to dispute resolution processes for problems no longer nominally covered by insurance'.

<sup>141</sup> Allan, op cit, p 59.

<sup>142</sup> Allan, op cit, p 9. See also Allan, Evidence, 8 August 2002, p 15.

<sup>143</sup> Submission 18, 2 July 2002, p 3.

same way as a motor vehicle, house and contents or medical and hospital treatment.<sup>144</sup>

- 4.23** The Committee notes that there seems to be confusion among consumers as to the exact nature of home warranty insurance in this regard. The Committee is concerned that some consumers may not understand that pursuant to the Amendment Act home warranty insurance insures consumers against non-completion and defects *only* in the event of the insolvency, death or disappearance of a builder and that in any other circumstance, namely, where the builder is still trading, the consumer must pursue the builder to rectify or obtain compensation for defects or non-completion. The Committee recommends that the Department, in collaboration with insurers and industry associations, develop information for consumers clearly explaining the nature of home warranty insurance, with particular emphasis on its last resort nature.

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### **Recommendation 3**

The Committee recommends that the Department of Fair Trading, in collaboration with insurers and industry associations, develop information for consumers clearly explaining the nature of home warranty insurance, with particular emphasis on its last resort nature.

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## **Impact of the Reform Regarding Insurance Cover for Structural and Non-Structural Defects**

- 4.24** The nature of this reform was set out in Chapter 3, paragraphs 3.6-3.10. The Committee notes that few submissions addressed the impact of this particular reform and that witnesses did not generally express strong views about the distinction between structural and non-structural defects. However, stronger and divergent views were expressed on the reduced period of cover. In this regard, some industry associations and insurers indicated their support for the reform, while the representatives of BARG were adamant that this reform significantly disadvantaged consumers.

### **Insurers' views**

- 4.25** HIA Insurance Services submitted its view that this reform (as well as all of the reforms in the Amendment Act) will have positive benefits for builders. However, apart from stating that the reduction in the period of cover for structural defects to six years would create '...a more certain framework for consumers and builders,'<sup>145</sup> HIA Insurance Services did not elaborate on its view.

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<sup>144</sup> Allan, op cit, p 9.

<sup>145</sup> Submission 17, 26 June 2002, p 4.

**4.26** Royal & SunAlliance supports this reform but described it as only having a relatively minor impact. In this regard the insurer stated that the reduction in the period of cover from seven years to six for structural defects ‘...is not, on its own, of particular impact’ and stated in evidence that:

The shortening of the indemnity period to six years will probably have no real effect in relation to non-completion losses because they generally occur in the first two to three years. It will have some effect on the defect claims associated with insolvency.<sup>146</sup>

**4.27** Royal & SunAlliance estimates that the impact would probably be ‘nil on non-complete claims, perhaps 4% on defect claims and approximately 2% overall’.<sup>147</sup> The insurer acknowledged that the separation of claim types into two categories and the reduction in the period of cover for non-structural defects to two years, will have some impact on consumers, as follows:

It would appear to us that the impacts of this amendment are complex and would probably include:

- A transfer of a component of cost and risk from the contractor to the consumer, for non-structural defects in the period 2 years to 6 years;
- Where the contractor is dead, insolvent or had disappeared, then that cost and risk transfer, previously covered by insurance, will be recognised with a corresponding drop in premium, ie the policy holder benefits but at the expense of the claimant
- Where that contractor is NOT dead, insolvent or missing, then there is no benefit to the consumer (either policy holder or claimant)
- There is a benefit to the contractor as he will no longer be required to rectify work that is currently covered by statutory warranty
- This benefit is paid for by the complainant who must go without or pay for his own repairs

To put this in perspective (and some of the numbers are educated guesses):

- In NSW 76% of total claims are defect claims (R&SA experience)
- The average cost of all defect claims is approximately \$8,000 (R&SA experience)
- IF defect claims are split %75 structural 25% non-structural (educated guess)
- AND IF structural claims average \$10,000 (educated guess)

<sup>146</sup> Evidence, 25 July 2002, p 6.

<sup>147</sup> Submission 9, 21 June 2002, p 7.

- THEN non-structural claims would average \$2,000, (seems reasonable)
- IF 70% of non-structural claims arise and are reported within the first 2 years (educated guess)
- THEN WE HAVE a cost transfer from contractor to homeowner of 6% of total claim numbers at an average claim cost of \$2,000.
- The overall impact is of the order of 4% of defect claims and 2% of total claims costs.
- Looked at from another angle, other consumer goods of a comparable value of say \$2,000 to \$5,000 (computers, audio, and visual equipment etc) are generally covered by a manufacturers warranty or guarantee of only 12 months.<sup>148</sup>

**4.28** Royal & SunAlliance concluded that ‘on balance’ the amendments were not unreasonable. The Committee notes that the National Manager of Warranty and Construction for Royal & SunAlliance, Mr Michael Huntly, informed the Committee that he did not perceive any definitional disputes arising regarding the distinction between structural and non-structural defects.<sup>149</sup>

### **Builders’ views**

**4.29** Mrs Elizabeth Crouch, the Executive Director of HIA New South Wales, advised the Committee that ‘[g]enerally people’s comments have been quite positive about the two year and six year period.’<sup>150</sup> HIA also stated its view that, coupled with the last resort reform, this amendment will create a more predictable insurance environment and thereby will facilitate the entry of more insurers into the market.<sup>151</sup> The HIA only went so far as to acknowledge a ‘perception’ of a reduction in consumer protection in relation to the decrease in the period of cover from seven years to six for structural defects:

The reforms contained in this Bill are critical to the ongoing provision of home warranty insurance in the market and critical to maintaining consumer protection. HIA submits that the cost reductions and improved service levels that will flow from these reforms as a result of new competition will more than outweigh any perception of a reduction in consumer protection from 7 years to 6.<sup>152</sup>

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<sup>148</sup> Submission 9, 21 June 2002, pp 7 and 8.

<sup>149</sup> Evidence, 25 July 2002, p 25.

<sup>150</sup> Evidence, 22 July 2002, p 25.

<sup>151</sup> Submission 8, 24 June 2002, p 4.

<sup>152</sup> Submission 8, 24 June 2002, p 6.



**4.30** The Committee also notes the submission of Mr John Fransen, the Chairman of Builders for Active Industry Reform (BFAIR) who, although not specifically addressing the reforms in the Amendment Act, suggested a similar reform:

Reintroduce the concepts of general defects and major structural defects with corresponding 3 and 7 year liability periods (as per the Building Services Corporation Scheme).<sup>153</sup>

**4.31** The National Electrical and Communications Association welcomed the reduction in the insurance period from seven years to two years for non-structural work.<sup>154</sup>

**4.32** The Committee notes that others in the building sector were less supportive of this reform. For example, the Master Builders Association of New South Wales (MBA), while not opposing the reform, was critical of what it sees as the ‘inconsistency’ the reform creates with the statutory warranties in the Act. As noted in Chapter 2, paragraph 2.24, the period of cover provided by the statutory warranties is seven years. The MBA submission highlighted that the new periods of cover for structural and non-structural defects, of six and two years respectively, differ from the period of cover provided by statutory warranties. The MBA is concerned that this will create ‘...potential problems for those principal parties, builders and consumers covered by the legislation in interpreting the period of cover.’<sup>155</sup> In this regard, the MBA submission states:

The MBA is of the opinion that neither the industry or consumers understand the inconsistency created between Part 6 and the remaining provisions in the Act. The MBA expects that many builders now assume that the cover for all work is now split into structural and non-structural periods throughout the Act. Which previously mentioned is not the case. Inconsistency is not helpful to licence holders required to comply with the legislation.<sup>156</sup>

**4.33** The Committee shares the concern of the MBA that builders may not understand the difference between the insurance cover for structural and non-structural defects and the length of statutory warranties under the *Home Building Act 1989*. The Committee recommends that the Department work with the MBA and other industry associations to develop information that clearly sets out the obligations of builders and kit-home suppliers in relation to home warranty insurance and statutory warranties.

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<sup>153</sup> Submission 2, 27 May 2002, p 6.

<sup>154</sup> Submission 16, 27 June 2002, p 1.

<sup>155</sup> Submission 11, 19 June 2002, p 3.

<sup>156</sup> Submission 11, 19 June 2002, p 7.

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**Recommendation 4**

The Committee recommends that the Department of Fair Trading work with home building industry associations to develop information that clearly sets out the obligations of builders in relation to home warranty insurance and statutory warranties.

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- 4.34** Mr Delahunty from SPASA informed the Committee of his view that definitional disputes may arise in relation to the two categories in their application to swimming pools and spas:

**CHAIR:** I want to ask you about structural and non-structural defects... In the context of your members—pool builders—are any definitional disputes likely to arise?

**Mr DELAHUNTY:** Very much so. For a start, the legislation talks about structural defects and then refers to structural elements. It goes on to describe what those structural elements are.

**The Hon. JOHN RYAN:** Foundations, floors, walls, roofs, cons and beams.

**Mr DELAHUNTY:** We do not have many of them in pools so which part of the pool is covered? ...

**The Hon. JOHN RYAN:** Not to be too difficult, some of the definition might be applicable to pools. It says that, for the purposes of section 103B, "structural defect" means any defect in the structural element of the building that is attributable to defective design, defective or faulty workmanship or defective materials or any combination of that and, in addition, results in or is likely to result in the building or any part of the building being required to be closed or prohibited from being used or which prevents or is likely to prevent the continual practical use of the building or any part of the building or is likely to result in the destruction of the building or any part of the building or physical damage to the building. Those things might reasonably be applied to swimming pools but we require your expertise to tell us whether they are.

**Mr DELAHUNTY:** That definition would apply to the coping—the walkway—around the pool. For instance, if the coping was damaged—let us say there is terracotta tiling around the pool—it would be wise not to use the pool because somebody could be injured on the broken tiles. It could then be argued that the building is not habitable or useable because of that failure, yet that failure is non-structural: The pool will not leak, collapse or fall down. It is purely a decorative cover around the pool and is subject to extremes of heat and cold and misuse by the owner that could render it unserviceable. However, given the terminology in the legislation, at the end of the day it could be argued that it is a structural defect.<sup>157</sup>

- 4.35** The Committee is concerned that there is confusion about what constitutes a structural defect and a non-structural defect in the context of swimming pools and spas. If confusion

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<sup>157</sup> Evidence, 31 July 2002, p 24.

exists at the industry association level, then it is certain to exist among builders and consumers. The Committee considers that this confusion needs to be overcome, and suggests that the Department provide formal advice to SPASA in this regard. The Committee also recommends that the particular characteristics of swimming pools and spa construction should be incorporated into the proposed guideline document suggested in Recommendation 7.

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### **Recommendation 5**

The Committee recommends that the Department of Fair Trading provide advice to the Swimming Pool & Spa Association of NSW Limited as to how the definition of 'structural defect' in section 57AC the *Home Building Regulation 1997* applies to all aspects of the construction of swimming pools and spas.

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### **Recommendation 6**

The Committee also recommends that the particular characteristics of swimming pool and spa construction be incorporated into the proposed guideline document suggested in Recommendation 7.

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### **Consumers' views**

- 4.36** The President of BARG, Mrs Irene Onorati, criticised this reform as a regression and recommended that it be abandoned.<sup>158</sup> She argued that the new periods of cover were inadequate and suggested, among other matters, that disputes may arise regarding the definition of structural and non-structural defects:

Cover for non-structural defects have been limited to a period of two years. Under the previous scheme the insurance cover matched the full time-limit of the statutory warranty of seven years for all aspects of building work. BARG is also outraged by the evidence of the witness speaking on behalf of Royal and Sun Alliance Insurance and HIA before this Committee that this too was a term added to the condition of home warranty insurance by the Government without consultation with consumers that was not essential for security of private insurance scheme. There has been no reduction in premiums for this or other reduction in cover. We are also concerned about the potential for litigation and delay that may arise in defining the difference between structural and non-structural claims. Residential building work, such as tiling, brickwork, flashing, waterproofing, painting, et cetera, is not likely to be considered structural work. If consumers are having renovation work carried out that only involves non-structural work, for example they are having the house painted or some tiling work done, they have to pay a premium to cover items for seven years, but their

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<sup>158</sup> Evidence, 8 August 2002, p 4.

effective cover runs out in two. Does this increase appropriate consumer protection?<sup>159</sup>

- 4.37** Mrs Onorati pointed out that many consumers would not be aware of the difference between structural and non-structural defects.<sup>160</sup> One consequence of this for consumers is that the insurance period may run out before a consumer became aware that a particular defect was a non-structural one. This point was also raised by Professor Allan as noted below.

### **Other views**

- 4.38** The Committee notes that Professor Allan was supportive of setting the period of cover for non-structural defects at two years.<sup>161</sup> In exploring the options for improving the building and insurance process in Australia in his review, Professor Allan cited the shortening of non-structural cover to two years as a 'very high' priority and stated the pros and cons as follows:

**Pro:** Would bring Australia into line with the USA, Canada and Britain thereby making its HBWI market more acceptable to international re-insurers. Would relieve builders of having to give warranties on fixtures and fittings (for example, stoves) in excess of the manufacturers' warranties.

**Con:** Would require greater vigilance on the part of homebuyers to detect and remedy non-structural faults before their cover expired.<sup>162</sup>

- 4.39** The Committee notes that the Report produced by the New South Wales Parliament Joint Select Committee on the Quality of Buildings briefly examined the new distinction between structural and non-structural defects.<sup>163</sup> The Committee expressed concern about the lack of consultation on this reform, its relationship to the Building Code of Australia and definitional issues:

The Committee is concerned about the recent creation of the 'structural defects' definitions for home warranty insurance providers in amendments to the *Home Building Act* implemented in July 2002. The Committee notes that the Department of Fair Trading, who prepared the amendment, did not consult with the Building

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<sup>159</sup> *ibid.*

<sup>160</sup> Evidence, 8 August 2002, p 5.

<sup>161</sup> Evidence 8 August 2002, p 20.

<sup>162</sup> Allan, *op cit*, p 59.

<sup>163</sup> The Joint Select Committee commenced its inquiry in March this year. The terms of reference for the inquiry were framed around three themes: first, building and construction standards; second, the way in which buildings are inspected and certified as being properly built; and third the licensing of builders and the way in which disputes are resolved through the Department of Fair Trading. While home warranty insurance was not a focus of this inquiry, the Committee was required to inquire into 'the extent to which matters such as inappropriate building standards and shortfalls in the current certification system have resulted in increased pressure on the home warranty scheme: Joint Select Committee on the Quality of Buildings, Terms of Reference (c) (iii).

Codes Development and Reform Unit in Planning NSW on developing these definitions and the definitions make no direct reference to the Building Code, nor do they use the same terms as the statutory warranties under the Act.

Only 'structural defects' are defined under the Amendment, which leaves open to status of other defects, not only in terms of content but even their title. The Committee notes that Queensland Building Services Authority defines both structural and non-structural building items and even uses 'plain English' expressions to do it...

The Committee believes that the definitions of 'defects' for insurers should be comprehensive and reconciled to include the common terms used in statutory warranties and the Building Code of Australia. The Commission and Tribunal should apply the same interpretation of the Code and statutory warranties and quality standards in their proceedings and decisions.<sup>164</sup>

- 4.40** The Joint Select Committee on the Quality of Buildings recommended that common definitions of defective work should be used by the Consumer Trader and Tenancy Tribunal (CTTT) and the Building Conciliation Service (BCS).<sup>165</sup> The Committee supports this recommendation.
- 4.41** The Committee is concerned about the potential definitional difficulties that this reform may present, as raised by SPASA, BARG and the Joint Select Committee on Quality of Buildings. In this regard, the Committee notes that during hearings reference was made on several occasions to the Victorian *Guide to Standards and Tolerances*. That document sets out acceptable standards and tolerances for domestic building work, where such standards and tolerances are not prescribed in Victorian legislation or Australian Standards.<sup>166</sup> The Committee notes in particular the comments of Professor Allan, who suggested to the Committee that the guide be adopted in New South Wales to assist with determining what is a defect and with dispute resolution.<sup>167</sup>
- 4.42** The Department advised the Committee that it is currently examining the possibility of developing a document like the Victorian guide for use in New South Wales stating that: '[w]e will make every attempt to introduce something like that in New South Wales.'<sup>168</sup> The Committee believes that this is a necessary step and recommends that as part of this undertaking, the Department should consider drafting the guide to identify which home

<sup>164</sup> Joint Standing Committee on the Quality of Buildings, *Report Upon the Quality of Buildings*, July 2002, p 141.

<sup>165</sup> Joint Standing Committee on the Quality of Buildings, *Report Upon the Quality of Buildings*, July 2002, Recommendation 48, p 155.

<sup>166</sup> Baker, Evidence, 11 July 2002, p 23; Crouch, Evidence, 22 July 2002, p 25; Allan, Evidence, 8 August 2002, pp 16, 22 and 25. Building Control Commission, *Guide to Standards and Tolerances*, April 1999.

<sup>167</sup> Evidence, 8 August 2002, pp 16 and 25.

<sup>168</sup> Baker, Evidence, 11 July 2002, p 23

building defects fall within the definition of structural defects and which fall into the residual category of non-structural defects.

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### **Recommendation 7**

The Committee recommends that the Department of Fair Trading develop a guide for use in New South Wales along the lines of the Victorian Guide to Standards and Tolerances. The Committee also recommends that the guide should identify which defects fall within the definition of structural defects and which fall into the residual category of non-structural defects.

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## **Impact of the Alternative Indemnity Arrangements Reform**

**4.43** The nature of this reform was set out in Chapter 3, paragraphs 3.11-3.14. The Committee notes that the submissions and evidence received by the Inquiry express general support for this reform. No negative impacts of this reform were identified. The Committee is aware of at least two industry associations in New South Wales that are actively pursuing the establishment of alternative arrangements.

### **Insurers' views**

**4.44** Royal & SunAlliance welcomed this reform, with qualification regarding the regulation of new arrangements:

Our position is fairly straightforward on the introduction of, or legislation enabling the introduction of, alternative home building indemnity schemes or arrangements:

- We welcome fair competition
- We believe in a level playing field for all competitors
- Therefore, alternative indemnity schemes or arrangements must be subject to the same statutory prudential rules as licensed insurers, including but not limited to – minimum capital rules, reinsurance arrangements and reporting and audit requirements.<sup>169</sup>

**4.45** Mr Huntly from Royal & SunAlliance elaborated on this position in evidence:

**Mr HUNTLY:** One of the things Royal and SunAlliance has always said, and we maintain, is that it is never our desire to be left with as much of the warranty market. We always maintained, and still maintain, that responsible competition would be welcome into the warranty market from other insurers. Any competition is welcome as long as it is on a level playing field. So to the extent that we have stringent capital requirements put on insurance companies from the APRA and all

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<sup>169</sup> Submission 9, 21 June 2002, p 9.

the other regulatory matters with which we comply, any mutual or not-for-profit scheme, to our way of thinking, should be subject to exactly the same requirements...

**The Hon. JOHN RYAN:** In terms of the regulatory environment, what specifically were you seeking to have imposed on mutuals that is imposed on you?

**Mr HUNTLY:** The new APRA guidelines for capital adequacy.

**The Hon. JOHN RYAN:** That is largely a Commonwealth responsibility, though, is it not? I do not think that is an area where the State Government has to legislate, is it?

**Mr HUNTLY:** Probably not. Some of our submissions have mentioned the fact that, if insurers should be authorised in the warranty market, all State governments authorise insurers yet they do not regulate the insurers. I think their authorisation methodology should reflect federal requirements.

**The Hon. JOHN RYAN:** One response that might be made in response to that is that a mutual is unable to operate unless it is able to get underwriting. Does the fact that mutuals can get a private underwriter for their mutual schemes provide, to some extent, the level playing field that you are looking for?

**Mr HUNTLY:** Absolutely. If they get an underwriter that is covering their mutual, ground up, that is fine. We do not have a problem with that.<sup>170</sup>

- 4.46** The Committee agrees that a level playing field is necessary to the maintenance of a viable home warranty insurance scheme in New South Wales but also understands the necessity of encouraging new alternative arrangements. The Committee recommends that the Government ensure that an appropriate regulatory framework is imposed on new alternative indemnity arrangements that it approves pursuant to this reform.

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### **Recommendation 8**

The Committee recommends that the Minister for Fair Trading ensure that an appropriate regulatory framework is imposed on new alternative indemnity arrangements that it approves under s 192A of the *Home Building Act 1989*.

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<sup>170</sup> Evidence, 25 July 2002, pp 4-5. Mr Turner from HIA Insurance Services 'reiterated' Mr Huntly's views: Evidence, 25 July 2002, p 5.

**Builders' views**

**4.47** The Committee is aware of at least two industry bodies currently exploring the possibility of establishing an alternative indemnity arrangement: the MBA and the Swimming Pool & Spa Association of New South Wales Limited (SPASA).<sup>171</sup>

**4.48** Mr Peter Meredith, the Director of Housing for the MBA, advised the Committee that the MBA is examining the possibility of establishing an industry-based home warranty insurance scheme. Mr Meredith described the scheme as follows:

For some time the MBA has been looking at trying to develop a not-for-profit industry scheme as an alternative to the system that currently runs in New South Wales. In regard to the provision of home warranty insurance, the only successful arrangement or the only arrangement that can work is a not-for-profit scheme—either a government-backed scheme, an industry scheme, or possibly a combination of both. Consequently we have been working for some time now to try to develop this scheme. We have been looking at supporters and backers to help develop this scheme.

We have certainly been talking to insurance companies and insurance providers, not necessarily to operate at the front end, but more to operate at the back end, and to support the scheme in that way. If we present to the industry an industry run scheme, because of the attitude of builders in general towards insurance companies, they are seeking a different approach. They would not be receptive to, and they would be reluctant about being presented with, another scheme when it is perceived that insurance companies have control over the operations of the scheme...

The approach of the scheme is to encompass all licensed builders across New South Wales and eligibility criteria will apply. However, there would not just be a financial focus on builders. We would focus also on their past performance, their technical capabilities and their business management and other factors would be assessed. That is different to the current situation. Insurers are simply focusing on financial performance rather than taking into account the past performance of builders, longevity in the industry, and other factors.

We are well placed in country and regional areas to utilise various divisions of the association that have been established and to involve builders. We are in a good position to assess the capacity of these builders. In country and regional areas word circulates quite quickly about the performance of local builders and new builders coming to town. We believe that we are in a position to recognise that and to utilise that capacity to assess builders. It puts us in a good position to establish these criteria and not simply to focus on the financial qualifications of builders.<sup>172</sup>

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<sup>171</sup> SPASA is a national organisation that describes itself as 'a voluntary, self assessing, self regulating non-profit trade association for the swimming pool & spa industries in Australia': This information is taken from the SPASA web site at: [www.spasa.com.au](http://www.spasa.com.au) (5 August 2002).

<sup>172</sup> Evidence, 22 July 2002, p 4.



**4.49** The Committee notes that on 12 July 2002, the Minister for Fair Trading, the Hon John Aquilina MP (the Minister), announced a \$100,000 grant to the MBA for a feasibility study on developing an industry-based home warranty scheme. In announcing the grant the Minister stated that:

The Government is willing to consider any model developed by the Master Builders Association, or any other industry group, that delivers the same or greater levels of consumer protection as the current home warranty arrangements.<sup>173</sup>

**4.50** The Committee encourages the New South Wales Government to continue to support the endeavours of industry bodies in New South Wales to establish alternative indemnity arrangements.

**4.51** The General Manager of SPASA, Mr Paul Delahunty, advised the Committee that SPASA has made a submission to the Minister for approval of an alternative scheme under the new section inserted into the *Home Building Act 1989* by the Amendment Act. Mr Delahunty described the scheme as similar to the one that operates for pool builder members in Queensland:

It is not insurance and that is one of the reasons we are keen to get it up and running. It is not insurance per se; therefore, we do not have to approach an underwriter to underwrite the whole scheme. For instance, the scheme that the MBA is promoting must be underwritten by an insurance company, preferably one that will be prepared to jump through the Government's hoops as far as being approved. The system that we have put to the Minister is a mutual discretionary fund controlled by the fund operators, which would be our industry association. It meets all the requirements as far as the legislation is concerned, other than it being an insurance company.<sup>174</sup>

**4.52** The Committee notes that in Queensland swimming pools do not come under the legislation requiring mandatory insurance but that SPASA provides insurance for its Queensland members under a mutual indemnity fund.

### **Consumers' views**

**4.53** The representatives of BARG informed the Committee in evidence that they thought it would be beneficial to consumers if new alternative indemnity arrangements were established as a result of this reform.<sup>175</sup>

<sup>173</sup> Aquilina J, Minister for Fair Trading, 'Grant helps explore home warranty options', *Media Release*, 12 July 2002.

<sup>174</sup> Evidence, 31 July 2002, pp 20–21.

<sup>175</sup> Onorati and Russo, Evidence, 8 August 2002, p 9

### **Impact of the Reform Relating to Legal or Other Reasonable Costs**

- 4.54** The nature of this reform was set out in Chapter 3, paragraphs 3.15-3.16. This reform is clearly a beneficial one for consumers who make a successful insurance claim. In this event, the consumer can also recover the 'legal or other reasonable costs' expended in seeking to enforce or recover against a builder or supplier. Previously, insurance contracts did not allow a consumer to recover such costs.
- 4.55** The Committee notes, however, that if a claim amounts to more than \$200,000, there is no provision for extra cover to account for legal and other reasonable costs. The \$200,000 maximum is inclusive of these costs.
- 4.56** Only one of the submissions to the Inquiry addressed this reform specifically. In this regard, Royal & SunAlliance stated its view that '[t]he inclusion of legal and other related costs in the insurance cover is a small benefit to the consumer.'<sup>176</sup> None of the witnesses heard by the Inquiry raised this reform as a matter of interest or concern.

### **Impact of Reform Permitting the Limitation of Liability for Non-Completion to 20% of Contract Price**

- 4.57** The nature of this reform was set out in Chapter 3, paragraphs 3.17-3.22. The response of insurers and builders to this reform can at best be described as mild. Royal & SunAlliance identified the impact of this reform, not as a factor in stabilising the industry or reducing premiums, but rather as encouraging consumers to only make progress payments that reflect the actual amount of work done. The Committee acknowledges this beneficial impact of the reform for consumers and the scheme as a whole. The Committee notes however, that the representatives of BARG argued strongly that this reform would leave some consumers with inadequate cover in relation to loss arising from non-completion of building work if the loss amounts to more than 20% of the contract price.

#### **Insurers' views**

- 4.58** In evidence, Mr Huntly from Royal & SunAlliance advised the Committee that this reform was not one that the industry lobbied for but that it will be '...very helpful in its own right.'<sup>177</sup> HIA Insurance Services also expressed support for this reform.<sup>178</sup>
- 4.59** In terms of the impact of this reform, Royal & SunAlliance's submission expressed the view that this reform '...ensures that insured home owners do not make progress payments that exceed the actual amount of work completed by more than 20% of the

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<sup>176</sup> Submission 9, 21 June 2002, p 9.

<sup>177</sup> Evidence, 25 July 2002, p 2.

<sup>178</sup> Submission 17, 26 June 2002, p 3.

contract price or the home owner assumes the risk if they do so.<sup>179</sup> When asked how the reforms in the Amendment Act will contribute to the 20% reduction in premiums estimated by Royal & SunAlliance, this particular reform was described as follows:

The 20% non-completion limitation provides a benefit in the sense that it makes consumers think more about not making payments way in advance of the work being completed. The overall effect of that is that when a loss occurs all the payments will not be made when the slab is poured; the payments will be made to cover certain elements of the work. Theoretically, the average claims cost should drop accordingly in conjunction with that sort of activity.<sup>180</sup>

- 4.60** The submission from Royal & SunAlliance also acknowledged that this reform might have a negative effect on some builders by impacting upon their cash flow, but claimed that it will not do so 'unreasonably nor unrealistically'.<sup>181</sup>

### **Builders' views**

- 4.61** The Committee did not receive many comments from builders about the impact of this reform. The Committee notes that Mr Shane McCartin, the General Manager of Business Services for HIA expressed the view that this reform provides *more than adequate cover* for consumers:

We then get to the scope of coverage or 20 per cent of the \$200,000. I can only speak on what is given to us by the underwriter for the HIA insurance scheme, but the average claims cost or payout is under \$40,000 with Royal and Sun Alliance. Therefore, we consider that the \$200,000 with the 20 per cent is more than adequate.<sup>182</sup>

### **Consumers' views**

- 4.62** The representatives of BARG were critical of the impact of this reform on consumers and recommended that insurance cover for non-completion should be restored to the full amount.<sup>183</sup> Mrs Onorati argued that, coupled with the maximum insurance cover set at \$200,000, this reform would mean that in some cases the extent of cover would be insufficient:

Although the consumer pays premiums for \$200,000 worth of cover, this cover becomes limited to 20 percent of the contract price for work left unfinished. This leaves virtually nothing for the cost of pursuing the builder in the last resort scheme. There will be nothing left to meet the cost of paying the additional

<sup>179</sup> Submission 9, 21 June 2002, p 9.

<sup>180</sup> Evidence, 25 July 2002, p 5.

<sup>181</sup> Submission 9, 21 June 2002, p 9.

<sup>182</sup> Evidence, 22 July 2002, p 29.

<sup>183</sup> Onorati, Evidence, 8 August 2002, p 4.

mortgage or rental costs during the inevitable long delay in the project until their home is rectified or completed. There will be nothing to compensate the consumer for the additional cost of engaging a new builder. Often builders charge extra provisional sums for completing somebody else's work because this work is more complicated and can involve more risk.<sup>184</sup>

- 4.63** The Committee acknowledges the point that a consumer may not have adequate cover in relation to non-completion of building work if the losses arising from non-completion (such as the costs associated with delays, damage caused by non-completion, alternative accommodation, recovering payments to the contractor or engaging another contractor to complete the work) amount to more than 20% of the contract price. It is difficult to assess the impact of this reform in this regard without data about the average cost of non-completion claims. If a consumer has only paid for building work that has already been done, according to the periodic payment structure, and no damage has been caused to the home by non-completion, 20% of the contract price may be sufficient.
- 4.64** The Committee observes that coverage for non-completion in New South Wales may be less than in other jurisdictions. See in this regard, Chapter 3, paragraph 3.22.
- 4.65** The Committee notes the point alluded to by Mrs Onorati, that while the consumer must pay premiums that reflect the maximum level of cover being \$200,000, the cover actually provided is limited to 20% of the contract price if a claim relates to non-completion.<sup>185</sup>
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### **Recommendation 9**

The Committee recommends that the New South Wales Government consider examining the 20% limitation on liability for non-completion of work with a view to determining the impact of this reform on consumers.

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### **Recommendation 10**

The Committee further recommends that the New South Wales Government give consideration to amending the *Home Building Regulation 1997* to provide that, instead of limiting liability resulting from non-completion of building work to 20% of the contract price, a contract of insurance may limit liability resulting for non-completion of building work to an amount that is '20% of the sum insured or 20% of the contract price, whichever is greater.'

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<sup>184</sup> Evidence, 8 August 2002, p 3.

<sup>185</sup> *ibid.*

### Other views

**4.66** In evidence before the Committee, Professor Allan stated that this reform (as well as others in the Amendment Act) has had the desired effect of ‘calming’ down the insurers.<sup>186</sup> In his review, Professor Allan described this reform as a ‘medium priority’ and stated the pros and cons of the reform as follows:

**Pro:** Would prevent insurance fraud where a builder and consumer conspire to understate the true contract value.

**Con:** Could penalise honest homebuyers who are tricked by dishonest builders into making progress payments in advance of the work being properly completed.<sup>187</sup>

## Impact of the Amendment Act on Home Warranty Insurance

**4.67** As previously noted, the main aim of the Amendment Act was to ensure the long-term viability of the New South Wales 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 who indicated that without the reforms their presence in the market was tenuous. From an insurer’s perspective therefore the reforms have been successful: in the main they reflect the reforms that the insurers lobbied for and insurers have been enthusiastic about the stabilising effect that the reforms have had on the market.

### Coverage of home warranty insurance

**4.68** The Amendment Act reduces the extent of insurers liability and thereby their overall risk. The last resort reform, the 20% liability cap for non-completion and the reduction in the period of cover for structural and non-structural defects all represent a reduction in the coverage of home warranty insurance. And, while the incorporation of ‘legal and other reasonable costs’ as an element of liability increases the coverage of home warranty insurance, the Committee notes that Royal & SunAlliance appears to view this increase as relatively unimportant.

### Market stability

**4.69** The Committee observes that there appears to be a consensus among the participants in the Inquiry from the insurance sector that the Amendment Act has achieved its aim of promoting stability in the home warranty insurance market. By way of example, the Committee notes the following comments of the ICA:

<sup>186</sup> Evidence, 8 August 2002, p 27.

<sup>187</sup> Allan, op cit, p 60.

The Home Building Amendment (Insurance) Act 2002 has created a situation that made this class of business viable for the current underwriters to maintain their presence in the market.<sup>188</sup>

- 4.70** HIA Insurance Services also identified the Amendment Act as ensuring the stability of the scheme.<sup>189</sup> The Committee also notes that Mr Turner of HIA Insurance Services had indicated his view that any retraction of the reforms would create instability:

We were obviously extremely concerned in December about the long-term viability of the market. I reiterate my earlier comments: We believe the reforms that have been put in place both in Victoria and New South Wales—this must be viewed in the national context not just in the context of this State—will achieve sustainability in the market through competition, adequate premium rating for insurers and profitability for insurance. We believe the reforms are a step in the right direction towards ensuring sustainability in the marketplace in the long term. I should add that any retraction of those reforms in any way could, in our view, jeopardise the future sustainability of the marketplace.<sup>190</sup>

- 4.71** Royal & SunAlliance similarly views the reforms as having served the purpose of stabilising the market:

We are fairly happy to see the reforms come out. Royal and SunAlliance first spoke to both the Victorian and New South Wales governments late last year about the need for reform, so we were particularly pleased to see the package come out, particularly the attempt to harmonise the two schemes. So we support them fully. Not all the reforms were as a result of our lobbying, only some of the key ones we wanted are in there, but we do not think any of the reforms are bad reforms, they all help in their own particular way and they have certainly served the purpose at the moment that they were designed to achieve in stabilising the existing warranty market...<sup>191</sup>

- 4.72** The Committee acknowledges that in the case of Allianz/Dexta the reinsurance arrangement put in place by the Victorian and New South Wales Governments (see Chapter 2, paragraph 2.61) was a significant factor in maintaining their presence in the home warranty insurance market. Dexta has, however, also acknowledged the Amendment Act in this context.<sup>192</sup>

- 4.73** The Committee notes the MBA's concern that there is no *guarantee* that existing insurers will not leave the market, but this will always remain the case.<sup>193</sup>

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<sup>188</sup> Submission 12, 24 June 2002, p 1.

<sup>189</sup> Submission 17, 28 June 2002, p 4.

<sup>190</sup> Evidence, 25 July 2002, pp 7-8.

<sup>191</sup> Evidence, 25 July 2002, p 2.

<sup>192</sup> Dexta Corporation Ltd, 'Important notice', *Media Release*, 1 May 2002.

<sup>193</sup> Submission 11, 19 June 2002, p 4.

### Increased competition

**4.74** The Committee found the insurance sector to be generally optimistic as to whether new insurers were likely to join the market as a result of the Amendment Act, although some were more guarded in their comments than others. As noted previously, Royal & SunAlliance informed the Committee that it welcomed competition in the market and that it in fact never wanted to be left with as much of the home warranty insurance market as it presently has. The insurer was cautious in its opinion whether new insurers would enter the market stating that '[t]he arrival or otherwise of future insurance is speculation at this stage'.<sup>194</sup> Dexta expressed the view that the amendments make home warranty insurance '...more attractive to potential insurers and reinsurers'.<sup>195</sup> The ICA stated that the Amendment Act has '...provided an opportunity for other interested insurers to become involved in the New South Wales market for home warranty insurance'.<sup>196</sup> And finally, HIA Insurance Services commented that:

...the insurance scheme contemplated by the [Amendment Act] provides greater encouragement for other insurance providers to enter the private home warranty market thus providing increased competition and improved levels of customer service.'<sup>197</sup>

**4.75** The Committee is aware that at least one insurer is considering entering the home warranty insurance market. The Committee was advised by IAG, which was generally supportive of the reforms, that it is currently considering its position with respect to entering the market.<sup>198</sup>

**4.76** The Committee also notes that if the alternative indemnity arrangements being explored by the MBA and SPASA (see paragraphs 4.48 and 4.51 respectively) come to fruition they will also have the effect of increasing competition.

**4.77** Several submissions to the Inquiry (for example from small builders and the Law Society), referred to the lack of competition in the home warranty insurance as being problematic.<sup>199</sup> BFAIR suggested in its submission that the Government should '...increase the number of insurers by reducing the risk for them. Make home warranty a business they want to be in.'<sup>200</sup> The Committee notes that the reforms go some way to achieving this result. Based on the assessment of the insurers already in the market, the views of the ICA, and the fact that the IAG is contemplating entering the market, the Committee is optimistic that the

<sup>194</sup> Evidence, 25 July 2002, p 2.

<sup>195</sup> Dexta Corporation Ltd, 'Dexta to continue providing home warranty', *Media Release*, 20 June 2002.

<sup>196</sup> Submission 12, 24 June 2002, p 1.

<sup>197</sup> Submission 17, 26 June 2002, p 4.

<sup>198</sup> Submission 14, 25 June 2002, p 4.

<sup>199</sup> For example: Submission 2, 27 May 2002 p 4; Submission 5, 10 June 2002; Submission 13, 24 June 2002, p 3; Submission 15, 21 June 2002; and Submission 19, 5 July 2002.

<sup>200</sup> Submission 2, 27 May 2002, p 6.

Amendment Act has contributed to a more stable environment conducive to new insurers offering home warranty insurance. The Committee notes, however, the warning by Mr Meredith of the MBA that:

Additional competition could be meaningless for builders because insurers appear to be reluctant to offer cover where a builder is already eligible or has eligibility with another insurance provider. Insurers seek to establish an exclusive arrangement with builders.<sup>201</sup>

### **Premiums**

**4.78** Several participants in the Inquiry expressed concern about the level of premiums that consumers had to pay.<sup>202</sup> The Committee notes that among Inquiry participants there were disparate views about how the reforms will impact on premiums, a point also made by Mr Schmidt of the Department:

There have been mixed comments on the impact of these reforms on insurance premiums, just as there has been in the wider field about government reforms in other areas of insurance. The comments seem to range between "It will stabilise the market and constrain future premium increases", to an insurer signalling that "Premiums might drop up to 20 per cent in the next two years."<sup>203</sup>

**4.79** Mr Schmidt's later quote refers to the statement made by Royal & SunAlliance that its premiums may reduce by as much as 20% in the next two years as a result of the reforms.<sup>204</sup> In evidence, Mr Huntly from Royal & SunAlliance expanded on this statement, identifying the last resort reform, and to a lesser extent the 20% liability limitation reform, as the main trigger for the reduction:

**Mr HUNTLY:** Without any other intervening factors, premiums will reduce as a result of these reforms...

**CHAIR:** ...I note that at page 7 of the Royal and SunAlliance submission the statement is made that it is estimated that premiums may reduce by as much as 20 per cent over the next two years. It appears to us that the submission implies that this reduction will be a direct result of the reforms in the amending legislation. Which reforms do you have in mind?

**Mr HUNTLY:** It is the three or four that I mentioned before. The move from first to last resort takes an element of uncertainty away from insurers and the lack of control that we talk about in the outcomes—for instance, it removes termination of contract issues from us and puts them back into a more robust environment with the new building tribunal arrangements. That is a saving. The

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<sup>201</sup> Evidence, 22 July 2002, p 3.

<sup>202</sup> For example, Submission 1, 27 May 2002; Submission 20, 4 July 2002, p 9; and Onorati, Evidence, 8 August 2002, p 2.

<sup>203</sup> Evidence, 11 July 2002, p 7.

<sup>204</sup> Submission 9, 21 June 2002, p 7. See also Huntly, Evidence, 25 July 2002, p 5.



\$10 million cap removes some reinsurance requirement from us—we could not get it from the end of this year any way but at the moment there is a cost factor in reinsurance. At present negotiations are under way with the New South Wales and Victorian governments about the operation of the cap, and my understanding is that a cost factor will be associated with the cap that insurers will have to bear. However, at the moment it is difficult to judge the extent to which that will kick in.

The 20 per cent non-completion limitation provides a benefit in the sense that it makes consumers think more about not making payments way in advance of the work being completed. The overall effect of that is that when a loss occurs all the payments will not be made when the slab is poured; the payments will be made to cover certain elements of the work. Theoretically, the average claims cost should drop accordingly in conjunction with that sort of activity. We cannot really judge the structural and non-structural elements at present as we previously had not measured claims according to whether they were structural or non-structural. Our submission contains a rough guesstimate of a cost benefit of 2 per cent to 4 per cent for that reform.

The shortening of the indemnity period to six years will probably have no real effect in relation to non-completion losses because they generally occur in the first two to three years. It will have some effect on the defect claims associated with insolvency. Effectively, the move from first to last resort is the key to the premium reductions. It provides a level of certainty. It is clear that if a builder is insolvent, has disappeared or is dead, the policy is triggered and we can step in and manage the claim, finish the houses and fix the defects. That is the benefit. At the moment when a builder is still around there can be a three-, four- or five-way fight that drags on for an inordinate amount of time. It will relieve some of the burden from insurers in that regard.<sup>205</sup>

**4.80** Mr Huntly advised the Committee that Royal & SunAlliance intends to review its premiums in October this year, with a view to implementation of any changes in January 2002:

No, we would conduct our review of pricing in October. If there is any change it would be implemented for 1 January next year. We generally have about a two-month lead time into any pricing changes that we seek to make. We traditionally review pricing once a year. We will now review it in October and again early in the new year because we have made a commitment that we will act immediately to reduce premiums when we see the signs of benefits flowing through.<sup>206</sup>

**4.81** Mr Turner of HIA Insurance Services also expressed the view, although more cautiously than Mr Huntly, that premiums are likely to reduce if the reforms are successful in bringing new insurers into the market:

I think more generally that the reforms, quite aside from the insurers who are in the market at the moment, if the reforms have the effect of bringing competition to the market, then competition will drive premiums down. It will drive them lower by the pure nature of the competition. But the reforms have to have the

<sup>205</sup> Evidence, 25 July 2002, p 6.

<sup>206</sup> *ibid.*

effect of reducing the frequency of claims and the cost of claims, and that would have to have an effect in the mid to long term on the premiums charged.<sup>207</sup>

**4.82** The Committee is aware that Dexta has also expressed a cautious view about the impact of the reforms on premiums:

The reforms deal with some of the areas that have been of concern to insurers while maintaining a high level of protection for the consumer. Over time, the new measures and the earlier government moves last year should combine to impact on claims made under builders warranty policies. If claim numbers and levels fall, and a new actuarial pattern emerges and is maintained, insurers will be able to review and reframe premium and security requirements for builders. This trend could accelerate if more insurers can be attracted into the market.<sup>208</sup>

## **Impact of the Amendment Act on Home Builders**

**4.83** The evidence received and heard by the Committee indicates that the Amendment Act is perceived as having both positive and negative impacts on home builders. The Committee has noted the divergent views of the two largest industry associations – HIA and MBA. In this regard HIA was overwhelmingly supportive of all of the reforms contained in the Amendment Act while the MBA was much more reserved in its assessment and expressed scepticism that the reforms would have a positive impact on the home warranty insurance market. A concluding review of the positive and negative impacts of the Amendment Act on builders is undertaken below.

### **Negative impacts**

**4.84** Several participants in the Inquiry advised the Committee that the Amendment Act has created a sense of uncertainty among builders. The MBA also expressed doubt that the majority of builders would be aware of the amendments.<sup>209</sup> The Committee notes that when the reforms were announced the Government established a ‘home warranty insurance hotline’ for builders and consumers seeking information about the reforms.<sup>210</sup> The hotline is still operational and it is hoped that this resource, coupled with the work of the industry associations in informing their members about the reforms, will see that this uncertainty is short lived.

**4.85** The Committee was advised by Royal & SunAlliance that the 20% liability cap for non-completion is likely to have some negative impact on builders. It was argued that as the reform is likely to encourage consumers only to pay builders in stages, in accordance with the work that they complete, the reform will impact on a builder’s cash flow. The

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<sup>207</sup> Evidence, 25 July 2002, p 5.

<sup>208</sup> Dexta Corporation Ltd, ‘Home Warranty Insurance Reforms’, *Media Release*, 10 May 2002.

<sup>209</sup> Meredith, Evidence, 22 July 2002, p 1.

<sup>210</sup> Aquilina J, Minister for Fair Trading, ‘Minister announces home warranty insurance hotline’, *Media Release*, 15 March 2002. The hotline number is 1800 678 588.

Committee does not view this impact as being unreasonable, particularly as it has a consequential positive impact on consumers, as noted in paragraph 4.59.

- 4.86** The Committee notes the concerns of the MBA that the move to last resort will place increased pressure on the dispute resolution mechanisms of the CTTT and the BCS thus negatively impacting on builders engaged in dispute resolution. The Committee recommends that the Department consider the impact that the Amendment Act may have on dispute resolution and investigate ways that the CTTT and the BCS can effectively absorb this pressure.
- 4.87** The Committee also notes that the Joint Select Committee on the Quality of Buildings made a number of findings and recommendations in relation to dispute resolution.<sup>211</sup> The Committee endorses those recommendations.

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### **Recommendation 11**

The Committee recommends that after the *Home Building Amendment (Insurance) Act 2002* has been operational for six months, the Minister for Fair Trading should consider the impact that the reforms have had on dispute resolution resources with a view to meeting any additional demands on the Consumer Trader and Tenancy Tribunal and the Building Conciliation Service.

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### **Positive impacts**

- 4.88** The Committee notes that several submissions emphasised that builders should take responsibility for their work and their actions and that insurance should not be able to be used by builders to avoid liability. The last resort model addresses this point of view by placing responsibility for defective work onto builders and for contractual disputes in the hands of consumers and builders (with reliance on dispute resolution processes), as noted by the IAG:
- It is our understanding that the [Amendment] Act aims to put insurers in the position of being the last resort in protecting consumers' rights...This is important to maintain premiums at an affordable level and to make sure than builders perform their duties in accordance with the building contracts which consumers have entered into in good faith.<sup>212</sup>
- 4.89** The Committee views this as a positive impact of the reform because it encourages builders to improve the quality of their work and their dealings with consumers.
- 4.90** The Committee is of the view that any new alternative indemnity arrangements established in New South Wales, if successful, will provide builders (and consumers) with much needed choice of home warranty insurance providers. They may also have the effect of

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<sup>211</sup> Joint Standing Committee on the Quality of Buildings, *Report Upon the Quality of Buildings*, July 2002, Chapter 6.

<sup>212</sup> For example, Submission 14, 25 June 2002, p 2.

increasing competition and thereby lowering premiums. Sector specific arrangements such as the one proposed by SPASA may also cater more effectively for the needs of certain areas of the building industry.

### **Other comments**

**4.91** The Committee notes that throughout the Inquiry, small builders, industry associations and others raised some issues and concerns relating to the experience of builders in relation to the New South Wales Home Warranty Insurance Scheme that pre-date the Amendment Act. While these issues are outside the terms of reference for the Inquiry, and the Amendment Act was not designed to address these concerns, they have been summarised below. The Committee also points out that some of the recommendations of the Allan Review and the Joint Select Committee on the Quality of Buildings may have ramifications for these issues. The Committee recommends that the Government consider the issues set out in the following paragraphs in any future review of the scheme that it may undertake.

**4.92** *Delays and poor service delivery.* Several builders expressed frustration about claimed delays and poor service delivery in their dealings with insurers, particularly with regard to applications for insurance. The Committee is concerned about these problems and notes that, as set out in Chapter 2, paragraphs 2.65-2.67, the Department is working on administrative reform to require insurers to establish service standards for processing builder applications to promote the faster turn around of applications and improve customer service to builders applying for insurance. The Committee supports this initiative being finalised.

**4.93** *Lack of transparency of financial criteria.* The Committee also notes that several submissions and witnesses expressed concern about the lack of transparency of the financial criteria used by insurers to determine eligibility for home warranty insurance.<sup>213</sup> The Committee has already noted, in Chapter 2, paragraph 2.53, that the criteria used by insurers are far from clear. This fact was also noted by Professor Allan who found that:

The criteria that insurers use for judging builder eligibility for [home warranty insurance] are unstated, unclear and subject to discretionary variation. This makes it difficult for builders to know what is precisely required of them to obtain insurance for a planned level of building activity.<sup>214</sup>

**4.94** In light of these difficulties, the Committee was pleased to learn that the Department is examining administrative reform to require insurers to develop and publicise their eligibility criteria for builder assessments in a plain English format.<sup>215</sup> The Committee supports the Department in this important undertaking. The Committee was also advised by HIA Insurance Services that it is soon to release a plain English 'builders kit' and a more technical 'accountants kit' to provide builders with an understanding of eligibility criteria

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<sup>213</sup> For example: Submission 11, Supplementary Submission, 6 August 2002, p 5; and Submission 21, 16 July 2002, p 3. See also Allan, op cit, p 32.

<sup>214</sup> Allan, op cit, p 32.

<sup>215</sup> See Chapter 2, paragraph 2.71.

for home warranty insurance.<sup>216</sup> The Committee welcomes the production of such information but is mindful of the comments of Mr Meredith from the MBA who speculates that the provision of assessment criteria by HIA Insurance Services may be simply cosmetic:

While this initiative is welcomed, the guidelines will only be useful to builders if they can identify from the information displayed, the full extent of the financial information they are required to submit, and more importantly, to identify the weighting to be applied to the financial information. If the information simply identifies key performance indicators without the key weightings applied, then it is suggested that builders and their accountants will be none the wiser.<sup>217</sup>

- 4.95** *Prohibitive financial criteria:* The Committee was informed that some builders were experiencing difficulties with the ‘onerous’ financial assessment criteria of insurers. In particular, many participants from the building sector expressed dissatisfaction with the requirement by insurers that deeds of indemnity or bank guarantees be provided before insurance is issued.<sup>218</sup> The Committee also heard of difficulties experienced by new and young builders with good competency but few assets obtaining insurance, because of the prohibitive financial criteria.<sup>219</sup> The Committee is aware of new products developed by HIA Insurance Services that aim to help small and new builders obtain insurance.<sup>220</sup> The Committee encourages insurers to cater for the circumstances of small and new builders in this way.
- 4.96** *Control over insurers:* Some submissions expressed concern about insufficient control over insurers, for example that there is no avenue of appeal available regarding the decision making of insurers or a body to oversee the activities of the insurers.<sup>221</sup>
- 4.97** *Delays in settling disputes:* The Committee also heard that some builders were experiencing delays in having disputes processed and settled by the CTTT. The Committee does note however, that in June this year, the Minister announced that there has been significant reduction in waiting times for people seeking hearings at the CTTT and that the biggest improvement had been the establishment of the BCS.<sup>222</sup>

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<sup>216</sup> Turner, Evidence, 25 July 2002, p 14.

<sup>217</sup> Submission 11, Supplementary Submission, 6 August 2002, p 6.

<sup>218</sup> For example: Submission 5, 10 June 2002; Submission 6, 11 June 2002, p 7; Submission 11, 19 June 2002, p 12; Submission 15, 21 June 2002; and Submission 19, 5 July 2002.

<sup>219</sup> For example: Submission 13, 24 June 2002, p 4; Submission 21, 16 July 2002, p 3; and Submission 22, 6 August 2002, p 3.

<sup>220</sup> Aquilina J, Minister for Fair Trading, ‘Aquilina welcomes new home warranty insurance products’, *Media Release*, 19 December 2001.

<sup>221</sup> For example: Submission 2, 27 May 2002, p 5; and Submission 11, 19 June 2002, p 7.

<sup>222</sup> Aquilina J, Minister for Fair Trading, ‘Aquilina announces major improvement in Tribunal case loads’, *Media Release*, 24 June 2002.

- 4.98** *Illegal activity.* The Committee was disturbed to learn from some small builders, the MBA and SPASA that some contractors are opting to work without insurance as required or engaging in practices such as 'contract splitting' to avoid their insurance obligations.<sup>223</sup> As the evidence was anecdotal it has been difficult for the Committee to ascertain the extent of the practice. The Committee recommends that the Department investigate this situation as a matter of priority.

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### **Recommendation 12**

The Committee recommends that the Department of Fair Trading investigate allegations that some builders are working without obtaining insurance required by legislation and engaging in practices such as contract splitting to avoid insurance obligations.

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### **Recommendation 13**

The Committee recommends that the New South Wales Government take the issues raised in relation to the experiences of builders in relation to the New South Wales Home Warranty Scheme, as set out in paragraphs 4.92-4.98 of this report, into consideration as part of any future review of the scheme that it may undertake.

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## **Impact of the Amendment Act on Consumers**

- 4.99** The Committee acknowledges the views of the representatives of BARG that the Amendment Act will have a deleterious impact on the consumer protection afforded by the Home Warranty Insurance Scheme. In doing so, the Committee notes that these views 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 notes that some of the reforms will clearly have a positive impact on consumers. A concluding review of the positive and negative impacts of the Amendment Act on consumers is undertaken below.

### **Negative impacts**

- 4.100** The information presented to the Committee by BARG indicated the organisation's overall impression that the Amendment Act further downgraded a scheme that already failed to protect consumer interests. (The Committee has identified further the pre-existing

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<sup>223</sup> For example: Submission 2, 27 May 2002, p 5; Submission 5, 10 June 2002; Meredith, Evidence, 22 July 2002, pp 3 and 12; and Delahunty, Evidence, 31 July 2002, pp 22 and 25.

concerns about the scheme that were raised by BARG below, in paragraphs 4.110-4.117.) The Committee also notes the similar view of the Law Society that the Amendment Act represents a 'significant downgrading' of the rights of consumers:

The [Property Law] Committee believes that the most recently announced changes represent a significant downgrading of the rights of consumers. In principle, the move towards the concept of home warranty insurance being a 'fund of last resort' will add to the expense and uncertainty for consumers already facing the trauma of defective or incomplete building works. The Committee believes the consumer protection objectives of the domestic building legislation have suffered during the life of the privatised home warranty scheme, and that the Government will need to take a more active and direct role in the provision of home warranty insurance.<sup>224</sup>

- 4.101** The Committee is cognisant that some of the reforms in the Amendment Act reduce the extent of cover provided by home warranty insurance to consumers. In this regard the Committee identifies the last resort reform, the decrease in the period of cover from seven to six years for structural defects and to two years for non-structural defects and the 20% liability cap for non-completion claims. Any reduction in the extent of insurance cover can readily be identified as a 'negative' impact on consumers.
- 4.102** It has been difficult for the Committee to ascertain the precise extent of this reduction in cover and the impact that it will have on consumers. For example, without statistics on the incidences of loss arising as a result of defects where a builder is neither insolvent, dead or has disappeared, it is hard to assess how many consumers will be affected by the move to a last resort model. However, the Committee has not been persuaded that the impact of the Amendment Act on consumers is as 'significant' as posited by BARG or the Law Society, particularly in light of the necessity of the reforms in terms of maintaining the scheme as a whole, the positive impacts of the reforms and the conflicting views of others about the impact of the reforms on consumers.
- 4.103** In terms of other negative impacts of the reforms on consumers, the Committee is concerned that some consumers and builders may be uncertain about the distinction between structural and non-structural defects and that this may cause disputes. Recommendation 5 has been drafted to counter this situation. The Committee also notes the impact of the last resort reform on home builders in terms of dispute resolution (described in paragraph 4.86) is also applicable to consumers.
- 4.104** The Committee is pleased to note that the ongoing initiatives of the Department in relation to the Home Warranty Insurance Scheme (Chapter 2, paragraphs 2.71-2.73) indicate that the Government is continuing to assess the operation of the scheme with a view to consumer protection as well as ensuring the ongoing participation of insurers in the market. The Committee encourages the Government in this direction and recommends that it consider the points raised in paragraphs 4.110-4.117 in the context of its ongoing work in this area.

<sup>224</sup> Submission 15, 21 June 2002.

**Positive impacts**

- 4.105** The Committee concurs with the succinct statement made by Mr Schmidt of the Department about the principal impact of the reforms on consumers: '[f]or the consumers the scheme has been maintained; there is insurance in place.'<sup>225</sup> The evidence presented to the Committee suggests that, as well as maintaining the viability of the Home Warranty Insurance Scheme, the reforms will have other positive impacts on consumers. For example, if the reforms drive premiums down, as Royal & SunAlliance predicts (see paragraph 4.79), consumers will certainly benefit.
- 4.106** The Committee also agrees with Professor Allan's view that the last resort reform will have a positive impact on consumers by dispelling the myth of first resort insurance and thereby insuring that consumers do not have false expectations of their insurance cover. In this regard the Committee would like to emphasise the importance of Recommendation 3 to ensure that consumers are informed of the precise nature of home warranty insurance and particularly its last resort nature.
- 4.107** If the reforms ultimately pave the way for new insurers to enter the market, the increased competition is likely to benefit consumers in terms of choice, reduced costs and improved services. The Committee also notes the positive reception by BARG to the reform that facilitates the establishment of new alternative indemnity arrangements. If new arrangements such as those proposed by the MBA and SPASA come to fruition they are also likely to increase competition and thereby have some impact on service levels and premiums.
- 4.108** Consumers will also benefit from being able to recover legal and other reasonable costs from the insurer, although without statistics on how much money is spent on recovering from builders, it is difficult for the Committee to form a view about how beneficial this reform is likely to be.
- 4.109** Finally, the Committee recognises that while the 20% liability cap does reduce the level of cover provided to consumers by home warranty insurance, a positive benefit of the reform is that it will encourage consumers to make only progress payments that reflect the actual amount of work done by a contactor.

**Other comments**

- 4.110** The Committee notes that BARG raised some issues and concerns relating to the experience of consumers with the Home Warranty Insurance Scheme that pre-date the Amendment Act. While the Amendment Act was not designed to address these issues, and therefore they are strictly outside the terms of reference for the Inquiry, they are summarised below. The Committee points out that some of the recommendations of the Allan Review and the Joint Select Committee on the Quality of Buildings may go some way to addressing these problems. The Committee therefore urges the Government to consider

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<sup>225</sup> Evidence, 11 July 2002, p 8.



the issues set out in the following paragraphs in any future review of the scheme that it may undertake.

- 4.111** *Extent of cover.* BARG expressed the view that the extent of home warranty insurance cover (before the Amendment Act) was not sufficient to protect consumers. In this regard the representatives of BARG raised the \$200,000 maximum in cover and the period of insurance cover.<sup>226</sup> In relation to the level of cover the representatives of BARG made the following comments:

**Mrs Onorati:** BARG can provide the Committee with numerous examples of consumers who have lost over \$200,000 after a dispute with shonky builders. The costs that needs to be covered by the consumers are often far more than just the cost of the rectification. They can also include any or all of the following: demolition and waste disposal; the legal costs and cost of building consultants, et cetera, which derives from the dispute process; the cost of finding someone who is prepared to take over another builder's shoddy job; the cost incurred for rental accommodation and payment of the mortgage for the house they have not been living in; and building inflation costs of at least 10 percent due to protracted delay.<sup>227</sup>

**Mr RUSSO:** We understand the cap is there to assist in insurance companies actuarially to determine their extent of exposure. The problem that we have is this, particularly given the current state of the Sydney housing market, there are very few houses that are now being built which are under \$200,000, and so one of the problems that we have is, particularly as we have seen in recent cases, with some of the project home builders, \$200,000 is not enough, and where with one project home builder a demolition was ordered, his company subsequently went into liquidation. So the consumer then loses because the money that is recovered from insurance is totally insufficient, the house has to be demolished, reconstructed and there is nobody to chase. So we see a problem there.

The second area that we see a problem is that, as with a lot of these people who are here and a lot of the BARG people, their disputes go on for many years. In the case of one consumer, when the Building Services Corporation insurance was in place, the cost of his defects was \$85,000, the insurance at that stage was \$100,000. His current quote to meet all the works which could have been completed back then, but were not because of delays and whatever, is now \$170,000.<sup>228</sup>

- 4.112** The Committee notes that Royal & SunAlliance advised that a small number of claims reached the limit of \$200,000:

**The Hon. JOHN RYAN:** Are you able to give the Committee an indication as to how many claims have been paid in New South Wales that have reached the limit of \$200,000? One imagines that of those there would be a number where \$200,000 would be inadequate.

<sup>226</sup> Onorati and Russo, Evidence, 8 August 2002, pp 3 and 10.

<sup>227</sup> Onorati, Evidence, 8 August 2002, p 3.

<sup>228</sup> Russo, Evidence, 8 August 2002, p 10.

**Mr HUNTLY:** I am aware of no more than five in the past 18 months that have crossed my desk. That would be out of 1,200 to 1,800 claims.<sup>229</sup>

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### **Recommendation 14**

The Committee recommends that the New South Wales Government examine the possibility of a supplementary catastrophic fund to consider claims from consumers who had received full payment of \$200,000 from a home warranty insurance policy and still require additional funds to demolish/rectify or reinstate a building that was constructed for the purpose of being their principal residence.

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- 4.113** *Delays:* Mrs Onorati told of the experience of some consumers with delays and service difficulties in making claims on insurance policies.<sup>230</sup> The Committee was therefore pleased to learn that the Department is planning administrative reform to require insurers to introduce service standards for claims handling and to ensure appropriate access for consumers to claims personnel to discuss issues with the aim of improving claims management and customer service (see Chapter 2, paragraph 2.72). The Committee supports this timely initiative as a matter of priority.
- 4.114** *Dispute resolution:* BARG informed the Committee of problems that consumers had experienced with resolving disputes with builders, such as delays.
- 4.115** *Administration and enforcement of the scheme:* Mrs Onorati was critical of the administration and enforcement of the Home Warranty Insurance Scheme by the Department.<sup>231</sup>
- 4.116** *Quality of building work:* Mrs Onorati was critical of the quality of building work in New South Wales, and argued that the licensing system has failed to assess thoroughly the suitability, fitness and competence of licence holders.<sup>232</sup>
- 4.117** *'Completion' of building work:* Mr Russo of BARG informed the Committee that uncertainty as to the point at which building work could be said to be complete, for the purpose of home warranty insurance claims, caused difficulties.<sup>233</sup>
- 4.118** *Termination of contract in certain circumstances:* The Committee notes that in the Queensland scheme, a consumer who is able to show that she or he lawfully terminated a contract with a builder is able to claim insurance, even if that builder is not insolvent, dead or disappeared. In respect of the New South Wales scheme, the Committee notes that even

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<sup>229</sup> Evidence, 25 July 2002, p 19.

<sup>230</sup> Submission 7, 6 June 2002 and Onorati and Russo, Evidence, 8 August 2002.

<sup>231</sup> Onorati and Russo, Evidence, 8 August 2002, pp 2-3, 9, 12.

<sup>232</sup> Onorati, Evidence, 8 August 2002, p 2.

<sup>233</sup> Russo, Evidence, 8 August 2002, p 6.

where a consumer experiences difficulties with a builder, for example, where a builder refuses to comply with an order of the CTTT or has behaved violently or otherwise inappropriately, and terminates a contract in these circumstances, the consumer does not have access to insurance in the new last resort model.

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**Recommendation 15**

The Committee recommends that the New South Wales Government take the issues raised in relation to the experiences of consumers of the New South Wales Home Warranty Scheme, as set out in paragraphs 4.110-4.118 of this report, into consideration as part of any future review of the scheme that it may undertake.

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**4.119** *Builders Choice Awards:* The Committee notes the suggestion of Professor Allan that State and Territory Governments should adopt a system of awards for builders:

...at least introduce something that Alberta did, which is a "Builders Choice" award, where you get the consumers, the home buyers, when their home is completed, to rate their satisfaction with their builder and the 50 percent of builders who do best get the award and the others do not. In Alberta they had no consumer protection laws, but that measure alone largely cleaned up that industry, because consumers could then very quickly ask a builder, "Have you got a Builders Choice award", and they might say, "In the last five years I have won a Builders Choice award three out of five years" or they might say "I won it five out of five years". If they say, "We have never won a Builders Choice award", they just do not get work, or very little. So they now all compete to get awards and that has worked very well in Alberta.<sup>234</sup>

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**Recommendation 16**

The Committee recommends that the Minister for Fair Trading consider implementing a 'Builder's Choice Award' in New South Wales, along the lines of that operating in Alberta, Canada.

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<sup>234</sup> Evidence, 8 August 2002, p 19. See also, Allan, op cit, pp 15-17 and 51.

# **Appendix 1**

## ***Home Building Amendment (Insurance) Act 2002***































# **Appendix 2**

## **Submissions Received**

## Submissions Received

| <b>NO</b> | <b>AUTHOR</b>   |
|-----------|---|
| 1         | <b>COWELL</b> , Mr Gordon   |
| 2         | <b>FRANSEN</b> , Mr John (Builders for Active Industry Reform)                        |
| 3         | <b>WHITER</b> , Mr Alan (Whiter Brothers Builders)                                    |
| 4         | <b>ALLEN</b> , Mr Tony (Building & Insurance Victims Association Inc)                 |
| 5         | <b>EADY</b> , Mr Barry  |
| 6         | <b>WAYLAND</b> , Mr Sam (Chiesa Pty Ltd)  |
| 7         | <b>ANDREW</b> , W E & Z E   |
| 8         | <b>CROUCH</b> , Ms Elizabeth (Housing Industry Association Ltd)                       |
| 9         | <b>KIRK</b> , Mr Nick (Royal & SunAlliance Insurance Australia Ltd)                   |
| 10        | <b>SUTTON</b> , Mr Michael  |
| 11        | <b>SEIDLER</b> , Mr Brian (Master Builders Association of New South Wales Pty Ltd)    |
| 13        | <b>BLACK</b> , Mr R W (Artden Constructions Pty Limited)                              |
| 14        | <b>MOSTYN</b> , Mr Sam (Insurance Australia Group)                                    |
| 15        | <b>CULL</b> , Ms Kim (The Law Society of New South Wales)                             |
| 16        | <b>JOCHELSON</b> , Mr Geoffrey (National Electrical and Communications Association)   |
| 17        | <b>TURNER</b> , Mr David (HIA Insurance Services Pty Ltd)                             |
| 18        | <b>AQUILINA</b> , The Hon John (Department of Fair Trading)                           |
| 19        | <b>GALLAGHER</b> , Mr A T   |
| 20        | <b>DELAHUNTY</b> , Mr Paul (Swimming Pool & Spa Association of NSW Limited)           |
| 21        | <b>BUCKETT</b> , Mr Lionel (Australian Hardwood Homes)                                |
| 22        | <b>PIDCOCK</b> , Ms Caroline (Royal Australian Institute of Architects – NSW Chapter) |
| 23        | <b>O'CONNOR</b> , Mr D B (Department of Fair Trading)                                 |

# **Appendix 3**

## **Witnesses at Hearings**

## Witnesses at Hearings

|  |  |
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| 11 July 2002<br><b>Mr John Lance Schmidt</b>           | Deputy Director-General, Cabinet Office<br>(Formerly, Assistant Director-General, Policy and Strategy<br>Department of Fair Trading) |
| <b>Mr Peter Edward Smith</b>                           | Director, Home Building Division<br>Department of Fair Trading   |
| <b>Ms Lyn Fay Baker</b>                                | Assistant Director-General, Property and Licensing<br>Department of Fair Trading   |
| <b>Mr Christopher James Aird</b>                       | Manager, Legislation Branch, Policy and Strategy Division<br>Department of Fair Trading  |
| 22 July 2002<br><b>Mr William Peter Meredith</b>       | Director - Housing<br>Master Builders Association of New South Wales Pty Ltd   |
| <b>Ms Elizabeth Anne Crouch</b>                        | Executive Director, New South Wales<br>Housing Industry Association Ltd  |
| <b>Mr Shane Darren McCartin</b>                        | General Manager Business Services<br>Housing Industry Association Ltd  |
| <b>Mr Michael Peter Pyers</b>                          | Manager, Services and Operations<br>Housing Industry Association Ltd   |
| 25 July 2002<br><b>Mr Michael Gerard Huntly</b>        | National Manager, Warranty and Construction<br>Royal and Sun Alliance Australia Ltd  |
| <b>Mr David Turner</b>                                 | National Manager Warranty<br>HIA Insurance Services Pty Ltd  |
| 31 July 2002<br><b>Mr Anthony Thomas<br/>Gallagher</b> | Property Developer   |
| <b>Mr Lionel Clarence Bucket</b>                       | Builder (Australian Hardwood Homes)  |
| <b>Mr Paul Milton Delahunty</b>                        | General Manager<br>Swimming Pool & Spa Association of NSW Limited  |
| 8 August 2002<br><b>Mrs Irene Onorati</b>              | President<br>Building Action Review Group  |
| <b>Mr Salvatore Russo</b>                              | Pro Bono Solicitor<br>Building Action Review Group   |
| <b>Professor Percy Allan AM</b>                        | Principal<br>Percy Allan & Associates Pty Ltd  |

# **Appendix 4**

## **Minutes of Proceedings**

Proceedings of the Committee  
**Meeting No 66**  
 10:00am 9 July 2002  
 Room 814/815, Parliament House, Sydney

**1. MEMBERS PRESENT**

Mr Dyer (in the Chair)  
 Mr Hatzistergos  
 Mr Ryan

Also in attendance: Director, Ms Tanya Bosch; Committee Officer, Ms Heather Crichton

**2. APOLOGIES**

Mr Breen

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**4. DELIBERATIVE MEETING**

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**4.3 Inquiry into the *Home Building Insurance (Amendment) Act 2002***

The Chair briefed the Committee on the proposed hearing program.

Mr Hatzistergos advised the Committee that he would be unable to attend the hearings scheduled for July. Resolved, on the motion of Mr Ryan, that Mr Hatzistergos be granted leave until 1 August 2002.

Resolved, on the motion of Mr Ryan, that in order to better inform all those who are participating in the inquiry process, the Committee make use of the powers granted under paragraph 25 of the resolutions establishing the Standing Committees, and section 4(2) of the *Parliamentary Papers (Supplementary Provisions) Act 1975*, to publish submissions received from:

Mr Cowell  
 Mr Fransen, Builders for Active Industry Reform  
 Mr Whiter, Whiter Brothers Builders  
 Mr Allen, Building and Insurance Victims Association  
 Mr Eady  
 Mr Wayland, Chiesa Pty Ltd  
 Mr and Mrs Andrew  
 Ms Crouch, Housing Industry Association  
 Mr Kirk, Royal and SunAlliance  
 Mr Sutton  
 Mr Seidler, Master Builders Association  
 Mr Dickings, Insurance Council of Australia  
 Mr Black, Arden Pty Ltd  
 Mr Mostyn, Insurance Australia Group  
 Ms Cull, Law Society of NSW  
 Mr Jochelson, National Electrical and Communications Association  
 Mr David Turner, National Electrical and Communications Association  
 Mr Aquilina, Minister for Fair Trading

#### **4.4 Sub-Committee**

Resolved, on the motion of Mr Hatzistergos, that for future hearings to be held in pursuance of the Inquiries into Home Building Insurance and Coats of Arms, the Committee be enabled, if necessary, to sit as a sub-committee to take evidence.

#### **4.5 \*\*\***

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#### **6. PUBLICATION OF PROCEEDINGS**

The Committee resolved, on the motion of Mr Ryan, that in order to better inform all those who are participating in the inquiry process, the Committee make use of the powers granted under paragraph 25 of the resolutions establishing the Standing Committees, and section 4(2) of the *Parliamentary Papers (Supplementary Provisions) Act 1975*, to publish transcripts and tabled documents tendered at the public hearing held on 9 July 2002.

#### **7. ADJOURNMENT**

The Committee adjourned at 12:50, to reconvene 10:00am 11 July 2002.

Tanya Bosch  
Director



Proceedings of the Committee

**Meeting No 67**

10:00am 11 July 2002

Room 814/815, Parliament House, Sydney

**1. MEMBERS PRESENT**

Mr Dyer (in the Chair)

Mr Ryan

Also in attendance: Director, Ms Tanya Bosch; Acting Committee Officer, Ms Erin Brady

**2. APOLOGIES**

Mr Breen

**3. ON LEAVE**

Mr Hatzistergos

**4. PUBLIC HEARING**

The Committee sat as a sub-committee pursuant to its resolution of 9 July 2002.

The Committee began the first hearing of the Inquiry into the *Home Building Amendment (Insurance) Act 2002*

The public was admitted.

Mr Peter Smith was sworn and examined.

Ms Lyn Baker was sworn and examined.

Mr John Schmidt was affirmed and examined.

Mr Chris Aird was sworn and examined.

Mr Schmidt tendered a folder of documents

The witnesses and the public withdrew.

**5. PUBLICATION OF PROCEEDINGS**

The Committee resolved, on the motion of Mr Ryan, that in order to better inform all those who are participating in the inquiry process, the Committee make use of the powers granted under paragraph 25 of the resolutions establishing the Standing Committees, and section 4(2) of the *Parliamentary Papers (Supplementary Provisions) Act 1975*, to publish transcripts and tabled documents tendered at the public hearing held on 11 July 2002.

**6. ADJOURNMENT**

The Committee adjourned at 12:50, to reconvene 10:00am 22 July 2002.

Tanya Bosch  
Director

Proceedings of the Committee

**Meeting No 68**

10:00am 22 July 2002

Jubilee Room, Parliament House, Sydney

**1. MEMBERS PRESENT**

Mr Dyer (in the Chair)

Mr Ryan

Also in attendance: Director, Ms Tanya Bosch; Senior Project Officer, Ms Rachel Callinan; Committee Officer, Ms Heather Crichton

**2. APOLOGIES**

Mr Breen

**3. ON LEAVE**

Mr Hatzistergos

**4. PUBLIC HEARING**

The Committee sat as a sub-committee pursuant to its resolution of 9 July 2002.

The Committee began the second hearing of the Inquiry into the *Home Building Amendment (Insurance) Act 2002*  
The public was admitted.

Mr Peter Meredith was sworn and examined.

Mr Meredith tendered two documents:

- "HIA Wins Warranty Refoms for Builders"
- "Re: Application for High Rise Development"

Questioning completed, the witness withdrew.

Ms Elizabeth Crouch was sworn and examined.

Mr Michael Pyers was sworn and examined.

Mr Shane McCartin was sworn and examined.

The witnesses and the public withdrew.

**5. PUBLICATION OF PROCEEDINGS**

The Committee resolved, on the motion of Mr Ryan, that in order to better inform all those who are participating in the inquiry process, the Committee make use of the powers granted under paragraph 25 of the resolutions establishing the Standing Committees, and section 4(2) of the *Parliamentary Papers (Supplementary Provisions) Act 1975*, to publish transcripts and tabled documents tendered at the public hearing held on 22 July 2002.

**6. ADJOURNMENT**

The Committee adjourned at 1:10, to reconvene 10:00am 25 July 2002.

Tanya Bosch  
Director

Proceedings of the Committee  
**Meeting No 69**  
10:00am 25 July 2002  
Room 1108, Parliament House, Sydney

**1. MEMBERS PRESENT**

Mr Dyer (in the Chair)

Mr Ryan

Also in attendance: Director, Ms Tanya Bosch; Senior Project Officer, Ms Rachel Callinan.

**2. ON LEAVE**

Mr Breen

Mr Hatzistergos

**3. PUBLIC HEARING**

The Committee sat as a sub-committee, pursuant to its resolution of 9 July 2002.

The Committee began the third hearing of the Inquiry into the *Home Building Amendment (Insurance) Act 2002*

The public was admitted.

Mr Michael Huntly was sworn and examined.

Mr David Turner was sworn and examined.

The witnesses and the public withdrew.

**4. PUBLICATION OF PROCEEDINGS**

The Committee resolved, on the motion of Mr Ryan, that in order to better inform all those who are participating in the inquiry process, the Committee make use of the powers granted under paragraph 25 of the resolutions establishing the Standing Committees, and section 4(2) of the *Parliamentary Papers (Supplementary Provisions) Act 1975*, to publish transcripts and tabled documents tendered at the public hearing held on 25 July 2002.

**5. LEAVE**

Resolved, on the motion of Mr Ryan, that Mr Breen be granted leave for the remainder of the month.

**6. ADJOURNMENT**

The Committee adjourned at 12:10pm, to reconvene 10:00am 31 July 2002.

Tanya Bosch  
Director

Proceedings of the Committee

**Meeting No 70**

10:00am 31 July 2002

Room 814/815, Parliament House, Sydney

**1. MEMBERS PRESENT**

Mr Dyer (in the Chair)  
Mr Ryan

Also in attendance: Director, Ms Tanya Bosch; Senior Project Officer, Ms Rachel Callinan.

**2. ON LEAVE**

Mr Breen  
Mr Hatzistergos

**3. PUBLIC HEARING**

The Committee sat as a sub-committee, pursuant to its resolution of 9 July 2002.  
The Committee began the fourth hearing of the Inquiry into the *Home Building Amendment (Insurance) Act 2002*

The public was admitted.

Mr Anthony Gallagher was sworn and examined.  
Mr Lionel Buckett was affirmed and examined.  
Mr Gallagher tendered documents entitled: "Tax Invoice, DIB insurance broker"; "Form 3, Developer Policy Indemnity"; "Blackshaw Lindsay Solicitors"; "Symonds Building Services"; and "Financial Requirements for Licensing".

Mr Paul Delahunty was sworn and examined.  
Mr Delahunty tendered a document entitled "Australian Home Warranty, Deed of Guarantee and Indemnity", which is to remain confidential.

**4. PUBLICATION OF PROCEEDINGS**

The Committee resolved, on the motion of Mr Ryan, that in order to better inform all those who are participating in the inquiry process, the Committee make use of the powers granted under paragraph 25 of the resolutions establishing the Standing Committees, and section 4(2) of the *Parliamentary Papers (Supplementary Provisions) Act 1975*, to publish transcripts and tabled documents tendered at the public hearing held on 31 July 2002.

**5. ADJOURNMENT**

The Committee adjourned at 1:10pm, *sine die*.

Tanya Bosch  
Director

Proceedings of the Committee  
**Meeting No 71**  
2.40pm 6 August 2002  
Room 1043, Parliament House, Sydney

**1. MEMBERS PRESENT**

Mr Dyer (in the Chair)  
Mr Breen  
Mr Hatzistergos

Also in attendance: Director, Ms Tanya Bosch; Senior Project Officer, Ms Rachel Callinan.

**2. APOLOGIES**

Mr Ryan

**3. MINUTES**

Resolved, on the motion of Mr Hatzistergos, that the minutes of meetings number 66, 67, 68, 69 and 70 be adopted.

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**4. INQUIRY INTO HOME BUILDING AMENDMENT (INSURANCE) ACT 2002**

Resolved, on the motion of Mr Ryan, that in order to better inform all those who are participating in the inquiry process, the Committee make use of the powers granted under paragraph 25 of the resolutions establishing the Standing Committees, and section 4(2) of the *Parliamentary Papers (Supplementary Provisions) Act 1975*, to publish submissions numbered 19, 20, 21 and 22.

**5. ADJOURNMENT**

The Committee adjourned at 2.50pm, to reconvene 2:00pm 8 August 2002.

Tanya Bosch  
Director

Proceedings of the Committee

**Meeting No 72**

2.00pm, 8 August 2002

Waratah Room, Parliament House, Sydney

**1. MEMBERS PRESENT**

Mr Dyer (in the Chair)  
Mr Breen  
Mr Hatzistergos  
Mr Ryan

Also in attendance: Director, Ms Tanya Bosch; Senior Project Officer, Ms Rachel Callinan.

**2. APOLOGIES**

None

**3. PUBLIC HEARING**

The Committee began the fifth hearing of the Inquiry into the *Home Building Amendment (Insurance) Act 2002*

The public was admitted.

Mrs Irene Onorati was sworn and examined.  
Mr Salvatore Russo was sworn and examined.  
The witnesses withdrew.

Professor Percy Allan was affirmed and examined.  
Professor Allan tendered a document entitled "National Inquiry into Homebuilding Warranty Insurance", dated 8 August 2002.  
The witness and the public withdrew.

**4. PUBLICATION OF PROCEEDINGS**

The Committee resolved, on the motion of Mr Ryan, that in order to better inform all those who are participating in the inquiry process, the Committee make use of the powers granted under paragraph 25 of the resolutions establishing the Standing Committees, and section 4(2) of the *Parliamentary Papers (Supplementary Provisions) Act 1975*, to publish transcripts and tabled documents tendered at the public hearing held on 8 August 2002.

**5. ADJOURNMENT**

The Committee adjourned at 4.55pm, to reconvene 10.00am 12 August 2002.

Tanya Bosch  
Director

## Proceedings of the Committee

**Meeting No 75**

11:10am, 26 August 2002

Room 1108, Parliament House, Sydney

**1. MEMBERS PRESENT**

Mr Dyer (in the Chair)  
 Mr Breen  
 Mr Hatzistergos  
 Mr Ryan

Also in attendance: Director, Ms Tanya Bosch; Senior Project Officer, Ms Rachel Callinan.

**2. MINUTES**

Resolved, on the motion of Mr Hatzistergos, that the minutes of meetings numbered 71, 72, 73 and 74 be adopted.

\*\*\*

**4. INQUIRY INTO HOME BUILDING AMENDMENT (INSURANCE) ACT 2002**

Resolved, on the motion of Mr Breen, that in order to better inform all those who are participating in the inquiry process, the Committee make use of the powers granted under paragraph 25 of the resolutions establishing the Standing Committees, and section 4(2) of the *Parliamentary Papers (Supplementary Provisions) Act 1975*, to publish submission number 22.

Resolved, on the motion of Mr Breen, that the Committee publish the covering letter of Submission 23 and the supplementary submission to Submission 23 and that the appendix to Submission 23 remain confidential.

**5. CONSIDERATION OF CHAIR'S DRAFT REPORT**

The Chair submitted his draft Report on the *Home Building Amendment (Insurance) Act 2002*, which having been circulated to Members of the Committee, was accepted as being read.

The Committee considered the draft report.

Chapter One read and agreed to.

Chapter Two read.

Resolved, on the motion of Mr Ryan, that paragraphs 2.18, 2.19 and 2.20 be omitted and replaced with:

- 2.18** *Residential building work: The contract of insurance for residential building work must insure the person on whose behalf the work is being done against the risk of loss resulting from:*
- *non-completion of the work because of the insolvency or death of the contractor or because of the fact that, after due search and inquiry, the contractor cannot be found; and*
  - *a breach of a statutory warranty (explained below) in respect of the work.*<sup>235</sup>
- 2.19** *Supply of a kit home: A contract of insurance for the supply of a kit home must insure the person to whom the kit home is supplied against the risk of loss resulting from:*
- *non-supply of the kit home because of the insolvency or death of the supplier or because of the fact that, after due search and inquiry, the supplier cannot be found; and*

<sup>235</sup> *Home Building Act 1989*, s 99.

- materials and components used in the kit home not being good and suitable for the purpose for which they were used;
- faulty design of the kit home.<sup>236</sup>

**2.20** Note that the Amendment Act substitutes the phrase 'disappearance of' for the following phrase in the above paragraphs: 'or because of the fact that, after due search and inquiry, the [contractor or supplier] cannot be found'. This reform is examined in Chapter 3, paragraph 3.23.

Resolved, on the motion of Mr Ryan, that paragraphs 2.35 and 2.36 be omitted and replaced with:

**2.35** *If an insurer gives a written decision on a claim and the claimant disagrees with it, the claimant has 45 days in which to lodge an appeal against the decision with the Consumer Trader and Tenancy Tribunal (CTTT).<sup>237</sup> If the insurer does not give a written decision within 45 days of the claim being lodged, unless the claimant has agreed to extend the time, it will be deemed by law to be a refusal of the claim.<sup>238</sup> The claimant may then lodge an appeal against the insurer with the CTTT without any time limitations.*

**2.36** *The CTTT was established on 25 February 2002 when the Fair Trading Tribunal and the Residential Tribunal were merged to form a single specialist dispute resolution forum for consumer, trader and tenancy matters in New South Wales. The CTTT is also the forum for resolving disputes between builders and consumers involving up to \$500,000. All home building disputes must be considered for resolution by the Building Conciliation Service (BCS) before being accepted for a formal hearing by the CTTT. The BCS was established on 1 January 2002 and its role is to assist both customers and contractors to resolve their disputes without the need for costly and time consuming litigation.*

Resolved, on the motion of Mr Ryan, that paragraph 2.41 be omitted, and replaced with:

**2.41** *The Committee notes that the Housing Industry Association (HIA) has close links with HIA Insurance Services, as stated by the Executive Director of HIA New South Wales:*

*The first is that we licence our name to Aon to use the brand HIA Insurance Services. We also provide information technology and other builder assessment software to assist the insurer in making a decision about builders and their performance. The other important issue is that we provide them with direct policy advice.<sup>239</sup>*

**2.42** *The Committee also notes that it was advised by the MBA that it does not have formal relationships with any insurer:*

*The Master Builders Association of NSW has never had any relationship with HIH. The MBA had a joint venture agreement with Jardine Thompson Insurance Brokers (Jardines) to provide the MBA with brokerage services across a wide range of insurance products. Jardines had arrangements with HIH in respect of home warranty insurance and prior to the collapse of HIH, were also providing home warranty insurance on behalf of Dexta Corporation<sup>240</sup>*

Resolved, on the motion of Mr Ryan, that the following paragraph, including a new Appendix 8, be inserted after paragraph 2.43:

*Royal & SunAlliance also provided the Committee with details of its average premiums charged since 1998 in the Australian jurisdictions in which it operates, reproduced as Appendix 8. The information shows a steady increase in premiums in NSW over the five years, with a marked increase in the last year. The table also shows NSW to have the highest premium for 2002 compared to other jurisdictions.*

<sup>236</sup> Home Building Act 1989, s 100.

<sup>237</sup> Home Building Regulation 1997, cl 55.

<sup>238</sup> Home Building Regulation 1997, cl 54.

<sup>239</sup> Crouch, Evidence, 22 July 2002, p 17.

<sup>240</sup> Submission 11, Supplementary Submission, 6 August 2002, p 5.



Resolved, on the motion of Mr Ryan, that the following paragraphs be inserted after paragraph 2.46:

*Under the Conditions of Approval (see paragraph 2.17) approved home warranty insurance providers are obliged to provide certain information to the Department, including details of: claims paid and the value of those claims; claims that were not paid for reasons such as that they were not within the scope of cover; and average premiums charged for average cost of works for annual policies. There is no requirement for insurers to report the total value of premiums paid under the scheme. The Minister for Fair Trading reported to the Parliament in June 2000 that insurers in the scheme at that time had been 'inconsistent' in providing relevant information to the Government.<sup>241</sup>*

*The Department supplied the Committee with a summary of the statistics that it had collected with regard to the home warranty insurance market in NSW for the years 1997-1998 to 2000 – 2001. The statistics have been included as Appendix 10.*

*Royal & SunAlliance provided the Committee with details with regard to its claims and profits experience in NSW. These details have been included as Appendix 11. The Committee was not provided with the raw figures on which these estimates of profitability were calculated. Additionally, Royal & SunAlliance were the only insurer to provide any detail in this regard. The figures supplied were also limited to the profit and claims experience for the period 1997-2000 because, according to Royal & SunAlliance, '...the 2000 and 2001 years were too underdeveloped to provide any meaningful insight.'<sup>242</sup> The statistics given to the New South Wales Government for the years 1997-2000 were not adequate to determine whether the home warranty insurance market in this state was profitable or unprofitable in those years. These statistics do not however, suggest that it was unprofitable.*

*The Committee recognises that the Government is significantly disadvantaged in assessing claims by insurers for changes to the scheme if they do not have adequate, accurate and timely details from insurers about the insurance market. It is imperative that the New South Wales Government pursue its current initiatives to obtain more detailed and timely information about the scheme's profitability and claims experience. The Government should seek and publish annually appropriate information about the scheme similar to the practice of the Motor Accidents Authority in relation to the motor accident insurance scheme.*

Resolved, on the motion of Mr Ryan, that the second sentence of paragraph 2.47 be omitted, and replaced with:

*The Committee recommends that the New South Wales Government should continue to undertake its own data collection.*

Resolved, on the motion of Mr Ryan, that Recommendation 1 be amended to read:

*The Committee recommends that the New South Wales Government should continue with the implementation of a data collection procedure for the home warranty insurance market. The Government should specify, as part of the Conditions for Approval of insurers, that they must supply the Government with detailed market data concerning home warranty insurance premiums, claims and payouts.*

Resolved, on the motion of Mr Breen, that paragraph 2.48 be omitted and replaced with:

*The eligibility criteria used by insurers to determine whether to provide insurance cover to a particular builder is not regulated. The eligibility criteria are therefore determined by each insurer. The Committee notes that the criteria used by insurers are far from clear to the building industry, a point that was raised several times in submissions and in evidence given to the Inquiry. This issue is discussed further in Chapter 4, paragraph 4.93.*

Chapter Two, as amended, agreed to.

Chapter Three read.

<sup>241</sup> General Purpose Standing Committee No. 3, 2000-2001 Budget Estimates, Questions Placed on Notice at/after Hearing, Question 35.

<sup>242</sup> Submission 9, 21 June 2002, p 5.

Resolved, on the motion of Mr Hatzistergos, that paragraph 3.3 be omitted, and replaced with:

*The Committee notes that part of the New South Wales Home Warranty Insurance Scheme was already 'last resort', prior to the amendments, and that this remains unchanged by the Amendment Act. In this regard, the Home Building Act 1989 provides that the insurance cover for non-completion of residential building work or non-supply of a kit home is 'last resort' insurance cover (as explained further in Chapter 2, paragraph 2.18). The Amendment Act provides that, as well as in relation to non-completion of residential building work and the non-supply of kit homes, insurance for other aspects of residential building work, the supply of kit homes, and for certain other work is also to be last resort insurance.<sup>243</sup>*

Chapter Three, as amended, agreed to.

Chapter Four read.

Resolved, on the motion of Mr Breen, that paragraph 4.75 be omitted, and replaced with:

*The Committee is aware that at least one insurer is considering entering the home warranty insurance market. The Committee was advised by IAG, which was generally supportive of the reforms, that is currently considering its position with respect to entering the market.<sup>244</sup>*

Resolved, on the motion of Mr Ryan, that a new paragraph be inserted after paragraph 4.64 as follows:

*The Committee observes that coverage for non-completion in New South Wales may be less than other jurisdictions. See, in this regard, the table at paragraph 3.22.*

Resolved, on the motion of Mr Ryan, that two recommendations be inserted after 4.65 as follows:

*The Committee recommends that the Government consider examining the 20% limitation on liability for non-completion of work, with a view to determining the impact of this reform on consumers.*

*The Committee further recommends that the Government give consideration to amending the Home Building Regulation 1997 to provide that, instead of limiting liability resulting from non-completion of building work to 20% of the contract price, a contract of insurance may limit liability resulting for non-completion of building work to an amount that is '20% of the sum insured or 20% of the contract price, whichever is greater.'*

Resolved, on the motion of Mr Ryan, that the word "however" be deleted from paragraph 4.65, and that the final sentence of paragraph 4.65 be deleted.

Resolved, on the motion of Mr Ryan, that a new paragraph 4.116 be inserted as follows:

*Builders Choice Awards: The Committee notes the suggestion of Professor Allan that State and Territory Governments should adopt a system of awards for builders:*

*...at least introduce something that Alberta did, which is a "Builders Choice" award, where you get the consumers, the home buyers, when their home is completed, to rate their satisfaction with their builder and the 50 percent of builders who do best get the award and the others do not. In Alberta they had no consumer protection laws, but that measure alone largely cleaned up that industry, because consumers could then very quickly ask a builder, "Have you got a Builders Choice award", and they might say, "In the last five years I have won a Builders Choice award three out of five years" or they might say "I won it five out of five years". If they say, "We have never won a Builders Choice award", they just do not get work, or very little. So they now all compete to get awards and that has worked very well in Alberta.<sup>245</sup>*

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<sup>243</sup> *Home Building Amendment (Insurance) Act 2002, Schedule 1[3] – [7] and Schedule 2[1]-[6].*

<sup>244</sup> Submission 14, 25 June 2002, p 4.

<sup>245</sup> Evidence, 8 August 2002, p 19. See also, Allan, op cit, pp 15-17 and 51.

Resolved, on the motion of Mr Ryan, that paragraph 4.111 be moved and inserted after 4.109, and that the following paragraphs and recommendation be inserted:

*In relation to the level of cover the representatives of BARG made the following comments:*

**Mrs Onorati** BARG can provide the Committee with numerous examples of consumers who have lost over \$200,000 after a dispute with shonky builders. The costs that needs to be covered by the consumers are often far more than just the cost of the rectification. They can also include any or all of the following: demolition and waste disposal; the legal costs and cost of building consultants, et cetera, which derives from the dispute process; the cost of finding someone who is prepared to take over another builder's shoddy job; the cost incurred for rental accommodation and payment of the mortgage for the house they have not been living in; and building inflation costs of at least 10 percent due to protracted delay.<sup>246</sup>

**Mr RUSSO:** We understand the cap is there to assist in insurance companies actuarially to determine their extent of exposure. The problem that we have is this, particularly given the current state of the Sydney housing market, there are very few houses that are now being built which are under \$200,000, and so one of the problems that we have is, particularly as we have seen in recent cases, with some of the project home builders, \$200,000 is not enough, and where with one project home builder a demolition was ordered, his company subsequently went into liquidation. So the consumer then loses because the money that is recovered from insurance is totally insufficient, the house has to be demolished, reconstructed and there is nobody to chase. So we see a problem there.

The second area that we see a problem is that, as with a lot of these people who are here and a lot of the BARG people, their disputes go on for many years. In the case of one consumer, when the Building Services Corporation insurance was in place, the cost of his defects was \$85,000, the insurance at that stage was \$100,000. His current quote to meet all the works which could have been completed back then, but were not because of delays and whatever, is now \$170,000.<sup>247</sup>

*The Committee notes that Royal & SunAlliance advised that a small number of claims reached the limit of \$200,000:*

**The Hon. JOHN RYAN:** Are you able to give the Committee an indication as to how many claims have been paid in New South Wales that have reached the limit of \$200,000? One imagines that of those there would be a number where \$200,000 would be inadequate.

**Mr HUNTLY:** I am aware of no more than five in the past 18 months that have crossed my desk. That would be out of 1,200 to 1,800 claims.<sup>248</sup>

### **Recommendation**

*The Committee recommends that the New South Wales Government examine the possibility of a supplementary catastrophic fund to consider claims from consumers who had received full payment of \$200,000 from a home warranty insurance policy and still required additional funds to demolish, rectify or reinstate a building which was constructed for the purpose of being their principal residence.*

Resolved, on the motion of Mr Ryan, that recommendation 10 of Chapter 4 be moved to after paragraph 4.116.

Resolved, on the motion of Mr Ryan, that a new paragraph be inserted after paragraph 4.86, as follows:

*The Committee also notes that the Joint Select Committee on the Quality of Buildings made a number of findings and recommendations in relation to dispute resolution. The Committee endorses those recommendations.*

Resolved, on the motion of Mr Ryan, that a new paragraph be inserted after paragraph 4.116 and after Recommendation 10, as follows:

*Termination of contract in certain circumstances: The Committee notes that in the Queensland scheme, a consumer who is able to show that she or he lawfully terminated a contract with a builder is able to claim insurance, even if that insurer is not insolvent, dead or disappeared. In respect of the New South Wales scheme, the Committee notes that even where a consumer experiences difficulties with a builder, for example, where a builder refuses to comply with an order of the CTTT or has behaved violently or otherwise inappropriately, and terminates a contract in these circumstances, the consumer does not have access to insurance in the new last resort model.*

<sup>246</sup> Onorati, Evidence, 8 August 2002, p 3.

<sup>247</sup> Russo, Evidence, 8 August 2002, p 10.

<sup>248</sup> Evidence, 25 July 2002, p 19.

Chapter Four, as amended, agreed to.

Executive Summary, as amended, agreed to.

Resolved, on the motion of Mr Ryan, that the draft report (as amended) be the Report of the Committee and that the Chairman, Director and Senior Project Officer be permitted to correct stylistic, typographical and grammatical errors.

Resolved, on the motion of Mr Breen, that the report, together with the transcripts of evidence, non-confidential submissions, documents and correspondence in relation to the inquiry, be tabled and made public.

## **6. ADJOURNMENT**

The Committee adjourned at 1:00pm, *sine die*.

Tanya Bosch  
Director

## **Appendix 5**

### **Implementation of Home Building Reforms**

*History and background to the operation of building,  
licensing and insurance in New South Wales,  
tendered by Mr John Schmidt, Department of  
Fair Trading, 11 July 2002, Part 3.*













## **Appendix 6**

### **Queensland Scheme**

Insurance Council of Australia, Background Paper No. 9(b) *State and Territory Insurance Regimes: Builders Warranty Insurance*, Prepared by the ICA for the HIH Royal Commission, November 2001, pp 11-12.



## **Appendix 7**

### **Comparative Table of the Home Warranty Insurance Schemes in Australia**

Professor Percy Allan AM, Principal, Percy Allan & Associates Pty Ltd, *National Review of Home Builders Warranty Insurance and Consumer Protection*, Report Prepared for the Ministerial Council on Consumer Affairs, June 2002, Appendix 4, Tables 1.1 – 1.5, pp 76-84.





















## **Appendix 8**

### **Royal & SunAlliance Insurance Australia Ltd, *Average Premiums Across the Home Warranty Insurance Portfolio, 1998-2002***





## **Appendix 9**

### **Home Warranty Insurance Average Premiums Across Australia for 2000-2001**

Professor Percy Allan AM, Principal, Percy Allan & Associates Pty Ltd, *National Review of Home Builders Warranty Insurance and Consumer Protection*, Report Prepared for the Ministerial Council on Consumer Affairs, June 2002, Appendix 6, Chart 12, p 115.



## **Appendix 10**

### **Department of Fair Trading - Annual Reports Summary: Home Warranty Insurance**

Correspondence to the Committee from the  
Department of Fair Trading, 29 July 2002.



## **Appendix 11**

### **Royal & SunAlliance Insurance Australia Ltd, Claims Experience**

Submission 9, 21 June 2002, pp 5-7.





