

QUESTION 1

The Hon. TREVOR KHAN: Are you aware of the rationale adopted to remove the four storeys and above from the scheme?

Ms DONNELLY: I do not have direct knowledge but I thought you might ask that, so I have gone back and researched again. Obviously the Campbell report is one that does make some mention of the insurance conditions at the time. What is on the public record is discussions about insurance industry problems at the time, such as the failure of HIH, the fact that it was shortly after 9/11 and the concern about catastrophic claims. I do not have a complete knowledge at all.

The Hon. TREVOR KHAN: Can you take the question on notice? Plainly if what is going to come out of this inquiry are recommendations relating to a change in the scheme the Committee would be greatly informed by—

Ms DONNELLY: For some insight.

The Hon. TREVOR KHAN: —understanding the rationale for changing it in the first place. It does not have to be a political issue here on that sort of thing. There are going to be costs and benefits from any proposal and we need to work out what—

Ms DONNELLY: Yes. I am happy to take that on notice if that is useful.

ANSWER:

On 13 March 2002, the Hon John Aquilina MP, then Minister for Fair Trading in NSW and the Hon John Lenders MP then Minister for Finance in Victoria, jointly announced that the NSW and Victorian Governments would adopt uniform Home Warranty Insurance Schemes for the two states (**media release at Tab A**). The stated intent of the reforms was to address problems that had impacted on the Home Warranty Insurance market in Australia arising from global issues confronting the insurance industry, such as the collapse of HIH Insurance and the terrorist attacks of 11 September 2001. Among other changes, the announcement included that “high-rise multi-unit developments will not be required to carry this form of domestic dwelling insurance. Similar limitations on high-rise developments already apply in Queensland, Tasmania and the ACT”.

However, in June 2002, the Report of the National Review of Home Builders Warranty Insurance and Consumer Protection by former NSW Treasury Secretary, Professor Percy Allan AM, noted that “NSW did not proceed with this exemption, but instead agreed to underwrite private insurance for this purpose”. That report also identified a range of issues with aspects of insurance and building regulation nationally, and recommended amongst other things, that Governments consider as a high priority requiring “developers to provide last resort insurance on high-rise units when selling them” (**report attached at Tab B**)

In September 2002, the Standing Committee on Law and Justice also noted in its ‘Report on the *Home Building Amendment (Insurance) Act 2002*’, that the NSW Government decided not to proceed with exempting high-rise residential buildings from insurance (see point 2.68 in the **report attached at Tab C**).

Mr John Schmidt, former Assistant Director-General, Policy and Strategy, of the Department of Fair Trading, provided testimony at the Standing Committee's hearings that explained the context for the Government's announcement above, and subsequent retention of insurance for high rise buildings (see page 3-4 of the attached **transcript at Tab D**), including that:

"...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 nonstructural 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."

"New South Wales and Victoria decided that those issues should be addressed on a joint basis by the respective State governments so intensive negotiations took place to try to nut out an arrangement for the insurance to go forward ... 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 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."

On 31 December 2002, Dexta-Allianz ceased writing new home warranty insurance business, leaving 'Royal and Sun Alliance' and 'Reward' as the only remaining insurers in NSW market.

On 5 May 2003, then Minister for Commerce, the Hon John Della Bosca MLC, announced a further inquiry into the Home Warranty Insurance Scheme in NSW, to be led by Richard Grellman ('Grellman Inquiry', **media release at Tab E**). The reasons given for commissioning the review were:

"following the tragic events of September 11 and the collapse of HIH, insurance markets have been in turmoil. Last year, the State Government introduced a number of reforms in a bid to make access to home building warranty insurance easier. While there has been support for these reforms, there remains no clear consensus between interested parties on how we can make it easier for builders and consumers to access home warranty insurance. The situation is made more complex with only one insurer providing virtually all insurance policies."

The 'Final report of the NSW Home Warranty Insurance Inquiry' (**report attached at Tab F**), recommended ('Recommendation 7', on page 77 of the report):

- Excluding high-rise developments from the scheme.
- Including mandatory certification for the construction of high-rise projects, by approved certifiers only.

- As soon as practicable, insurers should seek to transfer catastrophe cover provided by the Government for claims arising above \$10 million from the collapse of any one builder, back to private sector reinsurers.

The context and reasons given in the Grellman Inquiry report (see in particular pages 15, 20, 32-34, and 77 of the report) were:

- the collapse of HIH in 2001 and the withdrawal of Dexta in 2002 from the scheme placed considerable pressure upon the principal remaining underwriter, Royal and Sun Alliance, and its ability to issue new policies and administer claims in a timely manner;
- the NSW Government was reinsuring all risk for high-rise policies for one underwriter that was underwriting 92% of the insurance scheme, Royal and Sun Alliance, with that arrangement due to end on 31 December 2003;
- at that time, NSW was the only State requiring mandatory cover for high-rise projects above three storeys;
- a high-rise construction ordinarily poses minimal risk to a consumer during the period of construction;
- insurers and reinsurers indicated they will not underwrite high-rise developments;
- submissions consistently called for high-rise to be removed from the Scheme;
- many submissions that noted consumer risk could be further reduced if mandatory certification is required at key construction stages, ensuring that faults are detected and corrected prior to building completion, such as:
 - Waterproofing;
 - Fire and noise rating;
 - Balcony drainage/design; and
- attributed to the Report of the NSW Parliament's Joint Select Committee on the Quality of Building ('the Campbell Inquiry'), a recommendation to remove the requirement for high-rise multi-unit developments [however, the July 2002 report of the Campbell Inquiry includes no such recommendation].

An insurance exemption for the construction of residential buildings more than three storeys high and containing two or more dwellings was subsequently introduced by the Home Building Amendment (Insurance Exemptions) Regulation 2003 under the then Minister for Commerce, the Hon John Della Bosca MLC, and which commenced on 31 December 2003 (**copy attached at Tab G**).

Additional insurers entered the NSW home warranty insurance market in the following years, but by 2009 were again exiting the market (there were also some other changes to parameters of the insurance scheme during his period). In 2010, the NSW Parliament passed the *NSW Self Insurance Corporation Amendment (Home Warranty Insurance) Act 2010*, establishing the NSW Government insurer, the NSW Self Insurance Corporation (now trading as 'icare'), as the sole provider of home warranty insurance (until 1 January 2018, when amendments to the *Home Building Act 1989* provided that other providers can apply to SIRA for a licence to enter the market alongside icare).

In 2012, the insurance exemption for the construction of high-rise residential flat buildings was revisited as part of the Review of the *Home Building Act 1989* and was canvassed as part of a public consultation Issues Paper. The outcomes of that review were announced in 2013 and included that the NSW Government would continue the exemption (**Position**

Paper attached at Tab H). The NSW Government's 2013 Position Paper stated (page 20-21):

“Although many respondents to the 2012 Issues Paper advocated for the removal of the exemption, others maintained that it should be continued.”

“A key rationale for the exemption is that the risks involved in high-rise works are materially different to those of individuals who are building a home. Developments of this nature are undertaken between larger, established developers and builders, and generally involve the use of commercial contractual arrangements, such as retention funds for defects.”

“Removing the high-rise exemption would be likely to place considerable upward pressure on home warranty insurance premiums, which in turn would have a significant impact on home building costs for consumers.”

“It is also likely that if the exemption was removed, applicants for home warranty insurance for high-rise development would need to meet very strict criteria to be eligible for cover. This would reduce the number of builders that are able to tender for high-rise developments and could reduce competition in the industry. This proposal does not preclude the exemption issue from being re-considered in the future. The NSW Government is currently pursuing reforms to strata and community title laws and will be releasing a position paper outlining its reform proposals in the coming weeks.”

The NSW Government's 2013 Position Paper on strata law reform subsequently included that developers of new residential strata buildings that are not covered by the insurance, would instead be subject to a building bond and inspection scheme (at page 17 of the **Position Paper attached at Tab I**). This was subsequently provided for in Part 11 of the *Strata Schemes Management Act 2015*, and the building bond and inspection scheme commenced on 1 January 2018).

In 2015, the NSW Government's review of the Home Building Compensation Scheme canvassed whether the insurance exemption for high-rise residential flat buildings over three storeys, should be broadened to also exempt low-rise multi-unit residential buildings other than duplexes (at page 28 of the **Discussion Paper attached at Tab J**). That review included an anonymous online survey on reform options, as well as calling for submissions. The survey received 765 responses to the question 'Should low-rise multi-unit buildings apart from duplexes be exempt from HBCF Insurance Requirements, of which 36.08% (276) responded 'Yes', and 55.29% (423) responded 'No', with 8.63% (66) responding 'not sure'. In addition, 29 submissions commented on this matter, with 37.9% (11) in support of that reform option, while 48.3% (14) opposed, and 13.8% (4) made other comments. Some submissions also indicated that they preferred that insurance cover be broadened rather than narrowed, potentially re-including high-rise buildings, including the Law Society of NSW, the law firm 'Kreisson', the Owners Corporation Network, Strata Community Australia, and the Real Estate Institute of NSW.

The outcome of that review was announced in November 2016 and did not include changes to the exemption.

QUESTION 2

The Hon. TREVOR KHAN: Well that might be the answer, but let's see. Can I just ask a further question? These issues are not limited solely to New South Wales. Have you looked at the schemes in other States and are you able to identify for us what other States do and the implications of those schemes in terms of costs and the like?

Ms DONNELLY: The other States do generally also have a limitation on coverage for high-rise. My understanding is that that would have been introduced roughly around the same period in other jurisdictions— building above three storeys does not tend to be covered. Most of the other jurisdictions have mandatory insurance. In Tasmania it is voluntary, so it is quite different in that regard. Queensland has a first-resort scheme, which means it is more of a first port of call where you have a problem, you seek rectification of a defect, you go to the insurer and then the insurer recovers. But most of the other jurisdictions have schemes that are quite similar to New South Wales.

The Hon. TREVOR KHAN: Right. Are you able to do two things for me? One is to give us a table that sets out the various schemes in the various States so that we can—

Ms DONNELLY: Certainly.

The Hon. TREVOR KHAN: Perhaps you might like to make a comment with regards to the pros and cons. The further thing that I would ask, if it is within your gift to do, is if you could identify for us what you would call an exemplar scheme in one of the States? It may be that nobody has an exemplar scheme; nevertheless it would be useful to know if there is one that might act as a model for future developments in this State.

Ms DONNELLY: Happy to take that on notice.

ANSWER:

The attached two tables provide a comparison of the insurance schemes operating in Australia (**Tab K**) and in some international jurisdictions, including New Zealand (**Tab L**). I note these are a summary only and rely on publicly available information about schemes that SIRA does not administer. I am not able to offer the Committee a recommendation of an 'exemplar' scheme, but I trust the information we have compiled for the Committee supports it to consider the matter.

QUESTION 3

The CHAIR: What was the deficit of the scheme in the most recent financial year?

Ms DONNELLY: In the most recent financial year—I am happy to take that on notice—I believe more like a figure of around \$40 million, 43, 44.

The Hon. TREVOR KHAN: Chair, I am not trying to cut it off, what time are you intending to go to?

The Hon. ROBERT BORSAK: Quarter past 11.

The CHAIR: Quarter past, maybe 20 past 11.

Ms DONNELLY: I am happy to confirm that figure.

The CHAIR: What is accumulated deficit in the scheme then?

Ms DONNELLY: I will take that on notice and check with icare.

ANSWER:

I have checked this matter with icare, who have advised as follows:

- The deficit of the scheme in the most recent year financial year 2018/19 is \$201.6 million.
- The accumulated deficit in the scheme is \$636.9 million. (\$201.6 million plus an accumulated loss of \$435.3 million to 30 June 2018).
- Approximately \$104.6 million of the \$201.6 million loss in financial year 2018/19 relates to policies that icare inherited and remain under-priced from inception. The remaining \$97 million loss is on the portfolio that was partly repriced during financial year 2018/19 and further price increases are scheduled to be enacted in 2019/20 and 2020/21.

I would like to clarify that the figures I referred to in the transcript above, related to a \$43 million dollar amount that was an estimate of icare's premium shortfall for some construction types that are not yet charged at 'break even' pricing, for insurance policies written in financial year 2018/19. That estimate was provided by icare in May 2018 and may not reflect subsequent actual experience.

QUESTION 4

The Hon. TREVOR KHAN: Are the increases in insolvencies identifiable by type of dwelling? For instance, are the insolvencies greater in multi-storeys than they are in single detached dwellings? Is there some form of characteristic?

Ms DONNELLY: Firstly, what I would say is I am not sure that there has been an increase in insolvencies. If you go back sometime, it has been hovering around 94 or 95 per cent over my time involved in the scheme.

The Hon. TREVOR KHAN: My apologies, I misstated.

The CHAIR: Claims related to the builder having disappeared.

Ms DONNELLY: I might take that on notice, if you do not mind

ANSWER:

Data that SIRA collects from insurers does identify the type of construction work that was insured, as well as whether a claim related to insolvency or another claims trigger. The proportion of claims where the responsible contractor is insolvent fluctuates from year to year. However, across construction types and whether projects are in metropolitan or regional areas, the primary claim trigger is insolvency. For the period from financial year 2002/03 to 2017/18:

- 89% of claims for the construction of new single dwellings were due to insolvency;

- 91% of claims for the construction of new multi-dwelling buildings up to three storeys were due to insolvency; and
- 92% of claims for the construction of new high-rise multi-dwelling buildings more than three storeys high were due to insolvency.

These figures include claims on policies written by former private sector insurers ('run-off insurers') up to 30 June 2010 as well as insurance written by icare since 1 July 2010. Claims for high-rise multi-dwelling buildings relate to policies of insurance written up to 31 December 2003.

I have enclosed additional charts at **Tab M**, which further breakdown these figures by the year in which the claim was notified to the insurer, and by metropolitan or regional location of the building work, and whether the insurance was underwritten by icare or by run-off insurers.

QUESTION 5

The Hon. TREVOR KHAN: Sure. With more claims relating to multi-storey than single detached dwellings, have you done an analysis as to why? I could potentially think of a couple of reasons why, but if there are more claims with regard to buildings up to three storeys, which are not particularly amazing engineering structures, why there would be more claims with regard to those buildings?

Ms DONNELLY: I am happy to take that on notice as well. There are more dwellings involved.

The Hon. TREVOR KHAN: True, that might be the answer.

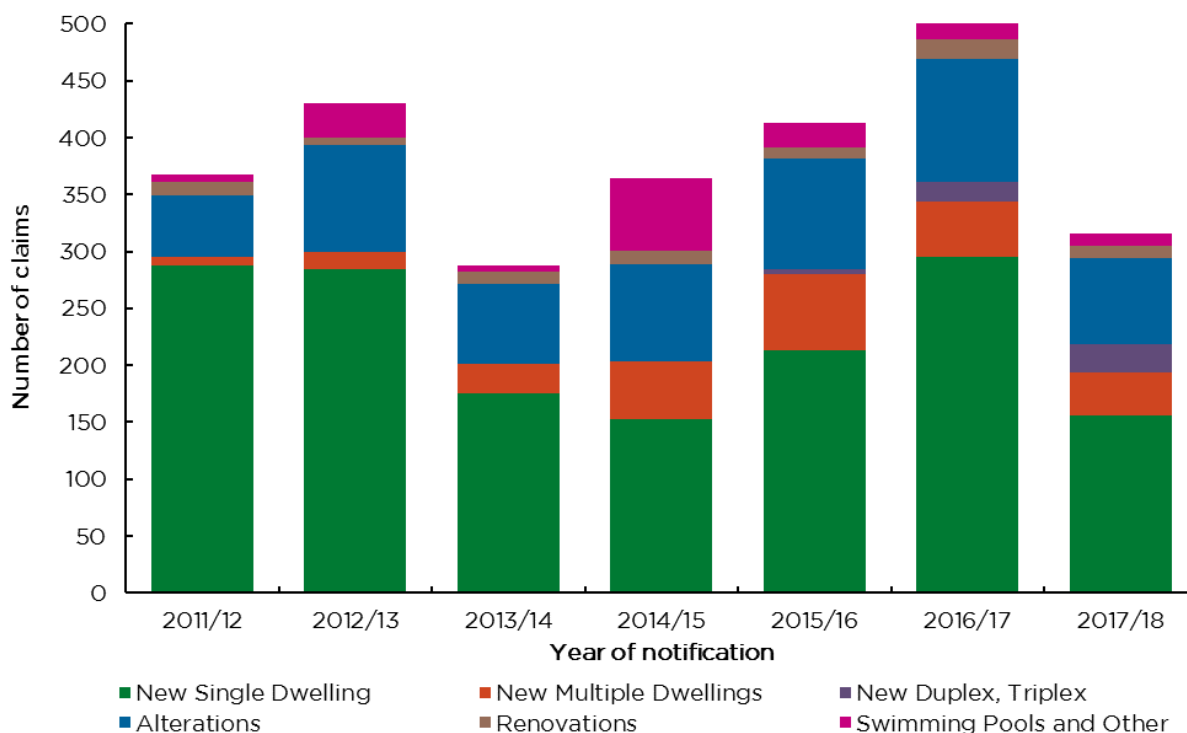
Ms DONNELLY: And therefore the amount of potential claims cost would be higher.

ANSWER:

For the period from financial year 2002/03 to 2017/18 there were 8,788 claims reported by insurers, of which:

- 57.8% (5,083 claims) related to the construction of new single dwellings; and
- 17.9% (1,574) related to the construction of new multi-dwelling buildings up to three storeys.

For insurance claims reported to SIRA by icare since 1 July 2010, I have included a chart of claims data (see below). This shows by year, the numbers of claims and types of construction to which they relate for the period to 30 June 2018. In every year, the highest proportion of claims relate to the construction of new single dwellings.



I note that in respect of multi-unit buildings, a single claim can relate to multiple dwellings (because a policy and a claim may relate to a whole building, whereas each dwelling may be issued a certificate under the insurance policy). I am able to supply the Committee data that breaks down claims that have been paid, by the number of certificates to which they relate. This is in respect of claims that icare has reported to SIRA for policies of insurance written since 1 July 2010. Of the total certificates for which a claim has been paid to 30 June 2018 (2,912 certificates):

- 43% related to new single dwellings (1,254 certificates with an average payment amount per certificate of \$98k); and
- 22.9% related to new multi-dwelling buildings up to three storeys (666 certificates with an average payment amount per certificate of \$31k).

Additional data about these matters is attached at **Tab N**

QUESTION 7

The Hon. ROBERT BORSAK: Can you take on notice too whether you can break it out on a table as to where the claims come from? In other words, are they foundations related, are they cladding related, are they electrical related?

Ms DONNELLY: I can tell you that my latest advice is that there are none that are cladding related. As I said, the top three are related to masonry and brickwork, exterior rendering and waterproofing. I can give you more detail about the types of defects.

The Hon. ROBERT BORSAK: Can you give us more detail on that, please.

Ms DONNELLY: Yes.

ANSWER:

In preparing the responses to this question I have identified an error in my testimony on 12 August (above). Having reviewed the table I was referring to at the hearing, I have identified that I mistakenly reported one of the top three as exterior render cracking instead of external balcony waterproofing which is on the line below in the data table. The table is provided at **Tab O**. I would also like to clarify that in my response above I was referring to flammable cladding.

icare has provided SIRA with defect types reported by icare's building consultants, who attend sites to evaluate defects that are the subject of claims. icare has only recorded this information since August 2015, and so provides only four years of summarised data. The data is subject to the caveat that many claims are multi-causal, with more than one defect being present in a single claim, and while icare's building consultants report to icare the defect types for each claim at the time of defect assessment, icare does not record the ultimate cost for each defect type within a claim. On that basis, information that icare has provided indicates:

- The most common defect listed is external balcony waterproofing, with 15.59% of claims having this defect listed
 - This defect occurs in 93% of claims arising from non-structural alterations & additions to multi-unit buildings.
 - This defect occurs in 52.82% of claims arising from non-structural renovations to single dwellings.
 - This defect occurs in 22.23% of claims arising from structural alterations and additions to multi-unit buildings.
- The second highest defect listed relates to issues with frames and trusses, with 10.41% of claims having this defect listed.
 - This defect occurs in 16.08% of claims arising from structural alterations and additions to single dwellings.
 - This also occurs in 11.19% of claims arising from new builds of single dwellings.
- Number three is external waterproofing (excluding external balconies), with 9.98% of claims having this defect listed.
- Number four is brickwork/masonry, with 9.83% of claims having this defect listed.
 - This defect occurs in 46.32% of claims arising from structural alterations and additions to multi-unit buildings.
- Number five is internal waterproofing, with 8.97% of claims having this defect listed
 - This defect occurs in 12.05% of claims arising from swimming pool installation.
 - This also occurs in 11.05% of claims arising from new multi-unit building
 - This also occurs in 11.05% of claims arising from non-structural renovations to single dwellings

A more detailed breakdown of the data is enclosed at **Tab O**.