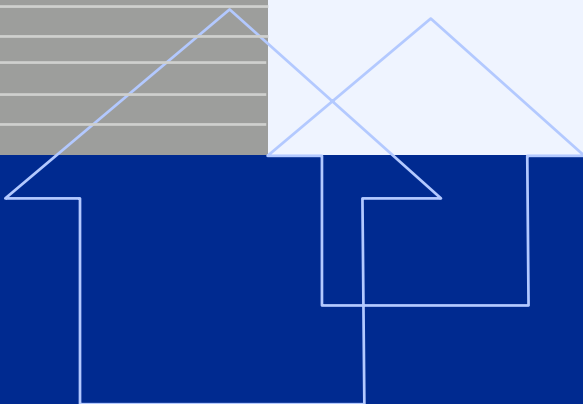


NSW
Home Warranty
Insurance 
Inquiry

Final Report

30 September 2003



Her Excellency Professor Marie Bashir AC
Governor of New South Wales
Office of the Governor of New South Wales
Chief Secretary's Building
Macquarie Street
SYDNEY NSW 2000

30 September 2003

Your Excellency

I am pleased to submit the Final Report of the New South Wales Home Warranty Insurance Inquiry.

Yours faithfully



Richard Grellman

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1.0 Executive Summary

The New South Wales Home Warranty Insurance Inquiry (the Inquiry) was announced by the Minister for Commerce, the Hon. John Della Bosca MLC on 5 May 2003. Mr Richard Grellman was appointed by the Governor of New South Wales to conduct the Inquiry.

It was clear to the Inquiry that many builders experience difficulty in obtaining insurance and have been frustrated by the lack of transparency. Notwithstanding, the building industry in New South Wales, including residential construction, has enjoyed significant growth and continues to be economically buoyant. **The Inquiry accepts, however, that there is a need for change.**

In making appropriate recommendations, the Inquiry was faced with a significant challenge – how to best balance the concerns of stakeholders with the aspirations of service providers without compromising scheme stability.

The Inquiry consulted extensively with builders, consumers and other interested parties to ensure that all concerns were heard and understood.

In examining approaches to achieve scheme stability, the Inquiry considered six options.

The Inquiry concurs with the implementation of the 2002 reforms arising from the Campbell Inquiry.

The Inquiry believes that the remaining Campbell Inquiry reforms, while contributing to building a more stable scheme, need to be complemented with specific measures addressing governance, licencing and dispute resolution arrangements. Section 9 lists this Inquiry's specific recommendations.

The Inquiry considers that these further reforms will provide the foundations for scheme stability. The scheme has undergone considerable change over the past 12 months. The Inquiry

believes that more time is needed for the full impact of recent, current and proposed changes to take effect in order to achieve optimal functionality. **Importantly, the Inquiry is satisfied that this measured approach is preferable to a profound change in the scheme make up. All such radical options, considered in detail later in this report, have a number of shortcomings, face implementation risk and will take considerable time to bring into effect causing instability and uncertainty in the meantime.**

In evaluating the options, the Inquiry recognises merit in building a scheme that strives to offer a greater level of consumer protection while promoting building industry confidence. The Inquiry found that ultimately the scheme should be underpinned by a system where consumers are the purchaser of insurance and, whilst not an immediate recommendation, remains a desirable aspiration for the scheme.

Transition requirements

The Inquiry recommends the early formation of an Interim Scheme Board (“ISB”), which will be responsible for overseeing the detailed legislative design, required to implement the Inquiry’s recommendations, should Government accept them.

The ISB’s activities should be completed by early 2004 to allow for a Bill incorporating amendments to be introduced into Parliament for the April 2004 session.

Scheme performance reviews

The Inquiry believes that regular reviews of emerging statutory schemes are important in assuring transparency and addressing problems at an early stage. Accordingly, the Inquiry recommends annual reviews of the scheme, with an independent review in four years to determine whether a consumer-purchased insurance product is feasible.

2.0 Introduction

Background to the Inquiry

On 5 May 2003, the Minister for Commerce, the Hon John Della Bosca MLC, announced an Inquiry into the NSW Home Warranty Insurance Scheme.

The Inquiry submitted an Interim Report to the Governor on 30 June 2003.

The Inquiry's approach

In accordance with the Terms of Reference (see below), public submissions were called and the Inquiry held meetings with stakeholders, service providers and other interested parties. The Inquiry's activities included:

Meetings

The Inquiry conducted 76 meetings with stakeholders, service providers and other interested parties. A summary of meetings is attached at Appendix 1A.

The Inquiry also responded to over 50 requests for information or queries about the Inquiry.

Roundtable discussions

The Inquiry conducted two roundtable discussions with major stakeholders on 6 August and 14 August 2003. The discussions provided a forum to canvass key scheme issues. The meeting attendees list is attached at Appendix 1B.

Submissions

The Inquiry considered 219 written submissions. Many organisations and individuals, particularly builders, provided considered advice and comment that greatly assisted the Inquiry's deliberations. A summary list of submissions received is attached at Appendix 2.

While submissions have been carefully considered by the Inquiry and in some cases formed the basis for stakeholder discussions, the submissions are kept confidentially. Some quotes from individual submissions have, with the permission of the author, been included.

Costing issues

The Inquiry considered how options and recommendations could be actuarially and financially costed.

The Inquiry concluded that at this time it was not appropriate to undertake actuarial modelling noting:

- concerns relating to accuracy and availability of scheme financial and claims data
- some recommendations require further development
- relatively short time since the implementation of the 2002 legislative changes provides insufficient experience to meaningfully model current scheme performance.

Terms of Reference

The Inquiry's Terms of Reference are:

1. Consider whether the legislative framework governing Home Warranty Insurance in New South Wales (including changes made to the existing scheme in 2002) is currently effective for consumers and industry.
2. Assess the potential for the entry of one or more additional insurers to the Home Warranty Insurance market and identify any legislative or administrative changes that would encourage the entry of additional insurers into the market.

3. Consider the need for, and viability and effectiveness of, options other than the existing scheme for the delivery of Home Warranty Insurance including, but not limited to:
 - 3.1 industry based schemes operating in Australia and elsewhere; and
 - 3.2 schemes incorporating government as insurer or re-insurer.
4. Having regard to the existing scheme and possible alternative options, identify a preferred Home Warranty Insurance model for consideration. The model should be accompanied by full financial and actuarial modelling to ensure it is robust and sustainable.
5. Identify the likely impact of a preferred model on the Home Warranty Insurance market.
6. Identify appropriate conditions of approval for any new model including requirements for prudential regulation.
7. Identify and assess any other issues requiring consideration in relation to the introduction of any new model for the Home Warranty Insurance market.
8. The inquiry is to have regard to, amongst other things:
 - 8.1 The June 2002 Report of the National Review of Home Builders Warranty Insurance and Consumer Protection by Professor Percy Allan.
 - 8.2 The July 2002 Report of the NSW Parliament's Joint Select Committee on the Quality of Building ("the Campbell Inquiry") and the Government's response to that Report.
 - 8.3 The September 2002 Report of the Legislative Council Standing Committee on Law and Justice on the Home Building Amendment (Insurance Act) 2002.
9. In undertaking the inquiry consult with both stakeholders and service providers.

10. Provide the following reports:
 - 10.1 An interim report by 30 June 2003.
 - 10.2 A final report by 30 September 2003.

3.0 What is home warranty insurance?

Protection for homeowners against loss caused by builders

Home Warranty Insurance provides a minimum level of protection for consumers of residential building services and subsequent purchasers. It provides cover against financial loss caused by the builder's failure to rectify or compensate for the builder's defective or incomplete work.

The New South Wales scheme is "last-resort" and, accordingly, an insurance claim can only be made when the builder has died, disappeared or is insolvent. Where the builder is still in existence the consumer must pursue their claim directly with the builder. As a consequence, the insurance policy has a dual nature, covering faulty workmanship but only when the builder has died, disappeared or is insolvent.

A Home Warranty Insurance policy provides cover during the construction period and for up to six years following completion for structural work and two years for non-structural work. As such, cover is provided for the benefit of the consumer against the risk of the builder becoming insolvent during construction and for up to six years post completion.

Insurance is available for builders and owner-builders. The procedure for obtaining the insurance is somewhat different for owner-builders.

Who is required to take out Home Warranty Insurance?

Home Warranty Insurance is required to be taken out by:

- Builders undertaking residential building work valued over \$12,000
- Owner-builders (i.e. holders of an owner-builder permit) who undertake owner-builder work valued over \$12,000. Owner-builders are required to obtain a certificate of insurance prior to entering into any contract for sale for the property, if the sale is within six years after completion of the work
- Developers (i.e. persons on whose behalf residential building work is/was undertaken in connection with four or more dwellings on property owned by the person). Developers must provide purchasers with a copy of the insurance obtained by the builder
- Persons supplying (and erecting) a kit home with a contract value of more than \$12,000.

Available compensation

Under the current scheme the minimum insurance required is \$200,000. Insurers may offer more if they wish. There are also specific limitations for losses in respect of:

- Deposits and payments which exceed the amounts specified as statutory limits for such deposits and payments
- Liquidated damages
- Defective owner-builder work itemised in any report required by the insurer before the policy was taken out
- Fair wear and tear or failure by insured to maintain the work
- Structural elements in any non-residential parts of the building which support or give access to the residential parts
- Normal drying out of the building work or the kit home components
- Beneficiary's failure to take reasonable and timely action to minimise damage

- Claim after expiry of manufacturer's warranty period for any appliance or apparatus, or, if no warranty, outside the reasonable lifetime of the apparatus or appliance
- Claim outside the reasonable lifetime of the work or materials, or the manufacturer's warranty of the materials
- Defect due to a faulty design by a beneficiary or a previous owner.

A high level overview of the schemes that operate across Australia is included in Appendix 3. All Australian schemes are mandatory.

Dispute resolution

The homeowner is required to make every legal effort to pursue the builder if the latter is still alive, solvent and can be found.

Consumers and builders are able to access the Consumer, Trader and Tenancy Tribunal (CTTT) to assist in resolving claims. The purpose of the CTTT is to provide an independent, low cost and accessible dispute resolution forum. It is also the avenue of an insurance claimant's appeal against an insurer's decision in regard to an insurance claim.

The CTTT was established in February 2002. A new statutory regime for dealing with home building disputes commenced on 1 July 2003. The key additional features included:

- Home Building Service's team of inspectors will make on-site inspections of claims and where appropriate have the power to issue a rectification order with which the builder must comply. The inspectors also provide quasi-mediation services at this time
- At the request of the CTTT member, the inspector is also to provide a report to the CTTT to assist clarifying aspects of the disputes
- Tribunal members are now also able to appoint an expert to advise the Tribunal.

The Inquiry has been advised that all claims under \$25,000 are now listed for hearing within 21 days after lodgement of the claim. Approximately 88 per cent of building-related matters were for less

than \$25,000. The Inquiry has been advised that 72 per cent of these matters are finalised at or before the only hearing.

Claims larger than \$25,000 are case managed. The first listing for these cases is to occur within 21 days and the purpose of this first meeting is to set the timetable for managing the dispute to resolution.

Following a decision through the CTTT, the consumer or builder could choose to further pursue the matter, on a question of law, through the Supreme Court. However, the cost of doing so is usually prohibitive.

From 1 July 2003, Home Building Service introduced on-site inspectors to provide quasi-dispute resolution services and issue rectification notices. Early indications show that intervention by inspectors is reducing the number of matters presented to the CTTT. The CTTT have advised that, for the two and a half months since the introduction of inspectors, there has been approximately a 30 per cent reduction (in comparison to the previous year) in the number of matters brought forward.

The CTTT is also low cost. For 2003-04 the CTTT expect to receive approximately 62,000 applications. The average cost of resolving an application is \$320. However, building matters can be more costly, reflecting their complexity.

Licensing arrangements

The Home Building Service, which officially commenced operation on 1 July 2003, is responsible for all building-related functions previously undertaken by different Divisions within the Office of Fair Trading such as licensing, compliance and insurance approvals and monitoring.

The Home Building Service is also responsible for dispute resolution (particularly early on-site intervention of disputes), inspections, education and training. The centralised core business units of the Home Building Service support regional service delivery through the Fair Trading Centres. The Home Building

Service is responsible for issuing builders' licences and enforcing licence conditions.

Prudential regulation

The Australian Prudential Regulatory Authority (APRA), as Australia's prime financial services regulator, is responsible, inter alia, for enforcing minimum capital adequacy and solvency requirements and other regulatory requirements for insurers who underwrite Home Warranty Insurance in New South Wales.

4.0 Home Warranty Insurance in NSW

Scheme history

The New South Wales Home Warranty Insurance Scheme has undergone significant change since its 1972 inception.

History of Home Warranty Insurance in NSW	
1972	Home Warranty Insurance was first introduced in New South Wales as a government-run scheme. Its purpose was to protect consumers from loss where a builder performed faulty work, incomplete work or became insolvent.
1972 - 1987	Two insurance schemes commenced operating under the 'House Purchasers Agreement' and 'Trade Indemnity Agreement'. Both schemes were administered by the Builders Licensing Board (the Board). The House Purchasers Agreement initially provided cover of up to \$40,000 for individual building work above \$1,000. The Trade Indemnity Agreement initially provided cover above \$200 up to \$1,000 for work performed by individual tradespersons.
1987	The Board was abolished and replaced by the Building Services Corporation (BSC), which was established under the <i>Building Services Corporation Act 1987</i> (later replaced by the <i>Building Services Corporation Act 1989</i>).
March 1990	<p>The Home Purchasers Agreement and the Trade Indemnity Agreement were replaced with the Comprehensive Insurance Scheme and the Special Insurance Scheme, established under the Building Services Corporation Act 1989.</p> <p>Under the Comprehensive Insurance Scheme the maximum cover for defective work was \$100,000 and \$25,000 for incomplete work. Major structural defects were covered for seven years, and general defects for three years, from the date of substantial commencement of the building work.</p> <p>The Special Insurance Scheme applied to other residential building work, being single trade or specialist trade work. The maximum level of cover was \$10,000 for one year.</p>

History of Home Warranty Insurance in NSW

1992	Report by the Royal Commission into the Building Industry released (the Gyles report), which recommended a move towards private underwriting.
1993	Report by the Inquiry into the Building Service Corporation (the Dodd report) which recommended the disbanding of Building Service Corporation and a move toward private underwriting.
1995	<p>The BSC was integrated into the Department of Fair Trading, now the Office of Fair Trading which from 2003 forms part of the Department of Commerce.</p> <p>After the State election in 1995, the Government examined the possibility of introducing an insurance scheme operated by the private sector.</p>
Late 1996	Legislation establishing a new private scheme was passed. Under the private scheme all defects were required to be covered for seven years. The minimum cover required was and still is \$200,000. This applied to both defective and incomplete work.
May 1997	<p>The private Home Warranty Insurance scheme commenced.</p> <p>The introduction of the scheme coincided with the disbandment of the BSC, but the Government retained responsibility for potential future claims made under the old BSC scheme. The Government continues to administer the run-off of the closed BSC scheme through the Fair Trading Administration Corporation. The scheme's assets have been exhausted and all claims are now being funded out of the Government's consolidated funds. Generally, no further claims will be accepted after 30 April 2004. However, the Home Building Act 1989 provides for the Commissioner for Fair Trading to exercise discretion to accept claims for an additional three years.</p> <p>In the initial years following the commencement of the private scheme there were up to five insurers underwriting the market. The market was competitive and premium levels were similar to the earlier government scheme.</p>

History of Home Warranty Insurance in NSW	
March 2001	<p>The collapse of HIH created severe dislocation of the Home Warranty Insurance market. HIH had around 30–40% of the market and, in many cases, HIH offered the lowest premiums and easiest criteria for builders to obtain cover. After the HIH collapse, significant delays were caused to builders attempting to obtain cover for new work. Some ex-HIH clients also could not meet the requirements of the remaining insurers underwriting the scheme - Royal & SunAlliance (now Promina), Dexta/Allianz and Reward.</p> <p>The Government also established the HIH Rescue Scheme. Consumers covered by HIH policies were indemnified by the Government, with the Rescue Scheme for Home Warranty Insurance administered by the Building Insurers' Guarantee Corporation (BIG Corp) and FTAC, and these entities have accepted \$69 million and \$42 million, respectively, in liabilities arising from HIH.</p>
Early 2002	The Home Warranty Insurance market was again in turmoil with the withdrawal of certain reinsurers.
March 2002	The NSW and Victorian Governments moved to put in place arrangements for the necessary reinsurance for Allianz to continue supporting Dexta to provide Home Warranty Insurance. However, on 31 December 2002, Dexta ceased writing new business as its insurer, Allianz, withdrew from the market. The New South Wales Government still retains certain exposures and liabilities relating to the period it provided reinsurance to Allianz.
February 2002	Creation of the Consumer Tenancy and Traders Tribunal.
June 2002	Report of the National Review of Home Builders Warranty Insurance and Consumer Protection (the Allen report) released.
July 2002	Report by the Legislative Council Standing Committee on Law and Justice on the Home Building Amendment (Insurance Act) 2002, examining the recent amendments (the Campbell report).
May 2003	Minister Della Bosca announces the Inquiry into the New South Wales Home Warranty scheme. Richard Grellman was appointed by the Governor of New South Wales to undertake the Inquiry.
1 July 2003	The launch of the Home Building Service, including recruitment of additional inspectors and investigators to provide onsite inspection and mediation services.

Current industry status

The New South Wales residential property market represents approximately 21 to 23 per cent of Australia's residential building activity. New South Wales has more residential building activity than any other State or Territory.

In New South Wales the high level of residential building activity reinforces the importance of a properly functioning scheme. Scheme problems, both real and perceived, can have a broader impact across the New South Wales and Australian economy.

In premium income terms, the scheme is relatively small, worth an estimated \$50 - \$70 million per annum. Royal and SunAlliance ("RSA"), now Promina, underwrites approximately 92 per cent of the scheme and Reward underwrites the balance.

The New South Wales Government also accepts significant risk. It currently reinsures all risk for high-rise construction policies (constructions above three storeys) issued by RSA. This cover is in place until 31 December 2003. The Government also reinsures any claims above \$10 million arising from the collapse of any one builder.

The scheme itself is broader than insurance alone. Recent data relating to building activity, owner-builder activity, licencing and training is considered below.

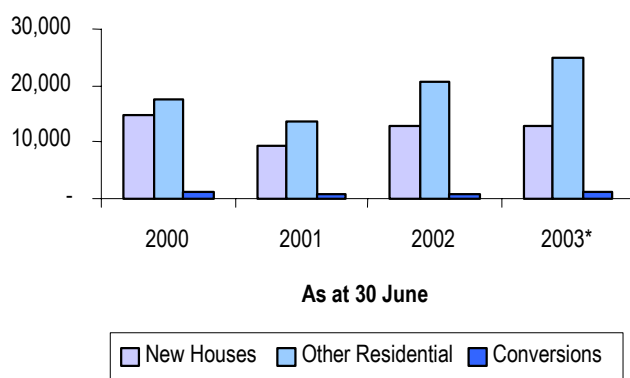
Building activity

"Housing is the engine of the Australian economy. In 2002/03, Australians spent directly \$44.3 billion dollars on building new homes and renovating existing homes, equivalent to 3.6 per cent of GDP. Not only does the housing industry contribute more jobs and more to GDP than either the mining or agricultural industry, but also industry activity levels lead the economy out of and into recession."

(Submission: Housing Industry Association)

The Australian Bureau of Statistics July 2003 building activity data included statistics up to 31 March 2003. The number of buildings under construction in New South Wales is depicted in the graph below.

No. of Buildings Under



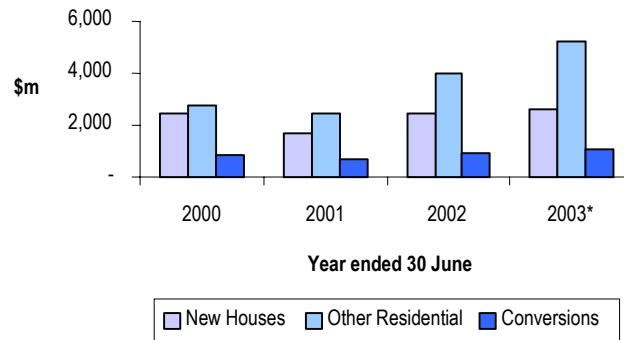
Source: Australian Bureau of Statistics (* Figures as at 31 March 2003)

There were approximately 39,000 buildings under construction in New South Wales at 31 March 2003. Of these, 13,000 were new houses and 25,000 were other new dwellings, including townhouses and apartment complexes. The balance represents conversions or renovations of existing buildings.

Total construction activity at 31 March 2003 was 14 per cent higher than activity levels at 30 June 2002.

Buildings under construction at 31 March 2003 were valued at \$8.9 billion, compared with \$7.4 billion at 30 June 2002. These changes are depicted in the graph below.

Value of Projects Under Construction



Source: Australian Bureau of Statistics (* Figures as at 31 March 2003)

The value of work completed in each year has also grown over the past three years, reflecting increased building activity.

Value of Work Completed



Source: Australian Bureau of Statistics (* Figures as at 31 March 2003 have been annualised)

Despite some representations to the Inquiry suggesting the scheme is having a severe economic impact on the sector, this data suggests ongoing and increasing activity levels. Aspects of the scheme may well have a negative impact on some stakeholders and service providers but other factors such as moving costs, stamp duty on transfer, inflating property values and

low interest rates seem to be supporting a healthy utilization of available skills.

Indeed it is possible that increasing building activity in recent years and the consequent demands of the construction industry and its various service providers is one reason why, anecdotally, consumers often experience delays in locating a builder and commencing construction.

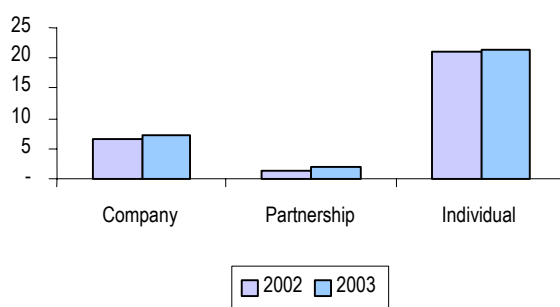
Licensing

Representations to the Inquiry indicated that, as a consequence of difficulties in obtaining insurance, there are many builders who have left or are contemplating leaving the industry.

The Inquiry requested the Office of Fair Trading's current information on licenced builder numbers. The total number of licences issued increased by three per cent in the year to 30 June 2003, with a total number of 162,000 licences at that date.

The diagram below depicts the number of full building licences issued (30,221 as at 30 June 2003), which account for only 26 per cent of the total number of licences issued. The number of full builders licences increased by approximately four per cent in the year ending 30 June 2003.

No. of Full Building Licences ('000)



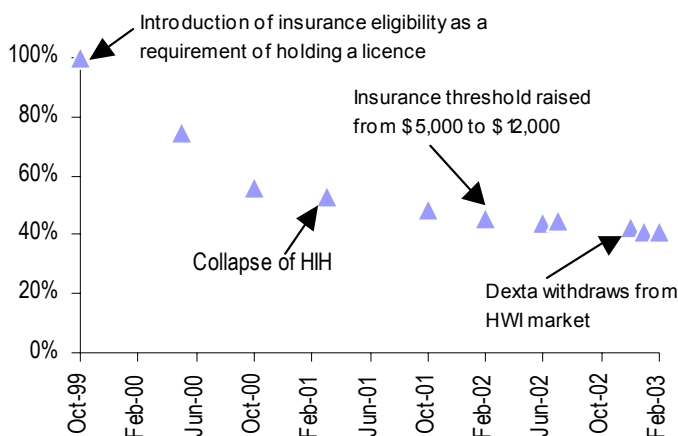
Source: Office of Fair Trading (2003)

Full building licences issued to partnerships increased by 29 per cent in 2002-03. This data appears to support anecdotal comment submitted to the Inquiry by builders, that some sole traders have formed partnerships to increase business equity and assets.

Licences are also issued on a restricted basis for work such as landscaping, swimming pools, kitchen, laundry and bathroom renovations. There was a 13 per cent increase in these licences in the year ending 30 June 2003, reflecting significant activity in the renovation and additions market. It is interesting that approvals for individuals in the renovations and additions category increased by 19 per cent in the year ending 30 June 2003.

Insurance access

The most common builder complaint to the Inquiry is the inability to access insurance. The Inquiry requested data from The Office of Fair Trading on the number of builders who received insurance eligibility. This data is depicted below.



Source: Department of Fair Trading 2003

The Inquiry emphasises that this diagram needs to be read with caution, for the following reasons.

In 1999, insurance eligibility was not a requirement for holding a licence. Accordingly, the data shows all (100 per cent) licenced builders as being eligible for insurance. However, this result is an aberration, as at that time, the builder's licence was not tied to insurance eligibility.

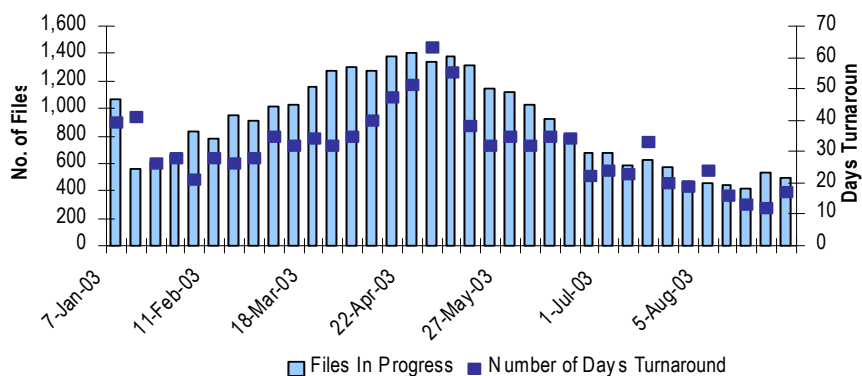
From 1 January 2000, builders were required to obtain a letter of eligibility for insurance to obtain a licence to construct residential housing projects. Consequently during 2000, the percentage of builders who held a licence and insurance eligibility fell dramatically to approximately 56 per cent.

In March 2001, HIH collapsed and this resulted in RSA's market share significantly increasing. This was followed by the withdrawal of Dexta from the market at the end of 2002. The percentage of builders who held a licence together with insurance eligibility continued to fall and by the end of 2002, approximately 42.5 per cent of builders were in that position.

Over the last six months, the percentage has declined by a further 1.5 per cent to approximately 41 per cent of builders. It appears that the percentage of builders who hold a licence with insurance eligibility is stabilising.

The Inquiry recognises that the collapse of HIH and the withdrawal of Dexta from the scheme placed considerable pressure upon the principal remaining underwriter, RSA, and its ability to issue new policies and administer claims in a timely manner. Significant delays were caused by the sheer increase in the number of builders applying for insurance. While these delays were an extremely unfortunate consequence of the insurance events of 2001, the Inquiry was advised that RSA has significantly reduced delays in attending to applications for cover. The backlog in applications for insurance eligibility is illustrated in the diagram below (for RSA's Australian market share). The diagram also indicates a considerable reduction in the volume of applications for insurance and consequent reduction in turnaround time in the last six months.

Total file performance



RSA note that for the past two months a full eligibility for insurance review is taking, on average, 22 days, with applications from smaller builders requesting insurance for turnover of \$1 million or less being processed in a shorter time frame. RSA advised that the majority of project approvals occur within 72 hours. RSA also advised that a full eligibility review is only undertaken once every few years. RSA may request additional information (eg. annual accounts) over the course of each year.

It is important that premium levels in any privately underwritten statutory scheme are neither too high (thus returning super-profits at the public's expense) nor too low (thus risking a poor or negative return on capital which might prompt withdrawal from the market). Anecdotal evidence suggests that underwriters are currently enjoying reasonable trading conditions with their Home Warranty Insurance products. The quote below from the submission prepared by AON to this Inquiry is apposite:

"Thanks to recent reforms, better builder education, improved underwriting practices and significant premium increases, in 2002 Home Warranty Insurance has turned the corner into profitability.

Extensive analysis of the period 1996 to 2002 also supports this view, indicating that Home Warranty insurance market conditions are improving. Our extensive analysis shows that:

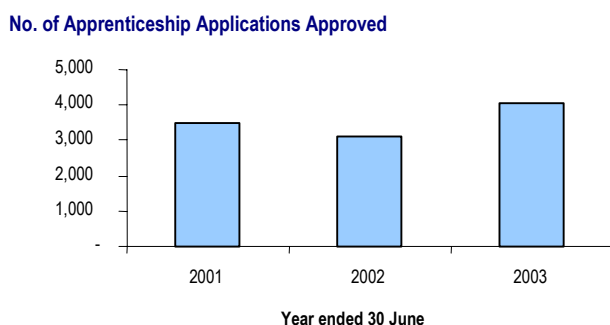
- *Loss ratios are on the decline.*
- *Claim experience has improved over the last five years due to improved underwriting and builders' corporate governance.*
- *If the changes introduced by the current reforms had been in force since 1996, a significant proportion of losses would have not been incurred.*
- *Premium rates have increased significantly. If 2003 premium rates had always been in force, this book of business would have been profitable."*

(Submission: AON)

Attracting and retaining new apprentices

The Inquiry met many builders concerned about their industry's inability to attract or retain new apprentices. Some builders provided examples of having to lay-off apprentices and other staff resulting from loss of work due to difficulties in obtaining insurance. No statistics were available to quantify the extent of this problem.

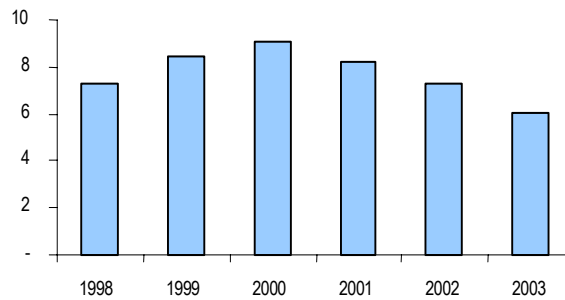
The Inquiry sought the NSW Department of Education and Training's current data on the number of apprentices in building related trades in New South Wales. The number of applications approved for building apprenticeships grew by 31 per cent in the year ended 30 June 2003.



Source: NSW Department of Education and Training (2003)

The Inquiry also examined industry training undertaken through TAFE institutes. Since 2000, there has been a steady decline in the number of TAFE enrolments for construction-related courses.

TAFE Enrolments for Construction Studies



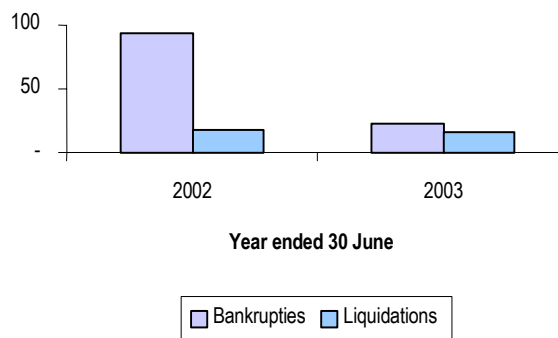
Source: NSW Department of Education and Training (2003)

Taken together, it is hard to sustain an argument that young people are profoundly avoiding pursuing opportunities in the building industry, although it is of very real concern to note that a percentage of these people may be experiencing difficulty in locating or retaining employment.

Insolvency statistics

Builder bankruptcy and liquidation data was sought from the Home Building Service. This data is presented below.

No. of Insolvencies



Source: Home Building Service (2003)

There is no formal process in place for measuring builder insolvencies. However, the number of bankruptcies and liquidations known to the Home Building Service dropped by 65 per cent from 110 events during 2001-02 to 39 events in the 2002-2003 financial year.

This unconfirmed data may be indicative of industry rationalisation and improved financial standing of builders arising from measures implemented as a result of the Campbell Inquiry and also the financial disciplines imposed on the building community by the underwriters. The Inquiry notes that the Home Building Service is intending to implement data recording processes to provide increased accuracy for future years.

Summary

The level of building activity in New South Wales is strong. The Inquiry notes comments by MBA National's Chief Executive, Mr Wilhelm Harnisch:

"The building and construction industry continues to be supported by current low interest rates, solid employment prospects and the large volume of work in the pipeline..."

...Work done in residential building peaked in the March quarter 2003 with a slight fall in the June quarter. However, any weakness is likely to be subdued, at least in the near term."

The Housing Industry Association also finds that the building industry, especially for housing, remains strong. The Chief Economist of the Housing Industry Association, Mr Simon Tennent recently stated:

"Stable low interest rates and underlying buyer confidence is ensuring that the housing slowdown is modest..."

...It continues to be good news, not only for the thousands of businesses employed both directly and indirectly in the industry, but also for the underlying health of the wider economy."

The number of licenced builders is fairly stable and there is an increase in the number of apprentices being trained. This is coupled with a relatively low level of identified bankruptcies and liquidations, confirming the strong performance of the building

industry, notwithstanding the practical difficulties some aspects of the underwriters' activity and procedural requirements have undoubtedly caused.

5.0 Stakeholders and service providers

The Inquiry held 76 meetings and received 219 written submissions from stakeholders, service providers and other interested parties. The Inquiry also responded to over 50 requests for information and other queries about the Inquiry.

These individuals and groups are listed in the tables below and a discussion of their concerns follows.

Stakeholders	
Consumers	<p>Consumers are the scheme's primary stakeholders. The scheme is intended to provide protection for consumers of residential building services and subsequent purchasers of homes.</p> <p>The Inquiry met with many consumers and, as recommended by the Building Action Reform Group (BARG), visited housing sites to inspect difficulties experienced by consumers.</p>
NSW Government	<p>The NSW Government is a key scheme stakeholder. The Government has a clear interest in the scheme's performance, ensuring consumer interests are protected and builders are able to obtain appropriate insurance cover and, importantly, that the scheme is stable and financially viable.</p> <p>The NSW Government currently retains certain insurance exposures relating to high-rise construction projects and claims above \$10 million relating to the collapse of individual builders.</p>

Service providers	
Builders	<p>The builders are the principal service provider and in general are responsible for acquiring Home Warranty Insurance. The Inquiry received over 135 written submissions from individual builders and met with over 30.</p>
Sub-contractors	<p>There are a variety of sub-contractors across a range of trades who are usually engaged by the builder during the construction of a residential property.</p>

Service providers

Insurers	Home Warranty Insurance is provided by insurers who are approved to offer it by the Minister for Commerce. The insurance policies offered must also be approved to ensure that they comply with the Home Building Act 1989. At present, the scheme is principally underwritten by RSA with Reward underwriting a smaller share of the New South Wales market. The Inquiry also met with other insurers who expressed an interest in underwriting the scheme.
Reinsurers	Reinsurers have an important role providing financial support to insurers who underwrite Home Warranty Insurance. A reinsurer accepts part of the risk from the insurer in return for receipt of a share of the premium income. Reinsurers also assist by sharing their international experience with local insurers. Failure to obtain reinsurance on a reasonable basis would significantly compromise an underwriter's ability to continue writing this class of business.
Insurance brokers	Insurance brokers are intermediaries who assist consumers in obtaining insurance policies. In New South Wales, AON is the predominant Home Warranty Insurance broker. Many other brokers now assist builders in obtaining insurance.
Regulatory bodies	There are a number of regulators involved in the scheme. The principal regulators are: <ul style="list-style-type: none"> ▪ Office of Fair Trading/Home Building Service – The Office of Fair Trading and its dedicated building division, Home Building Service, provide a range of consumer protection services, including the regulation of the New South Wales Home Warranty Insurance Scheme. The Home Building Service has officially been established since 1 July 2003 and should be regarded as being in the formative stages of its development. ▪ Consumer, Trader and Tenancy Tribunal – The CTTT was established in February 2002 to provide an independent, low cost and accessible dispute resolution forum for consumers and builders. ▪ Australian Prudential Regulation Authority – APRA is the prime prudential regulator for the Australian financial system. This includes the prudential regulation of insurers who underwrite the New South Wales Home Warranty Insurance Scheme.

Service providers	
Industry groups	<p>There are a number of industry organisations interested in the scheme representing insurers and builders.</p> <ul style="list-style-type: none"> ▪ The Insurance Council of Australia represents the interests of the Australian general insurance industry. ▪ The Master Builder Association (MBA) is a federation of nine MBA organisations across Australia. In New South Wales there is the MBA NSW and Newcastle MBA with MBA National maintaining an active watch on developments. ▪ The Housing Industry Association (HIA) is a national industry association and represents the residential housing industry and many companies/organisations in the construction industry. ▪ The Inquiry also met with B-Fair, Central West Builders Scheme, the South Coast Builders, and the Builders' Collective.
Other service providers	<p>There are a number of other service providers involved in the design and construction of a home. Without exhaustively identifying all parties, other important service providers include:</p> <ul style="list-style-type: none"> ▪ Structural engineers ▪ Building certifiers ▪ Architects ▪ Geotechnical experts ▪ Many other trades and professions.

Recurring criticisms

The Inquiry met with a number of stakeholders and service providers. Their current concerns are broadly similar to those detailed in previous reviews, including the Campbell Inquiry (2002) and the Allan Review (2002).

The specific concerns and criticisms are summarised below.

Long-term scheme stability

The scheme has undergone many changes (see Chapters 3 and 4), and most stakeholders and service providers expressed concerns about its lack of stability and predictability.

All insurers indicated their principal concern was long-term scheme stability. Stability assists insurers in pricing the risk at an appropriate level. Given there is a relatively long liability tail attached to this class of insurance, stability is particularly important.

Access to insurance

The majority of builders' submissions expressed concerns about the ability to access insurance or obtain the desired level of insurance coverage.

Importantly, builders indicated that there were extensive delays in obtaining the initial certificate of eligibility. The Inquiry met with representatives from the scheme's current underwriters and discussed the cause of delays in obtaining eligibility for insurance. Unfortunately, extensive delays were caused by the increase in the volume of applications from builders who were previously insured with HIH and Dexta. As noted earlier, the Inquiry was advised the application backlog has reduced and current delays in application processing have been reduced significantly.

Many builders were disappointed with the lack of transparency in applying for insurance. Some builders do not understand what information insurers require or the purpose of such information.

Financial requirements

Many builders were unhappy with the requirement to pledge their own assets, increase the paid-up capital in their businesses or obtain a bank guarantee to obtain insurance cover.

The Inquiry notes that RSA ordinarily requires a builder to hold a proportion of their capital (usually equivalent to 10 per cent of their turnover) inside the trading entity undertaking the building project. Where a builder cannot inject capital, RSA in practice has been requesting a bank guarantee. Reward Insurance does not require a builder to recapitalise their trading entity (although this of course is an option for a builder). Rather, Reward usually requires a

builder to pledge tangible security (e.g., property title deeds) or cash (usually equivalent to 20 per cent of their turnover).

Builders noted that where they could not provide sufficient assets, or obtain adequate bank guarantees, the level of insurance they could obtain was restricted.

The requirement to increase equity or pledge assets reflects the nature of a last-resort insurance scheme, where insurance is accessible if the builder dies, disappears or is insolvent. As a consequence insurers require the entities they underwrite to be adequately capitalised to reduce the occurrence of builder insolvency. Some consumers have observed that one by-product of this requirement is the generally improving financial robustness of many operating builders.

The underwriters' security requirement was often cited as oppressive for young and/or undercapitalised builders. This requirement is a by-product of the current scheme. On the eve of submission of the Inquiry's final report, RSA announced a new product offering that provides insurance for a material increase in turnover (up from \$1 million to \$2 million). This product, we are told, can be accessed by small builders relatively quickly.

Alternative models may address this concern but, as detailed later in this report, the Inquiry was unable to recommend an early move to a totally new model (See Option 4 later).

Regulatory control levels

Many consumers are concerned that there is a lack of regulatory intervention during the construction period, indicating that many problems, if addressed early could be rectified immediately, resulting in fewer claims.

Many builders felt insurers were quasi-regulators of the industry and that the regulatory role should only be undertaken by the scheme's regulator.

"The only logical, sensible approach, is to take that power away from insurers and to institute a system that is fair to all, that provides confidence in a licencing system, that delivers protection for all, and profitable enough to cover

claims and contingencies, and still have enough left over for both consumer and industry education.”

(Submission: Builders For Active Industry Reform)

Builders were also concerned about the adverse affect on the industry by a small number of builders who operate with low standards and were not excluded by the licencing process.

Many builders and consumers indicated that the principal regulatory tool should be the licencing stage and the subsequent enforcement of licences. In particular, if licencing is to be the principal gateway, the licencing tool could be more effective if it comprehensively addresses financial soundness, skills and experience and is also linked to continuing professional development.

Some insurers also noted that “under insurance” has been occurring in the absence of licence condition enforcement.

Insurers commented on the need to address “phoenix companies”, when a builder closes a business on one day and opens up a new entity shortly thereafter, to avoid meeting obligations.

Dispute resolution timeframe

Some consumers indicated that the CTTT is effective in addressing small claims. However, where there is a material claim against a builder, some of which exceed the scheme’s \$200,000 maximum cover, resolution can incur considerable time and cost. Many consumers also emphasised the stress and emotional trauma associated with pursuing claims. Some consumers felt disadvantaged and discouraged from attempting claim resolution through the CTTT.

Perceived CTTT bias

Some consumers asserted that certain CTTT members are biased towards the builder and do not objectively assess their individual concerns. Not surprisingly, some builders feel the CTTT is biased towards consumers.

Insurance cover levels

Some consumers provided examples of claims that were estimated to cost more than the \$200,000 insurance cover provided. These consumers felt the scheme did not provide sufficient cover.

Builders indicated the level of cover available to them was insufficient for construction levels they sought to undertake.

Access to last-resort cover

Consumers expressed their dissatisfaction with this aspect of the scheme. Many indicated they did not understand how the insurance policy worked and that its purpose was not clearly communicated to them prior to construction.

The “last resort” nature of the current system requires consumers to exhaust all avenues of action against the builder, even to the point of bankruptcy or liquidation, before the insurance can be accessed.

Insurers noted that a first resort insurance scheme:

- Can be difficult to maintain
- Is unstable
- Could work against encouraging builders to rectify problems.

Insurance for high-rise construction

Almost all parties met by the Inquiry stated that high-rise construction projects (three storeys and greater) are fundamentally commercial projects. Accordingly, project risks are materially different to those of an ordinary house construction.

A high-rise construction ordinarily poses minimal risk to a consumer during the period of construction. In the event that a consumer buys off-the-plan, any funds paid are held in trust and only released at the time of completion. Alternatively, if a consumer buys post-completion, the only realistic risk is from defects occurring during the warranty period.

The Inquiry found high-rise projects are often developed through a consortium: a developer, financier, builder, architect and engineer(s). If a builder becomes insolvent during construction the other parties in the consortium are at risk. The Inquiry also notes that developers and builders are generally larger organisations with more robust financial management than small builders, reducing risk (although increasing the impact) of insolvency. Often, a financier will monitor the developer/builders' financial security to some degree during construction.

The Inquiry received 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. These key stages could include areas most frequently reported as the cause of problems, such as:

- Waterproofing
- Fire and noise rating
- Balcony drainage/design.

The Inquiry notes that New South Wales is the only State requiring mandatory cover for high-rise projects.

Insurers and reinsurers indicated they will not underwrite high-rise developments. They highlighted the accumulation of risk associated with these projects; that is the potential for a defect occurring in one unit to extend across all units.

Indeed, submissions consistently called for high-rise to be removed from the Scheme.

"No distinction is made between single or multi-unit developments. Note – Insolvency of builders in single dwelling is the insurers problem, on a multi-unit development, it is the developers."

(Submission: Brian Burden of Stuart Pty Limited)

“The Government could elect to exempt high-rise development from the Home Warranty Insurance requirements and remove this section of the domestic building sector from the Home Warranty Insurance market.”

(Submission: Master Builders Association of NSW)

“We submit that suspension of the compulsory insurance scheme in respect of multi-unit projects is the preferable course.”

(Submission: Gadens Lawyers)

Insurance for high-value homes

Builders of high-value homes presented examples of specific problems. Builders noted that in some instances they were unable to provide sufficient capital to obtain the required level of insurance needed to construct the project. The Inquiry notes that the proportion of high-value housing projects represents approximately three percent of homes constructed.

A level playing field

None of the insurers want non-APRA approved underwriters in the NSW Home Warranty insurance market. They indicated that the entrance of non-APRA approved underwriters would create an uneven playing field. Allowing less financially sound entities to carry risk would also create long-term market instability.

Number of insurers

Assuming the scheme remains privately underwritten, almost all parties supported additional insurers underwriting the market. Additional insurers entering the market should provide greater competition which ought to lead to enhanced service standards and a more efficient offering of Home Warranty Insurance.

“We are on record as saying that we welcome new entrants to the market, so long as all risk carriers were treated equally from a capital requirements and prudential regulation perspective. We continue to hold that position.”

(Submission: Royal & SunAlliance).

However, this class of business is relatively small and could only support one or possibly two additional underwriters.

“Bearing in mind the market premium volume emanating from this class it is obvious that only a small number of insurers/reinsurers would be sufficient to service the market enabling them to establish books of business which are economical to run taking the longevity of this cover into account.”

(Submission: Munich Reinsurance Company of Australia).

Builders and consumers expressed strong concern with past insurance market instability, noting that insurance failures had caused significant distress to consumers and builders. If insurers are to remain underwriting the scheme then appropriate regulation of insurers was obviously desirable.

Enhanced resourcing of, and more aggressive prudential regulation by APRA, as recommended by Commissioner Owen in the HIH Royal Commission, should assist the stability of the underwriting community. However, it should be noted that global insurance and reinsurance trends can and might impact on local underwriters, even though both current players are domiciled in Australia and are Australian owned.

Licencing scheme

Under the current scheme, the Home Building Service administers builders' licences. Many consumers, builders and insurers, indicated that it is appropriate to strengthen the system's licencing function ensuring it adequately fills its primary gatekeeper role.

One interested party noted that where one entity controls licencing and enforcement a conflict of interest can arise and that handing licencing to an independent body would make licencing more transparent and accountable. However, it is recognised that a licencing body can only be independent if its governance framework is not captured by the industry it regulates.

Restricted access to builders

Some consumers noted that insurance cover restrictions limited the amount of work a builder can undertake. Consequently, they

felt insurance levels restricted their choice of builder although some consumers conceded that the recent increases in building activity may also be a factor.

Mandatory building standards

The lack of mandatory building standards is seen by both consumers and builders as a possible cause of difficulty in the dispute resolution process. A set of standards would provide an objective measure to determine the existence and extent of a defect and the rectification required.

6.0 Scheme reform principles

Hallmarks of a robust scheme

The Inquiry identified certain hallmarks that, if met, should provide for a robust, stable scheme. The hallmarks are discussed below.

Accessibility

The scheme must be accessible to both builders and consumers. Importantly, builders eligible for insurance should access that cover through a timely and transparent process.

Affordability

Insurance must be affordable to consumers. The Inquiry notes that while the builder obtains the insurance, the cost is often passed directly or indirectly to the consumer.

Fairness

The scheme needs to be, and seen to be, fair. While any compulsory insurance scheme is unlikely to fully satisfy all parties, it is important that a balance is obtained to satisfy the scheme's ultimate purpose – consumer protection.

Efficiency

A compulsory scheme must efficiently address mechanisms to obtain insurance, manage disputes and resolve claims.

Viability

The scheme must have long-term financial viability. A scheme that cannot support itself in the long-term is destabilising and, as evidenced through the collapse of HIH and the withdrawal of

Dexta, can cause significant distress to both consumers and builders.

Other criteria

In addition to the hallmarks of a robust scheme identified by the Inquiry, the following criteria were also taken into account in forming recommendations.

National consistency

Australia's two largest schemes are in New South Wales and Victoria, accounting for approximately 75 per cent of the nation's Home Warranty Insurance market.

The two schemes are broadly similar, which the Inquiry recognises as important for encouraging better practice, sharing of experience and encouraging building industry stability across these two States. If the scheme is to be privately underwritten, reasonable consistency between New South Wales and Victoria will be important to insurer operating efficiencies relating to information technology, administrative systems and staffing costs.

Implementation risk

Scheme reform will always carry an element of implementation risk. Change is often best achieved through a staged and well-managed transition process.

Urgency for change

The extent and consistency of recurring criticisms supports the need for early change. However, it is clear that each option considered in the next chapter will take a good deal of effort and of necessity, elapse of time to bring into effect. Radical options are likely to take longer to develop and implement.

Finding a balance

Any mandatory statutory scheme must balance the often competing pressures and differing strategic and commercial objectives of the various stakeholders and service providers. A

scheme can still be reasonably regarded as robust notwithstanding a degree of compromise imposed on many or indeed most of the stakeholders and service providers.

7.0 Options

The Inquiry considered six reform options.

- Option 1: Implementation of the 2002 reforms
- Option 2: Accelerated enhancements to current scheme
- Option 3: An industry scheme
- Option 4: Consumer Home Cover
- Option 5: A government scheme
- Option 6: A voluntary scheme.

Each option was evaluated against the principles identified in Section 6 and the recurring criticisms noted in Section 5.

Option 1: Implementation of the 2002 reforms

Overview

Option 1 is the “as is” scenario. This option requires no further legislative change. Following the Campbell Inquiry, the New South Wales and Victorian Governments jointly announced statutory reforms for Home Warranty Insurance in those states, including:

- Warranty coverage only as a matter of last resort – i.e., only in the event of a builder insolvency, death or disappearance
- Raising the threshold for building work requiring Home Warranty Insurance cover \$5,000 to \$12,000
- Reducing the cover period for structural defects from seven year to six years and two years for all non-structural defects
- For claims involving non-completion of work, instituting a limit of 20 per cent of the original contract price, up to a maximum claim of \$200,000
- Creating the Home Building Service with additional resources devoted to enforcement and on-site mediation activity. The Home Building Service has early dispute intervention facilities by allowing its inspectors to facilitate on-site mediations, although such mediations are not binding on either the builder or the consumer
- Introducing a financial test as part of the licencing process.

The Campbell Inquiry also recommended removing the requirement for high-rise multi-unit developments to carry Home Warranty Insurance although this recommendation was not adopted in New South Wales.

Since the 2002 reforms, the Home Building Service has been established and commenced operations from 1 July 2003. The Home Building Service has also undertaken the following:

- Released consumers and builders' information packs describing the effect of the 2002 reforms
- Released the Standards & Tolerances Guide
- Recruitment of an approximately 26 inspectors and 20 investigators to undertake on-site inspections across New South Wales
- Developing a financial test for builders' licences (still to be implemented)
- Developing new standard contract terms (still to be implemented)
- Introducing licencing for building consultants for prepurchase inspections (still to be implemented)
- Pilot testing an Advice and Advocacy centre for consumers (still to be implemented)
- Developing for insurers the conditions of approval to become an approved insurer and code of conduct (still to be implemented).

Discussion

The Inquiry has considered the 2002 reforms and found that they are important steps towards the establishment of a stable scheme. It is noted that many of these recommendations are yet to come into effect or are currently being developed for implementation. The implementation risks with Option 1 are inherently low as the required statutory amendments have already occurred.

While the 2002 reforms are important, the Inquiry found they are unlikely to assure long-term scheme stability. Further reform in the following areas is desirable:

- Establish an appropriate governance mechanism to provide Board oversight for the scheme (including insurer activity)
- Develop stronger licencing conditions to reflect the financial soundness of the builder and also the builder's skills, experience and continued professional development.

In addition, ongoing oversight of dispute resolution is also required to ensure existing arrangements are efficient and effective.

Should a new insurer enter the market, under Option 1, there are no mechanisms to ensure a smooth transition and consequently, entry of additional insurers may be destabilising.

Many of the recurring criticisms raised by stakeholders and service providers are not addressed under this option, which in the long-run could destabilise the scheme.

Option 2: Accelerated enhancements to current scheme

Overview

Option 2 builds upon the existing scheme, including key measures to foster greater long-term scheme stability.

Under Option 2:

- The scheme remains “last resort”
- Builders continue to obtain insurance
- A Scheme Board and Advisory Council are created
- A regulatory model for insurers is created
- An Industry Deed controlling the smooth entry of insurers into the marketplace is created
- A separate licencing division is created. The licencing division reports directly to the Scheme Board in relation to licencing performance
- A strengthening of the licencing process and continuing enforcement of the licencing conditions
- High-rise developments are excluded from the scheme, subject to an appropriate certification process.

Last resort insurance

The ‘last resort’ nature of the insurance would remain unchanged and insurance, obtained by builders, will provide consumers with cover only in the event the builder dies, disappears or becomes insolvent.

Under this model, insurers are still required to underwrite the builder solvency. Thus underwriting disciplines placed upon builders by insurers remain.

Creating a Scheme Board and Advisory Council

The creation of a Scheme Board is critical to achieving effective governance of the scheme. The Scheme Board should be comprised of independent directors with an appropriate mix of skills and experience. The Scheme Board directors must be

independent to allow them to fulfil their individual fiduciary obligations without the constraint of vested interest group representation.

The Inquiry examined alternate board structures, including the governance of the New South Wales Motor Accidents Authority. Under that model, the Board is comprised of the scheme's General Manager and five part-time independent, professional directors.

An adjunct to the Board is an Advisory Council of key stakeholders and service providers. The Council is thus well qualified to consider practical scheme issues. The Minister appoints the members of the Scheme Board and the Advisory Council.

Under this model the Scheme Board would comprise the Director General of the Department of Commerce (or delegate) and five part-time independent directors. Of the part-time Directors, one is to be appointed Chairman of the Board and one Deputy Chairman. The Scheme Board will be responsible for:

- Ensuring that regulatory functions are carried out properly and efficiently (licencing, enforcement, dispute resolution and regulation of insurers)
- Monitoring scheme integrity against Government objectives
- Recommend scheme changes to the Minister
- Providing independent guidance to the executive of the Home Building Service
- Approving the Corporate Plan for the Home Building Service and monitor progress using performance indicators and key priorities
- Approving the budget and annual accounts for Home Building Service.

The Scheme Board is not an executive board. Day-to-day management responsibility remains within the Department of Commerce, Office of Fair Trading and Home Building Service.

The Advisory Council will be a forum for key stakeholders and service providers to discuss scheme issues. The Council will comprise 12 members as follows:

- The chairman and deputy chairman of the Scheme Board
- The Director-General of the Department of Commerce or nominee
- Two representatives from the insurance industry, appointed by the Minister in consultation with the Insurance Council of Australia
- Two representatives of the building industry, appointed by the Minister in consultation with the MBA and HIA
- Two licenced builders, appointed by the Minister
- Two consumer representatives, appointed by the Minister
- One legal representative appointed by the Minister in consultation with the Councils of the Law Society and Bar Association.

The Scheme Board Chairman will also chair the Advisory Council, helping to ensure that the Council does not diverge too much from core issues.

This thinking closely resembles the governance structure of the New South Wales Motor Accidents Authority which is regarded by most observers as an effective and appropriate arrangement for a statutory scheme.

Introduction of a regulatory model for insurers

The New South Wales Home Warranty Insurance market was subject to considerable volatility following HIH's collapse and Dexta's withdrawal from the market.

The Inquiry discussed the option of introducing regulatory control over private insurers, in addition to APRA's existing prudential and regulatory requirements. The Inquiry found that regulatory oversight of insurer underwriting practices is appropriate for a statutory insurance class. The Inquiry considered a regulatory model whereby the regulator examines insurer pricing and cost structures to assess whether insurers obtain an adequate but not excessive return on capital. This approach promotes scheme stability and encourages insurers to remain long-term underwriters of the scheme.

Such an approach should also facilitate collection of scheme data to help the Scheme Board assess scheme performance and improve transparency.

The Inquiry notes that the New South Wales compulsory third party motor vehicle accidents scheme has effectively imposed a similar regulatory requirement upon insurers. Under this model, before an insurer can operate within a predetermined premium regime, a submission must be lodged with the regulator. The submission must include the derivation of the insurer's risk premium, and must explicitly identify all costs to be incurred by the insurer in acquiring the business, claims handling expenses and profit margin. The regulator disseminates Premium Determination Guidelines, approved by the Board, and insurers must abide by these guidelines in their filings. Insurers must file at least once a year. The regulator has the power to reject a filing, but there is also room for negotiation.

The Motor Accidents regulator also issues Market Practice Guidelines (essentially, a code of conduct) and Claims Handling Guidelines with which the insurers must comply. The regulator investigates non-compliance, on an exception basis, when complaints have been brought to the regulators attention and additionally performs regular compliance audits.

Industry deed

Long-term scheme stability is an important outcome for all parties. Entry of additional scheme underwriters introduces the possibility of scheme disruption. An industry deed, which is an agreement between the major stakeholders and service providers, is a mechanism used in some other statutory schemes.

For the Home Warranty Insurance scheme, an industry deed could comprise a non-binding agreement outlining the key parties' cooperative commitment to the scheme.

The industry deed could address:

- Insurer commitment to underwriting the scheme for an agreed period
- Government commitment not to materially intervene in the scheme, thereby allowing it to mature

- Key industry organisation commitment to developing key initiatives, including licencing and professional development.

Insurers indicated that creating an industry deed may also assist in attracting new underwriters to the market. The industry deed could also be a mechanism to assist the smooth entry of new insurers, minimising disruption to consumers, builders and existing underwriters.

The Inquiry notes that the industry deed would not preclude new insurers from entering the market, nor would it support collusive practices or restrict trade. In fact, the industry deed serves to improve transparency of regulatory and commercial arrangements and this should assist market competition.

Strengthened licencing process

Licensing requirements are the principal gateway determining whether a builder is eligible to build. The Inquiry recognises that certain licencing requirements were considered in the Campbell Inquiry and supports the timely introduction of a licensing system that includes:

- A financial test - noting that Home Building Service is currently developing a financial test for inclusion in their licencing system.
- Transparent reflection of the individual builder's skills and experience.
- The introduction of mandatory continuing professional development.

The Home Building Service anticipates introducing mandatory Continuing Professional Development to New South Wales in January 2004. Under the proposal, contractors will be required to accumulate a specified number of points, by attending professional courses, over three years. Self-certification will be achieved by maintaining a training diary. Builders unable to certify the minimum number of points over the required period will be refused licence renewal. Random compliance audits will be conducted ensuring system integrity.

The Inquiry also notes the recent Queensland licencing reforms, in particular the creation of strong linkages between licences, training and competency assessments. Specifically:

- Introducing a rigorous process for competency assessments, where applicants who do not have formal qualifications are required to have their skills assessed by an registered training organisation
- Linking all licence classes to nationally recognised qualifications.

The Inquiry notes that from 1 September 2003, Queensland has also made it an offence for a builder to engage an unlicensed contractor, ensuring that all trade contractors on site are licensed.

Under this model, a licence grading system could be introduced as a means to tie financial capacity, skill and experience and professional education levels to the different grades of licence. The grade of licence held by the builder would determine the type of building activity that could be undertaken. For example, a builder with a healthy balance sheet, significant skill and experience, and relevant education/qualifications could undertake high-rise construction. Smaller and/or younger builders would be limited to smaller housing projects until they develop further experience.

The Inquiry affirms that licencing reform is critical to long-term scheme stability and acknowledges that reform in this area is a priority for the Home Building Service.

The strengthened licencing process is intended to work in conjunction with the insurer's underwriting function.

Under this model, the licencing function is an autonomous unit within the Office of Fair Trading reporting to the Commissioner on administrative and executive issues. It will also report to the Scheme Board on the performance of the licencing function. The licencing unit and the Home Building Service will actively share data.

Dispute resolution model

Consumers and builders are concerned that current dispute resolution processes do not encourage efficient and fair resolution. The Inquiry considered a range of alternative dispute resolution

options, including the New South Wales Motor Accidents Authority dispute and claims resolution model.

The Inquiry recognises that the current dispute resolution framework operated by the CTTT is relatively new, having commenced in February 2002, with early on-site intervention by Home Building Service's inspectors starting on 1 July 2003.

The Inquiry notes that the inspectors have a quasi-dispute resolution role including the power to issue rectification orders. The integrity of such a role must be carefully monitored. The Inquiry is concerned that a real or perceived conflict of interest may exist between the inspectors' powers to mediate on-site and issue rectification orders and their obligations to the Home Building Service as the licencing authority. Hence the thinking under the previous heading regarding separation of the licencing function.

The current approach to dispute resolution must be carefully monitored and this will be a key responsibility of the Scheme Board. The Inquiry notes the level of skill, experience and remuneration of these inspectors also requires careful monitoring to ensure individual inspector effectiveness.

Exclusion of high-rise developments

As noted earlier high-rise construction projects are fundamentally different from stand-alone houses. High-rise housing projects are commercial projects, generally undertaken by a consortium. The Inquiry found that the consumer faced minimal risk during the construction period. If during construction the builder died, disappeared or became insolvent, the onus of responsibility to complete the project falls upon the developer.

The key consumer risk in high-rise projects is construction quality, thereby minimising the incidence of warranty-related claims, post-completion.

Under Option 2, high-rise projects are removed from the scheme reflecting their fundamentally different nature. Excluding high-rise developments is nationally consistent and recognises the reinsurers' low appetite for such risk.

The Inquiry also found that maintaining building quality is essential for post-construction consumer risk minimisation. To assure this outcome, the Inquiry found that excluding high-rise projects could only occur if independent certification is undertaken at key construction stages. A regulator-approved certifier would undertake the certification. The process could also address common high-rise construction rectification issues.

The Office of Fair Trading recently released an issue paper, *Living in strata developments 2003*, which includes discussion on key issues relating to strata title arrangements, including maintaining an appropriate sinking fund, quality of building and governance of strata arrangements. The Inquiry recognises that reform in these key areas is important to existing strata arrangements and future high-rise development. The early establishment of approved certifiers should assist in improving the quality of high-rise developments.

Discussion

Option 2's features were developed in discussion with stakeholders and were designed to establish the foundations of a stable scheme.

Option 2 provides reforms and/or ongoing oversight to the three underlying fundamentals considered by the Inquiry:

- Appropriate scheme governance
- A robust licencing regime
- A fair and efficient dispute resolution process.

In considering the features of Option 2, particular regard was had for the governance, licencing and dispute resolution framework that operate in the Queensland scheme. The Inquiry found that Queensland is realising the benefit of a stable scheme, that has been given time to mature and is underpinned by effective governance, licencing and dispute resolution. Such thinking and structure was drawn upon by the Inquiry.

The key features of Option 2 are the creation of a Scheme Board and Advisory Council. The Scheme Board will be the mechanism that provides ongoing scheme oversight. The Scheme Board will advise the Minister on all scheme aspects and also refer issues to the Advisory Council for discussion. The Inquiry believes that the creation of this governance model provides the necessary oversight mechanism to promote long-term scheme stability. The Master Builders Association similarly concluded:

“Master Builders is also supportive of the creation of a Board/Governance Model to supervise the scheme; one of the real problems in the current approach is the fragmentation of authority between Agencies (and indeed Ministries).”

(Submission: MBA National)

The Inquiry also found that a stronger, more comprehensive licencing system is highly desirable. An effective licencing system provides the principal regulatory function. Under Option 2, although insurers will still separately underwrite individual builders, a stronger licencing system should better reflect insurer underwriting requirements.

The Inquiry also supports the introduction of a grading system that transparently and systematically grades all builders. A grading system would serve to differentiate classes of builders and tie the type of building activity to the grade of licence. For a builder to move to a higher grade, there would be a requirement to demonstrate stronger financial capacity, skill and experience and completion of relevant professional education requirements. A transparent grading system would also assist consumers in readily identifying the suitability of a prospective builder.

The Inquiry considered who would be best placed to develop and operate a grading system, and in the absence of any independent private sector interest, found that the licencing regulator should provide the grading service.

The Inquiry supports an efficient and fair dispute resolution system. Protracted defect or contract disputes are not in the best interests of builders or consumers. A dispute resolution process promoting early intervention that is carefully case managed and

subject to a defined dispute resolution framework, is likely to reduce dispute numbers and duration. The Inquiry notes that the current dispute resolution framework is relatively new and the Scheme Board will need to monitor it carefully.

The Inquiry considered the implementation risk associated with further reform of the existing scheme. The implementation risk associated with legislating the Option 2 reforms is low and they could be effected relatively quickly.

Option 3: An industry scheme

Overview

The Inquiry received several proposals for industry schemes.

Based on the proposals presented to the Inquiry, common features of an industry scheme include:

- A first resort “warranty” scheme
- Access to insurance for all licenced builders
- The regulator to be the only licencing authority
- High-rise projects to be excluded from the scheme
- The reinsurance market to assist in providing reinsurance capital and expertise in establishing a new underwriting entity.

Some builders’ associations even suggested separate, regionally focussed industry schemes.

The Inquiry considered each of the proposed options and examined industry based insurance schemes operating in other jurisdictions.

The proposals submitted to the Inquiry provided a conceptual framework outlining the functions of an industry scheme.

“We are sure that with the help of the QLD Building Services Authority the Inquiry could properly recommend to the Government with direct Government support or management, or utilising an industry scheme backed by Government assistance or backed by reinsurance a Queensland scheme could be implemented in New South Wales.”

(Submission: MBA NSW).

The Inquiry noted that, in principal, the current legislation would allow the creation of an industry scheme, subject to Ministerial approval.

Discussion

The Inquiry noted that the proposals submitted require significant development in relation to operational and implementation issues.

In particular, all the proposals were based upon a non-APRA approved insurer underwriting the risk. As a consequence, the industry insurer would be outside APRA's regulatory scrutiny and run the risk of being undercapitalised by potentially not meeting minimum capital requirements for general insurers.

Insurer insolvency as a result of under-capitalisation will of course have a detrimental impact on the scheme and cause significant disruption to the domestic building industry. An inadequately capitalised and poorly regulated scheme is not in the interests of builders or consumers.

As highlighted by the Barrett (1998) Inquiry into the "leaky condo crisis" in Canada there are profound and unfortunate ramifications of an undercapitalised home warranty insurer failing, in part, through lack of regulatory oversight.

Although APRA scrutiny does not guarantee against insurer failure, such scrutiny must surely be desirable.

The following quote from the Housing Industry Association submission to the Inquiry is a timely reminder of some recent problems:

"The United Medical Protection Fund that recently collapsed in Australia is a recent example, as is the New Home Warranty (NHW) Fund in Canada which collapsed in 1999. NHW was established by the Canadian Home Builders Association of British Columbia as a "non profit" venture. It operated in competition against insurance policies sold by underwriters and captured a large share of the market.

On the basis of historical claims history NHW believed it had accumulated significant annual operating surpluses. NHW had set aside a "reserved fund" but did not have appropriate reinsurance protection or catastrophe cover.

In the later 1990's numerous claims arose in British Columbia over damage caused by water ingress to between 300-600 residential buildings, resulting in

the collapse of NHW. The collapse became known as the “leaky condo crisis” with direct report costs of around \$500 to \$800 million and an ultimate cost to British Columbia of over \$1 billion dollars. This was a major catastrophe for their economy and the Government was forced to implement a relief program of providing grants and interest free loans to homeowners to assist in meeting the cost of repairs.

Litigation is still ongoing against designers, architects, engineers, contractors as well as the municipal authorities that approved the building works resulting in the restricted availability of Professional Indemnity Insurance.

The NHW model is now internationally recognised as being flawed and British Columbia has subsequently passed the Homeowner Protection Act, requiring Home Warranty Insurance to now be prudentially regulated by the Canadian Financial Institutions Act, the equivalent prudential framework that which APRA operates in Australia.”

(Submission: Housing Industry Association).

Insurers and reinsurers also expressed this concern, with both commenting that the entry of a non-APRA approved insurer would destabilise the scheme.

“One other comment we wish to make is that all HW business should ideally fall under the regulation regime of the local insurance authority, avoiding opportunistic entries into the market.”

(Submission: Munich Reinsurance Company of Australia).

The Inquiry also notes that Option 3 relies on attracting appropriate reinsurance expertise and capital. The Master Builders Association of New South Wales has been working on developing an industry model. The MBA has been actively seeking the involvement of a reinsurer or underwriter to support such a model. To date, only a qualified expression of interest has been provided to the MBA by an insurer domiciled in the United States of America. Notwithstanding, the Inquiry understands that the insurer involved will not be APRA compliant.

More concerns with this option were expressed by the Housing Industry Association:

“The regime encapsulated in the ACT and Tasmanian Funds are considered inherently flawed, in that they:

- *Enable an inappropriate and prudentially deficient entity, ie. a mutual fidelity fund, to offer what is effectively an “insurance product” to consumers and carry on an “insurance business”.*
- *Operate outside of the established prudential framework for insurers and insurance business which is nationally regulated by the Australian Prudential Regulatory Authority (APRA) and Commonwealth legislation including the Insurance Act 1973, the Insurance Reform Contracts Act 2001 and the Insurance (Agents & Brokers) Act 1984.*
- *Do not guarantee that the prudential regulation of “insurance business” and “fidelity fund schemes” will be of equal standard to that which applies to “approved insurers” and “residential building insurance policies”.*
- *Establish single product funds to small isolated markets and hence lose the ability to spread claims losses across other product lines and other States.*
- *Create an anti competitive market environment, where the Funds will have a significant trading advantage over the other insurance businesses which are compelled to satisfy the full prudential requirements and scrutiny of APRA.”*

(Submission: Housing Industry Association).

The Inquiry notes that other features of Option 3 relating to licencing, governance and dispute resolution as outlined in Option 2, could be a feature of an industry scheme.

The Inquiry found that Option 3 carries high implementation risk. Further, if an industry scheme was to be pursued the Inquiry estimates that it would take at least 12 months to develop such a scheme, assuming reinsurance capital could be secured, with a further three to four years to achieve scheme functionality.

Lack of critical mass, even greater capital constraints and probable lack of expertise, mitigate against smaller regionally focussed industry schemes.

Should an industry scheme be formed and ultimately collapse, it is the industry that stands behind the scheme and accordingly, it is the industry that would pay for any shortfall in assets to meet all claims liabilities.

The Inquiry also notes that the New South Wales Government tests all its policy and statutory systems against the National Competition Policy. Under the National Competition Policy, governments are required to test whether a public monopoly is in the public interest or whether an equivalent or better standard of service could be provided by the private sector. While the Inquiry has not undertaken a full public-benefit review of industry schemes, the creation of an industry monopoly appears insupportable when private sector insurers are willing to provide an equivalent service.

As noted earlier in Chapter 6, New South Wales and Victoria account for approximately 75 per cent of the nation's home warranty market. The schemes in these two states are broadly similar and compelling reasons would have to exist for New South Wales to move in a different direction.

Finally, considerable work will be required to create a properly functioning industry scheme. This will obviously take time and the risk of instability and uncertainty in the meantime cannot be ignored.

Option 4: Consumer Home Cover

Overview

This option is underpinned by a different underwriting philosophy to each of the options discussed in this section. It has been developed throughout the course of the Inquiry with a view to hypothetically and logically providing an alternative that satisfies the scheme reform principles and recurring criticisms.

This option has been examined with a number of stakeholders during the inquiry and their concerns are documented.

The key elements of this scheme are:

- A “second last resort” product **purchased by consumers** rather than builders
- Compulsory cover up to \$200,000 for all building works including owner-builders, with an excess component:
 - Insurers would be compelled to provide this cover
 - Consumers could voluntarily top-up to a higher level of cover although provision of additional cover would be at the insurer’s discretion
 - Cover for both structural (six years) and non-structural (two years) defects in workmanship.
- Premiums would be based on contract value and the builder’s “graded” licence
- A robust licencing regime governed by an independent licencing board:
 - Graded licences reflecting the financial capacity, skills and experience and Continuing Professional Education of each builder
 - Strong enforcement of license conditions including a demotion in licence for material breaches by a builder.
- An aggressive dispute resolution model
- Compulsory certification of high-rise and multi-residence construction

- Introduction of a regulatory model for insurers
- Creation of an Industry Deed to smooth entry of additional underwriters
- Creation of Board/Governance model to govern the scheme.

A “second last resort” product

Under Option 4 insurance cover would be purchased directly by consumers rather than by builders.

In order to access their cover, consumers will be required to progress through a dispute resolution and claims assessment model. The cover is a “second last” resort as the consumer will be eligible for insurance once judgement against the builder has been obtained without having to prove the builder’s death, disappearance or insolvency.

Compulsory cover up to \$200,000 with an excess component

Under Option 4, all consumers will be required to obtain Consumer Home Cover. Every consumer will be eligible to obtain the minimum level of insurance (\$200,000), with the insurer compelled to offer such cover. Consumers seeking additional insurance negotiate separately with the insurer.

Under this option owner-builders will also be required to obtain insurance.

Premiums based on contract value and “graded” builders’ licence

The premium paid by consumers would be based on the contract value up to \$200,000 (with an option for additional cover) and the type of “graded” builders’ licence. In conjunction with this approach a new robust licencing regime is essential to accurately grade each builder.

For example, a consumer would be charged a standard premium relative to contract size, and would be eligible for an adjustment on the standard premium to reflect the type of graded licence.

A robust licencing regime

Underpinning this approach is the creation of a robust licencing regime capable of grading and differentiating builders based upon financial capability, skills, experience and professional development.

It would be desirable to establish a separate licencing function reporting to the Scheme Board. The licencing function would have the important responsibility of determining the licencing regime while also grading each builder. The Inquiry found that separating licencing and enforcement creates increased accountability within the licencing function. It is recognised that data would need to be shared between the licencing function and the other arms of the Home Building Service.

For the licencing process to be effective, strong enforcement of licence conditions by the enforcement authority will be required. Penalties, including licence demotion for material breaches, will therefore need to be imposed.

A new dispute resolution model

The model will adopt the same principles as outlined in the Option 2 dispute resolution and claims management model, being early intervention and statutory timeframes for dispute resolution.

Because of the importance of confronting and resolving disputes quickly, it will be important to ensure that the dispute resolution administrative infrastructure is sufficiently resourced and supported.

Features common with Option 2

Option 4 includes many features common with Option 2:

- Creation of a Scheme Board and Advisory Council
- Introduction of a regulatory model for insurers
- Creation of an Industry Deed to control the smooth entry of insurers into the marketplace.

These fundamental elements are required for long-term scheme stability, irrespective of the underwriting philosophy. Under Option 4, high-rise projects are also excluded from the scheme.

Discussion

The Inquiry developed Option 4 as an alternative model based upon a fundamentally different underwriting approach. While Option 4 is considered attractive, the Inquiry notes that such a radical change entails significant implementation risk.

The Inquiry notes concerns expressed by insurers and reinsurers regarding the feasibility of immediately relying upon the regulator's ability to develop, implement and enforce a robust licencing regime. In particular, Option 4 denies insurers the ability to directly underwrite builders; rather they specifically rely upon the effectiveness of the licencing regime to set premiums.

In discussing Option 4 with insurance and reinsurance representatives, none indicated their support for such a model at this time. In particular, insurers and reinsurers will require evidence that the new licencing function is effective and stable.

Some builders were also concerned that the licencing regime proposed would be unnecessarily harsh in classifying builders into different licence classes.

Insurers indicated such a radical change in the underwriting approach would require reinvestment in existing underwriting and claims management systems to meet the new system's requirements. Insurers were unable to confirm their preparedness to commit fresh capital to a new scheme and consequent development costs to underwrite it.

Insurers and reinsurers expressed concern that the dispute resolution model outlined in Option 4 could encourage consumers and builders not to reach resolution and instead wait for the insurance claim to be paid. They saw that the dispute resolution model proposed under Option 4 represented a return to the quasi last-resort scheme that existed prior to the 2002 legislative reforms. The Inquiry notes that if this were to occur, builders could be penalised in the form of licence demotion (if the breach was sufficiently material) and higher premiums.

The fundamental change towards a consumer product, as envisaged under Option 4, is not nationally consistent. However,

this inconsistency could be tolerated if it was thought that a generally stronger scheme could be created in New South Wales based on this thinking.

Option 4's implementation risk at this time is high. For example, such radical change could be undermined if a strong licencing regime is not designed, implemented and enforced. The implementation risk of Option 4 can be significantly reduced if most of the changes discussed in Options 1 and 2 are effected and have had time to achieve full functionality.

Option 4 is thus considered by the Inquiry to be conceptually desirable, representing a possible future pathway for the scheme.

Option 5: A Government scheme

Overview

The Inquiry received submissions preferring a return to a government run scheme, similar to the Queensland Building Services Authority (QBSA) model.

The Inquiry considered options for a government scheme, including assessing the effectiveness of the Queensland Building Services Authority model and its potential applicability in New South Wales. Key features of the Queensland scheme are included in the table below.

Overview of Queensland Building Services Authority
The Queensland Building Services Authority is a Statutory Authority established under the <i>Queensland Building Services Authority Act 1991</i> (QBSA Act).
The Government underwrites the scheme that is supported by a panel of private reinsurers principally through a quota share reinsurance arrangement.
The objects of the QBSA are: <ul style="list-style-type: none">▪ to regulate the building industry<ul style="list-style-type: none">– to ensure the maintenance of proper standards in the industry– to achieve a reasonable balance between the interests of building contractors and consumers.▪ to provide remedies for defective building work▪ to provide for the efficient resolution of building disputes▪ to provide support, education and advice for consumers, and those who undertake building work.
The QBSA is a body corporate and consists of: <ul style="list-style-type: none">▪ The Queensland Building Services Board. This is comprised of eight members who represent:<ul style="list-style-type: none">– builders and trade contractors (3)– consumers (2)– the accounting profession or the insurance industry (1)– the building and constructions unions (1)– a non-voting member who is a public service officer.

Overview of Queensland Building Services Authority

The General Manager and the organisational unit under the control of the General Manager.

The QBSA Home Warranty Insurance scheme provides protection against non-completion of contract works, rectification of defects and is the only scheme that provides consumers with protection against subsidence and settlement.

The QBSA has overall responsibility for the building industry in Queensland. It is not solely focussed on the provision of Home Warranty Insurance but is divided into five operational divisions dealing with:

- Dispute Management
- Licensing
- Insurance
- Building
- Information and Corporate Services.

Discussion

The Queensland model could not be directly applied to New South Wales without considering each state's particular requirements and the New South Wales Government's appetite to underwrite such risk.

The Inquiry discussed Option 5 with reinsurers who confirmed that even under a government scheme they would only be prepared to underwrite the current last resort product in New South Wales. The reinsurers noted that a movement towards a first resort warranty product could only be achieved when there was effective regulatory control of licencing and enforcement.

As a government scheme in New South Wales would be unlikely to deliver either a "first resort" product or insurance for all builders, then this option cannot be regarded as a panacea.

In New South Wales, the Government has moved away from operating insurance businesses. Accordingly, if the scheme was to be returned to Government, it is likely that the Government

would accept only a low level of risk transferring the balance to private sector reinsurers.

The Inquiry revisited the Dodd Report and the Crawford Report which both investigated the operations of the BSC. The findings of these reports highlight the potential for a government run scheme to be captured by industry. This has the potential to undermine key regulatory controls; including licencing, meaning reinsurers are unlikely to support such a scheme.

Notwithstanding the above, there was some support for a scheme similar to the Queensland model:

“Forget the rhetoric, look past all the wordy submissions and reports, and look again at the one single inescapable fact that has continually come out of all the inquiries, hearings and forums.

The fact is that the only Home Warranty Insurance Scheme proven to be acceptable to builders, consumers, insurers and government, is currently in place and working in Queensland.

We ask you to recommend the implementation of the same system in NSW.”

(Submission: Swimming Pool & Spa Association of NSW Limited).

“The Queensland model if for no other reason than efficiency and ease of access for industry participants is clearly and demonstrably a scheme which would work in New South Wales.”

(Submission: MBA New South Wales).

The Inquiry is grateful for the assistance provided by the Queensland Building Services Authority including the impact of the introduction of Queensland’s new licencing requirements in 1999, which included financial tests similar to those applied by New South Wales’ underwriters.

The Inquiry notes that the financial test in Queensland has four requirements:

- Net tangible asset requirement of between 6 per cent for turnover under \$250,000 down to 2.5 per cent for turnover above \$13.3 million
- A liquidity ratio, of debt to equity of at least 0.8 to 1
- Regular financial monitoring (at least yearly)
- Independent financial review or audit report of the builders’ accounts.

The Inquiry notes that the capital required under the financial test imposed by the underwriters in New South Wales is higher than that in Queensland. However, the underwriters of the New South Wales scheme do not impose the Queensland scheme's other compliance requirements, which are an imposition upon builders. The Inquiry does however recognise the transparency of the Queensland scheme's approach.

Following the 1999 introduction of financial tests in Queensland, more than 1,200 builders exited the licensing system (approximately six per cent of total licenced builders). At the same time there was a significant increase in trade contractor numbers, indicating a shift in homebuilder activities toward sub-contracting.

The Inquiry noted that in Queensland, while the inclusion of a financial test occurred approximately one and a half years earlier than in New South Wales, it had a significant impact on individual builders.

As mentioned earlier, the Inquiry notes the New South Wales Government National Competition Policy requirements and that the 2002 public-benefit review undertaken on the Queensland scheme favourably viewed introducing private underwriting at a later stage. In addition, whilst the Inquiry has not undertaken a full public-benefit review of a government scheme, the creation of a government monopoly appears insupportable when private sector insurers are willing to provide an equivalent service.

A number of the Queensland model's features are unrelated to risk bearance. These elements include a strong licencing function, early and effective dispute resolution and, importantly, a governing board. The Inquiry examined these features and concurs that these aspects are critical to scheme reform. In developing Option 2, the Inquiry considered and indeed adopted many of the Queensland scheme's features in formulating options and recommendations.

Additionally, the same two final points mentioned in the discussion of Option 3 above can be made of the Government scheme: lack

of consistency with Victoria and time to implement with instability and uncertainty in the meantime.

The Inquiry stresses that a government underwritten scheme is not a panacea for solving all concerns expressed by those industry groups advocating such a model. In fact the question of who underwrites the scheme, is a lesser concern relative to creating functioning governance, licencing and dispute resolution arrangements. Accordingly, the Inquiry found that it is in these areas were reform and/or ongoing oversight must be focused.

Option 6: A voluntary scheme

Overview

The final option considered by the Inquiry was a fully voluntary scheme under which consumers are solely responsible for taking out Home Warranty Insurance.

Under Option 6, neither consumers nor builders are compelled to obtain insurance cover.

A number of the elements of Options 1,2, 3, 4 and 5, such as strengthened licence criteria, enhanced regulatory enforcement and an improved dispute resolution process could be implemented under a voluntary scheme. In a voluntary insurance system, these elements are equally important.

Discussion

The Inquiry considered that a voluntary scheme is fraught with risk and does not satisfy the interests of builders or consumers.

The New South Wales scheme and those throughout Australia are compulsory and have been since inception (for New South Wales this was over 30 years ago). For this reason alone it is necessary to pause and reflect on why this is so. In short, the scheme's compulsory nature reflects the importance of providing consumers with a minimum level of protection.

Other home insurance policies such as house insurance and house contents insurance are voluntary. However, the decision to forgo these insurance products can be devastating, as the experience of many consumers in the recent NSW and ACT bush fires attests.

The purchase of a new home is usually the most important financial decision a consumer will ever make although many consumers are uneducated in building and construction issues. This supports the strong need for adequate consumer protection.

If the scheme was optional, it is likely that price sensitive consumers, perhaps the most vulnerable group, would elect to run the risk and not insure.

In the interests of consumer protection, the Inquiry reaffirms the need to maintain a minimum level of compulsory cover.

8.0 Additional matters

Rationalisation of industry bodies

The Inquiry notes that there are a number of industry groups representing builders. The Inquiry met with over 13 groups representing the building industry, hearing many diverging opinions. It is likely that the building industry could achieve change more efficiently and communicate concerns more effectively if the groups were rationalised under one peak industry body. The Inquiry therefore encourages industry groups to carefully consider this possibility.

Licencing of natural persons only

The Inquiry heard many proposals addressing the prevention of “phoenix” company activity. That is, when a builder closes a business on one day and opens up a new one shortly thereafter to avoid meeting obligations.

The Inquiry considered the option of licencing natural persons only. However, potential difficulties with this approach arise for larger building companies. The Inquiry considers that there is merit in issuing licences only to natural persons where the capital base is less than \$500,000. Corporate entities could obtain a licence only if their capital base is above \$500,000.

The Inquiry also notes the importance of the regulator collecting better information on the activities of individual builders to track and isolate “phoenix” company behaviour.

Register of insurance claims

An important source of information for prospective purchasers is previous insurance claims on a property. Accordingly, a system similar to the publicly accessible motor vehicle database (REVS) could be relevant to prospective house purchasers. The Inquiry notes that such a database would complement the existing web-enabled database that allows the public to identify outstanding claims against individual builders.

Mandatory building standards

The Inquiry understands the Building Code of Australia (BCA), which includes Standards Australia building standards is reviewed periodically to ensure their applicability.

The Inquiry noted consumer and builder concern about the absence of comprehensive, mandatory building standards.

The Home Building Service recently issued the *Standards and Tolerances Guide* (July 2003), which may assist consumers and builders to reach early agreement on defects. The Inquiry recommends that the *Standards and Tolerances Guide* be regularly reviewed to ensure it remains up-to-date.

Individual tradespersons

Under current legislation, Home Warranty Insurance must be obtained for any residential building work above \$12,000. For non-structural work, such as painting, the two years' statutory cover is mandatory.

In the case of non-structural work, where no building permit is required, individual tradespersons, such as painters, often undertake work above \$12,000. In practice, this work is often performed without consumer or tradesperson recognition that cover is required. The Inquiry suggests that the proposed Interim Scheme Board consider mechanisms for excluding such work; for

example, excluding the insurance requirement where it is performed without a required development application.

Owner-builder activity

Owner-builder permits are issued to consumers seeking to supervise construction projects themselves. Prior to receiving an owner-builder permit, the consumer must successfully complete a short course.

Many parties with whom the Inquiry met commented on, or provided examples of, the increase in owner-builder activity. The Inquiry sought the Office of Fair Trading's current information on the number of owner-builder permits. The number of owner-builder permits issued in the year ending 30 June 2003 was 16,450. This compares to 23,807 permits issued in the previous year ending 30 June 2002, which represents a 31 per cent decrease.

There are a number of reasons explaining the decline in the permits issued:

- Project homes can be constructed in much shorter timeframes than construction projects supervised by owner-builders.
- There have been significant increases in renovations and additions builder activity. It was suggested to the Inquiry that this work often exceeds the \$12,000 threshold at which insurance becomes compulsory and that consumers and builders are 'stepping around' the requirement to obtain an owner-builder permit.

The Inquiry was unable to accurately determine the volume of non-approved owner-builder activity. The Inquiry suggests that this issue be investigated by the proposed Interim Scheme Board to determine the extent of such activity and consider appropriate measures to reduce non-approved owner-builder activity.

9.0 Recommended approach

Introduction

The Inquiry evaluated, in accordance with the principles identified in Section 5, a range of scheme reform options.

The Inquiry found all options require the establishment of foundations to encourage scheme stability. To achieve this outcome, reform and/or ongoing oversight is required in terms of:

- Establishing an appropriate governance structure
- Building a robust licencing regime
- Ensuring dispute resolution processes are fair and efficient.

Implementing change in these areas is essential to a stable scheme, irrespective of which party underwrites its risk.

The Inquiry commends the early implementation of the 2002 reforms, canvassed in Chapter 7, emerging from the Campbell Inquiry.

The Inquiry found that these reforms alone, while contributing to building a more stable scheme, do not create the principal mechanisms to govern and regulate it. Accordingly, in addition to the Option 1 recommendations, the Inquiry also recommends that the proposals outlined in Option 2 be implemented. The specific recommendations are included in the table below.

Inquiry primary recommendations

1.
 - Creating a Scheme Board and Advisory Council.
 - The Scheme Board would be small, independent and professional with responsibilities for:
 - the regulatory activities of Home Building Service (licencing, enforcement, dispute resolution and regulation of insurers)
 - Monitor scheme integrity against Government objectives
 - Recommend scheme changes to the Minister
 - Provide independent guidance to the executive of Home Building Service
 - Approve the corporate plan for Home Building Service and monitor progress using performance indicators and key priorities
 - Approve the budget and annual accounts for Home Building Service.
 - The Scheme Board would comprise five part-time independent directors and the Director-General of the Department of Commerce or nominee.
 - Scheme Board members would be appointed by the Minister.

The existing Home Building Service advisory council would be reconstituted in favour of the recommended Advisory Council and would consist of the following members appointed by the Minister:

 - the Chairman and Deputy Chairman of the Scheme Board
 - Director General of the Department of Commerce or nominee
 - two representatives from the insurance industry, in consultation with the Insurance Council of Australia
 - two representatives of the building industry, in consultation with the MBA and HIA
 - two licenced builders
 - two consumer representatives
 - one legal representative, in consultation with the Councils of the Law Society and Bar Association.
 - The Advisory Council would be a forum for key stakeholders and service providers to discuss key scheme issues.

Inquiry primary recommendations

2.
 - Introducing a system to regulate insurers.
 - Introduction by Home Building Service of Premium Determination Guidelines (developed in conjunction with insurers). These guidelines are mandatory and would require insurers to submit annual filings with the Scheme Board. This would be in addition to APRA reporting requirements.
 - The filing would outline the insurers premium calculation, expected claims costs, other add-on costs and profit margin.
 - Introduction by Home Building Service of Market Practice Guidelines and Claims Handling Guidelines (developed in conjunction with insurers). These guidelines are mandatory and Home Building Service will monitor compliance by insurers against the performance guidelines.
3.
 - Creating an Industry Deed to control the smooth entry of insurers into the marketplace.
 - The Industry Deed would provide a non-binding but collaborative arrangement between Government, the Insurers and other key interested parties, addressing key issues including the commitment of:
 - insurers to underwrite the scheme for an agreed period of time
 - Government not to materially intervene in the scheme for an agreed period
 - key industry organisations to the development of fundamental initiatives, including licencing and professional development.
 - The Industry Deed would also contain protocols for sharing key scheme data.
4.
 - Creating an independent licencing function, within the Office of Fair Trading and reporting directly to the Scheme Board and to the Commissioner on executive and administrative matters.
 - The licencing function would be independent of Home Building Service, but would share knowledge and data with Home Building Service.
5.
 - Strengthening the licencing processes and enforcement of licencing conditions.
 - As a priority, licence conditions should be strengthened to address financial soundness, skills and experience and prescribe mandatory professional development.
 - A robust grading system of licences developed by the new licencing function in liaison with the Advisory Council.
6.
 - Monitoring of the new dispute resolution mechanisms by the Scheme Board to assess their effectiveness.
 - A formal independent assessment of the existing dispute resolution mechanisms to occur by 31 December 2004.

Inquiry primary recommendations

- | | |
|----|---|
| 7. | <ul style="list-style-type: none"> ▪ 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 Inquiry considers these reforms will provide the foundations for scheme stability, noting that time must be given to allow for these reforms to be implemented and mature.

Over the course of the Inquiry, a number of additional matters, discussed in Chapter 8, were brought to the Inquiry's attention. The Inquiry has considered these matters and secondary recommendations relating to these issues are included in the table below.

Inquiry secondary recommendations

- | | |
|----|---|
| 1. | <ul style="list-style-type: none"> ▪ Encourage building industry groups to form a working party to consider rationalisation under one peak industry body. |
| 2. | <ul style="list-style-type: none"> ▪ Evaluation by the new licencing function of the merits of issuing Builder's licences to natural persons only where the capital base is less than \$500,000. Corporate entities, with capital above \$500,000, could obtain a licence at the entity level. |
| 3. | <ul style="list-style-type: none"> ▪ Home Building Service to introduce a register of insurance claims that is available via the Home Building Service's website. |
| 4. | <ul style="list-style-type: none"> ▪ Home Building Service to undertake an annual review of the <i>Standards and Tolerances Guide</i> to ensure the guide remains relevant to current builder and consumer issues. |
| 5. | <ul style="list-style-type: none"> ▪ Evaluation by the Interim Scheme Board of mechanisms to exclude non-structural work performed by individual tradespersons from the requirement to obtain compulsory insurance. |

Inquiry secondary recommendations

6.
 - Evaluation by the Interim Scheme Board of owner-builder activity, including the extent of non-approved owner-builder construction work, and consider appropriate measures to regulate non-approved activity.

The Inquiry recognises the merit of building a scheme that offers a greater level of consumer protection. Consequently, Option 4, considered by the Inquiry to be conceptually desirable, represents an aspirational recommendation possibly achievable with the creation of functional governance, licencing and dispute resolution arrangements that are given time to mature.

Transition requirements

The Inquiry emphasises the importance of translating the recommendations into options that can be implemented. To effect change the Inquiry also recommends a transition program for the recommendations, should they be accepted.

The Inquiry suggests the early formation of an Interim Scheme Board (ISB) to be charged with implementing the accepted recommendations.

Implementation Taskforce

The ISB is to be formed by 1 November 2003 and will have completed its task by early 2004.

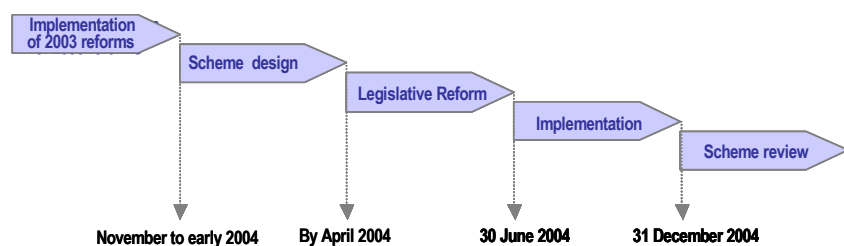
The ISB will be appointed by the Minister and include:

- The Director-General of the Department of Commerce or nominee
- Five part-time independent professional persons.

The ISB's implementation program will conclude with the completion of a Bill for submission to Parliament in the April 2004 session. It is envisaged that the ISB will emerge as the Scheme Board following successful passage of the legislation.

Transition to a new scheme

The transition timetable for the new scheme is depicted in the diagram below.



Under this approach, the key activities and timing are:

- Appointment of ISB by Minister [By 1 November 2003]
- Detailed design of Inquiry recommendations [By early 2004]
- Bill of amendments introduced and passed in Parliament [By April 2004]
- Scheme Board appointment effective from [1 July 2004]
- Implementation of legislative reforms [1 July 2004 to 30 June 2005].

Annual performance review of scheme

The Inquiry recognises the importance of regularly reviewing emerging statutory schemes. This is important to assure the transparency of the scheme's transition program and will assist in early detection of problems.

The Inquiry recommends that an annual review be undertaken for the first three years of the scheme's operation.

The Inquiry also recommends that, at the end of the fourth year, an independent review be undertaken to assess the opportunity for introducing a Consumer Home Cover product (Option 4).

Further recommendations	
1.	▪ Annual review of the scheme at the end of each of the first three years of operation. (Note: In addition, the Scheme Board will report to the Minister on scheme performance from time to time).
2.	▪ An independent review at the end of the fourth year of operation to assess the opportunity for introducing Consumer Home Cover (As per Option 4).

10.0 Glossary

- **APRA** – The Australian Prudential Regulation Authority.
- **BSC** –The Building Services Corporation administered the Home Warranty Scheme from 1987 to 1997.
- **CTTT** – The Consumer Tenancy and Trader Tribunal.
- **First resort** – A first resort insurance policy allows a consumer to make a warranty claim against the insurer without the consumer seeking rectification or compensation from the builder.
- **HBS** – Home Building Service, established on 1 July 2003, is the regulator for the scheme.
- **High rise building** – A building over three storeys in height, including a lift well.
- **Home Warranty Insurance** - Home Warranty Insurance is a statutory class of insurance that is compulsorily acquired by the builder for the benefit of the consumer.
- **Last resort** – A last resort insurance policy allows a consumer to claim against the insurer, only when the builder has died, disappeared or is insolvent.
- **Non structural** – Defects relating to the finishes on a residential construction only.
- **Owner-builder** – An owner-builder is a person who supervises the construction of their own property. In NSW, owner-builders are required to undertake a short course and apply for an owner-builders permit.
- **Premium** – Premium income is received by an insurer for accepting risk at the time an insurance policy is issued.
- **QBSA** – The Queensland Building Service Authority
- **Reinsurance** – Reinsurance is “insurance for insurers”. Insurers usually share risk underwritten with a reinsurer, who receive premium income from the insurer for accepting risk.
- **Structural defects** –defects that affect the fundamental structure of the house.

11.0 References

- Report of the National Review of Home Builders Warranty Insurance and Consumer Protection; Professor Percy Allan (June 2002)
- Report of the NSW Parliament's Joint Select Committee on the Quality of Buildings ("the Campbell Inquiry") (July 2002) and the Government's response to that Report.
- Report of the Legislative Council Standing Committee on Law and Justice on the Home Building Amendment (Insurance Act) 2002.
- Report of the Royal Commission into the Building Industry; Gyles (1992)
- Report of the Inquiry into the Building Services Corporation; Peter Dodd (1993).
- Report of Inquiry into Outstanding Grievances Against the BSC; Peter Crawford (1995)
- Australian Bureau of Statistics "Building Activity, New South Wales", Australia, 31 July 2003.
- Builders Licencing Board Report 1986
- Builders Licencing Board Reports 1 July 1986 – 31 March 1987
- Building Services Corporation Annual Reports 1986 to 1995
- Home Building Act 1989 and Home Building Regulation 1997 (with amendments).
- Public Benefit Test - Queensland Building Services Authority Act 1991 and Regulations, Economic Insights Pty Ltd, August 2002.
- Queensland Building Service Authority Annual Reports, 1999, 2000, 2001 & 2002.
- Queensland Building Services Authority, Fact Book New Licencing from 1 September 2003.

12.0 Appendices

Appendix 1A - Meeting with stakeholders

DATE	STAKEHOLDER REPRESENTATIVES
19 May 2003	Mr Brian Seidler, Master Builders Association Mr Peter Meredith, Master Builders Association Mr Paul Stokoe, Master Builders Association Mr Chris Gordon, Crestway Constructions Pty Ltd Mr David T Newey, Gillis Delaney Brown Lawyers Ms Caroline Pidcock, The Royal Australian Institute of Architects Mr David R Gale, Austin Australia Pty Ltd Mr Bob Black, Arden Constructions Mr Gordon Leggett, Main Corp Construction Group Pty Ltd Mr John Hodges, Richard Crookes Constructions Pty Ltd
20 May 2003	Mr Darryl Pidcock, Swiss Re Australia Ltd
21 May 2003	Mr Allan Hansell, Government Relations Insurance Council of Australia Limited Ms Jane Nelson, Insurance Council of Australia Limited Mr Michael Phillips, Insurance Council of Australia Limited
26 May 2003	Mr Murray Nugent, Reward Australian Home Warranty Insurance Solutions
28 May 2003	Mr Jacob Mamutil, Insurance Australia Group Mr George Karagiannakis, Insurance Australia Group
29 May 2003	Mr Hans Moll, Munich Reinsurance Company of Australia Mr Steven Burroughs, Munich Reinsurance Company of Australia Mr Allan Obando, Munich Reinsurance Company of Australia
30 May 2003	Mr John Fransen, B.F.A.I.R. Mr Bob Black, Arden Constructions Mr Lionel Buckett, Builder Mr Hank Leeuw, Builder Mr Ross Kirby, Builder Mr Malcolm Kirby, Builder
30 May 2003	Mr Nick Kirk, Royal & Sun Alliance
10 June 2003	Mr Robert Fuller, Master Builders Association, Newcastle
11 June 2003	Ms Elizabeth Crouch, Housing Industry Association Mr Shane McCartin, Housing Industry Association

DATE	STAKEHOLDER REPRESENTATIVES
11 June 2003	Ms Irene Onorati, Building Action Review Group Mr Sal Russo, Russo & Partners Ms Janette Nix Mr Jamal Boules Ms Natasha Scuderi Mr Goulson Salih Mr Albert Falzon
13 June 2003	Mr Brian Seidler, Master Builders Association, Wollongong Mr Paul Stokoe, Master Builders Association, Wollongong Mr Lance Beevers, L & L Beevers Builders Mr Larry Rice, Casrica Homes Mr Andrew Connors, Connors Building Ms Colleen Camarda, Camarda & Cantril Commercial Builders Mr John Dowling, John Dowling Building
16 June 2003	Mr Phil Bickerstaff, NSW Treasury Mr Steve Hunt, NSW Treasury
17 June 2003	Mr Hadyn Wood, Victorian Building Commission Mr Jeff Norton, Director, Victorian Building Commission
17 June 2003	Mr Greg Donovan, HIA Insurance Mr David Turner, AON Risk Services Australia Ltd
17 June 2003	Mr Gary Turland, Turland Building Company
19 June 2003	Ms Natasha Scuderi, Consumer Ms Irene Onorati, BARG Mr Alfred Frasca, Building Engineer
26 June 2003	Mr Geoff Sheldon, Master Painter's Association Mr Brian Tompson, Contractor Mr Michael Peters, Contractor
30 June 2003	Mr Nick Evtshenko, Builder
30 June 2003	Mr Phil Sim, Australian Building Services, NSW
30 June 2003	Mr Ian Brown, Insurance Australia Group Ltd Mr Jacob Mamutil, Insurance Australia Group Ltd
1 July 2003	Dr Ron Silberberg, Housing Industry Association Ltd Ms Elizabeth Crouch, Housing Industry Association Ltd
3 July 2003	Mr Wilhelm Harnisch, Master Builders Association Mr Todd Ritchie, Master Builders Association
7 July 2003	Mr Chris Hartcher, Member for Gosford Group of Central Coast builders

DATE	STAKEHOLDER REPRESENTATIVES
7 July 2003	Mr Albert Falzon, Consumer Ms Irene Onorati, President BARG Mr Alfred Frasca, Building Engineer
7 July 2003	Mr Robert Fuller, Master Builders Association, Newcastle Various Master Builders Association members
9 July 2003	Mr Brendon Sturgeon, Central West Home Builders Scheme Mr Allan Hurford, Bathurst & Orange Plasterboard Centres Mr Allan Reith, Consultant Mr Bruce Hackett, Builder
16 July 2003	Mr Lindsay Le Compte, Home Building Service
21 July 2003	Mr Wilhelm Harnisch, Master Builders Association
22 July 2003	Mr Darryl Pidcock, Swiss Re Australia Ltd
22 July 2003	Mr Greg Donovan, AON Risk Services Australia Ltd Mr David Turner, AON Risk Services Australia Ltd
23 July 2003	Mr Hans Moll, Munich Reinsurance Company of Australasia Ltd Mr Allan Obando, Munich Reinsurance Company of Australasia Ltd
23 July 2003	Mr Warwick Temby, Housing Industry Association
23 July 2003	Mr Jacob Mamutil, Insurance Australia Group Ms Susan Moxham, Insurance Australia Group
24 July 2003	Mr Warwick Gard, Ernst & Young Mr Lindsay Le Compte, Home Building Service Mr Rod Elliott, Home Building Service Mr Michael Carroll, Home Building Service Ms Linda Scolah, Home Building Service Ms Linda Uhlberg, Home Building Service
25 July 2003	Ms Kate McKenzie, Department of Commerce Mr David O'Connor, Commissioner for Fair Trading Mr Lindsay Le Compte, Home Building Service Mr Rod Stowe, Office of Fair Trading
25 July 2003	Mr Nick Kirk, Royal & Sun Alliance Mr Paul Jameson, Royal & Sun Alliance
30 July 2003	Professor Marton Marosszeky, University of NSW
30 July 2003	Mr Sal Russo, Russo & Partners
30 July 2003	Mr Brian Seidler, Master Builders Association NSW Mr Peter Meredith, Master Builders Association Mr Paul Stokoe, Master Builders Association NSW
31 July 2003	Mr David Dawes, Master Builders Association – ACT
31 July 2003	Mr Nick Kirk, Royal & Sun Alliance
31 July 2003	Mr John Lenders MLC, Minister for Finance (Victoria)
5 August 2003	Mr John Lewer, Construction Diagnosis

DATE	STAKEHOLDER REPRESENTATIVES
12 August 2003	Minister Della Bosca
21 August 2003	Mr Michael Phillips, Insurance Council of Australia
21 August 2003	Mr Jacob Mamutil, Insurance Australia Group
22 August 2003	Mr Phil Dwyer, The Builders' Collective
22 August 2003	Mr John Trowbridge, Suncorp-Metway
25 August 2003	Mr Jacob Mamutil, Insurance Australia Group Mr Ian Brown, Insurance Australia Group Ms Sue Moxham, Insurance Australia Group
26 August 2003	Mr Frank Earl, Arthur Gallagher Consulting
28 August 2003	Mr Brian Seidler, MBA NSW
28 August 2003	Mr Darryl Pidcock, Swiss Re Australia Ltd
2 September 2003	Professor Marton Marosszeky, University of NSW
3 September 2003	Mr Murray Nugent, Reward Australian Home Warranty Insurance Solutions
3 September 2003	Mr Lindsay Le Compte, Home Building Service
3 September 2003	Mr Nick Kirk, Royal & Sun Alliance
3 September 2003	Mr Brian Seidler, Master Builders Association NSW
3 September 2003	Dr Ron Silberberg, Housing Industry Association Ltd Ms Elizabeth Crouch, Housing Industry Association Ltd
4 September 2003	Mr Phil Dwyer, B-FAIR
4 September 2003	Mr Hayd Wood, Victorian Building Commission
9 September 2003	Mr Paul Jameson, Royal & Sun Alliance
9 September 2003	Mr Hans Moll, Munich Reinsurance Company of Australia
11 September 2003	Mr Phil Sim, Australian Building Services
11 September 2003	Minister Della Bosca Minister Meagher
12 September 2003	Mr Peter Coatman, Victorian Department of Treasury
15 September 2003	Minister Della Bosca Minister Meagher
19 September 2003	Mr Michael Phillips, Insurance Council of Australia
19 September 2003	Ms Kate McKenzie, Mr David O'Connor, Mr Rod Stowe, Department of Commerce
19 September 2003	Ms Irene Onoratti, BARG Ms Janette Nix
22 September 2003	Mr Brendan Sturgeon, Central West Home Builders Scheme
23 September 2003	Mr Jacob Mamutil, Insurance Australia Group

DATE	STAKEHOLDER REPRESENTATIVES
26 September 2003	Ms Kay Ransome, Consumer Tenancy & Traders Tribunal
27 September 2003	Mr Nick Kirk, Mr Paul Jamieson, Royal & SunAlliance

Appendix 1B - Roundtable discussions

The following tables set out the attendees at the round table discussions held during the course of the Inquiry.

ROUND TABLE NO. 1 – 6 AUGUST 2003	
Mr Lindsay Le Compte	Home Building Service
Mr Rod Stowe	Office of Fair Trading
Mr Wilhelm Harnisch	Master Builders Association
Mr Todd Ritchie	Master Builders Association National
Mr Richard Calver	Master Builders Association
Mr Brian Seidler	Master Builders Association NSW
Mr David T Newey	Gillis Delaney Brown
Mr Warwick Temby	Housing Industry Association
Mr Jacob Mamutil	Insurance Australia Group
Mr Paul Jameson	Royal & Sun Alliance
Mr Michael Huntly	Royal & Sun Alliance
Mr Darryl Pidcock	Swiss Re Australia Ltd
Mr Hans Moll	Munich Reinsurance Company of Australia
Mr Allan Obando	Munich Reinsurance Company of Australia
Mr David Turner	AON Risk Services Australia Ltd
Mr Greg Donovan	AON Risk Services Australia Ltd
Mr Sal Russo	Russo & Partners

ROUND TABLE NO. 2 – 14 AUGUST 2003

Mr Lindsay Le Compte	Home Building Service
Mr Sal Russo	Russo & Partners
Ms Irene Onorati	BARG
Mr Murray Nugent	Reward Australian Home Warranty Insurance Solutions
Mr Phil Sim	Australian Building Services
Professor Marton Marosszeky	University of NSW
Ms Colleen Camarda	South Coast Builders
Mr Lance Beaver	South Coast Builders
Mr Bob Black	Arden Constructions
Mr Robert Fuller	Master Builders Association Newcastle

Appendix 2 - List of written submissions

- Mr Peter Sillato, JPS Constructions
- Mr Brock Bowen, Sutech Pty Ltd
- Mr David Dawes, Master Builders Association - ACT
- Mr Phil Dwyer, Dwyer Builders
- Mr Hank Leeuw, HJL Constructions Pty Ltd
- Mr Brendon Sturgeon, Central West Home Builders Scheme
- Mr Colin Campbell, Home Warranty Action Group Inc
- Mr Geoffrey Ferns, Teamcare Insurance Brokers
- Mr Phil Sim, Australian Building Services (NSW) Pty Ltd
- Mr Philip Graf, Buildsafe
- Mr Mark Able-Grabe, A. Able Restoration Pty Ltd
- Mr Andrew Stoner MP, Member for Oxley
- M.R., G.A. and G.R. James
- Mr Stephen Worthington, Worthingtons Building Consultancy
- Mr Gary Anderson
- Mr Robert Riddell, Gadens Lawyers
- Mr Nicholas Bettar, Baseline Constructions Pty Ltd
- Helen Macindoe
- Mr Peter Haack, P & R Haack Pty Ltd
- Mr John Fuller
- Mr Maurie Prior, Maurie Prior Housing Pty Ltd
- Mr Wayne Leeson, Stone Edge Homes
- Mr Eddie Doran, Doran Homes
- Mr Michael Condoleon, Cosmopolitan Group
- Mr John Fransen, B-FAIR, Builders for Active Industry Reform
- Mr Brendon Sturgeon, Central West Home Builders Scheme
- Mr Andrew Slater, Ironbank Building Services
- Mr Mervyn Cross, Hinchey & Cross Pty Ltd
- Mr Erland Olofsson, ET Construction Pty Ltd
- Mr Jim Loghmani, Nestco Pty Ltd
- Mr Robert Brittain, Brittain Constructions
- Mr Nick Karahalios, Pacific Projects (Aust) Pty Ltd

- Mr L Bellincanta, L & EA Bellincanta Pty Ltd
- L & P Brooks, Lysle Brooks Building & Joinery
- Whiter Brothers Builders
- Mr Cunningham, Vision Trading Pty Ltd
- Mr Chris Perfrement, Perfrement Homes
- John Wylie Constructions Pty Ltd
- V M Weatherall, Building Partners Pty Ltd
- Mr Stephen Gardner, SR & VH Gardner Building Contractors
- Mr Nick Luisi, NBS Building Services
- Mr Frank Hupp, Smith Group Pty Ltd
- Mr Kerry Spicer, K & N Spicer Constructions
- Mr Peter Scott
- Mr Richard Siltala, T & R Siltala Pty Ltd
- Mr Robert Everdell, Everdell Joinery & Construction Pty Ltd
- Mr Heath Bax, Bax Builders Pty Ltd
- Mr Robin Weir, H & R Weir Building Consultants Pty Ltd
- Mr Michael Roedl, Cumberland Building Services Pty Ltd
- Professor Marton Marosszaky, Multiples Chair of Engineering Construction Innovation, University of NSW
- Mr David FitzSimons, ARANAC
- Mr Robert Jackson, Robert K Jackson & Co. Pty. Ltd
- Ms Sandra Pianta, Director, J & S Contracting (Kootingal) Pty Ltd
- Mr Gino Gigliotti, Icon Building Group
- Mr Vittali, Vittali Building & Construction
- Mr Alan Kramer, Buildwest Construction
- Mr Stephen Thompson, The Medium Size Builder Trust
- Mr Rick Rawlins, Rick Rawlins Pty Ltd
- Mr Graham Tilston, Graham Tilston Building
- Mr Brett Walter, Walter Homes
- Mr John Hokin, Hokin Classic Homes
- Mr Malcolm Kirby, Kirby Construction Pty Ltd
- Mr R J Pearl, R & P Pearl Building Services Pty Ltd
- Mr Peter Moffitt, Dorset Constructions
- Monper Pty Ltd
- Mr John Diakos, Diacon Constructions Pty Ltd
- Mr Michael Grundy, Linchpin Constructions
- Mr Kevin King, H R King & Son Pty Ltd

- Mr Barney Allam, Allam Maxi Homes
- Mr Philip Bartush, MD, Bartush Homes Pty Ltd
- Bio-Building Design Pty Limited
- Mr Michael Buggy, Parker Constructions
- Mr Chris Wurst Builders
- Mr Grant Blumer, Riverina Property Inspection Reports
- Ms Elizabeth Crouch, Housing Industry Association NSW
- Mr Raymond Clyde Gordon, Gordon Homes
- Mr Nicholas Glezos, Master Builders Association Eastern Suburbs Division
- Mr Douglas Atcheson
- Mr Peter Conroy
- Mr Phil Dwyer, Dwyer Builders
- Mr Ewen Stewart, Ewen Stewart Association Pty Ltd
- Mr Allan Hurfood, Bathurst & Orange Plasterboard Centres
- Mr Nick Evtoushenko, Gordon Nicholas Pty Ltd
- Ms Jan Casagrande
- Mr Ken Barnwell, HW Barnwell Pty Ltd
- Mr Alan Carstens, Grindley Construction Pty Ltd
- Mr Robert Riddell, Gadens Lawyers
- Mr Cameron Scott Fell, Construction Pacific Pty Ltd
- Mr Keith Bingham, Bingham Pty Ltd
- Mr Len Goulding, Home Team Construction Pty Ltd
- Mr Philip Harvey, PJH Design
- Mr Paul Moir, Quote Fast Software Sales
- Mr Barry Armstrong, Armstrong Homes
- Mr Gerry Swindale, TFFAN
- Mr William Winterton, Winterton Constructions Pty Ltd
- Mr Zoltan Petri, The Pest Management Company
- Dr. David Doyle, (on behalf of Master Builders Association ACT- David Dawes) The Builders Lawyer
- Mr John Coburn, Building Contractor
- Mr Gordon Leggett, MainCorp, Construction Group Pty Ltd
- Mr Walsh, MJ Walsh Pty Ltd
- Mr John O'Neill, O'Neill Construction (Aust) Pty Ltd
- Mr Ian Brown, Deputy Chief Executive Officer, Insurance Australia Group Ltd

- Mr Geoff Morphett, Director, Morphett Constructions Pty Ltd
- Mr Hans Moll, Munich Reinsurance Company of Australia
- Mr Bill Symington
- Mr Nick Kirk, Royal & Sun Alliance
- Mr Kenneth Stewart, KJ & L Stewart Building Co Pty Ltd
- Mr Paul Stapleton, Peak Constructions Pty Ltd
- Mr Bert Hovius, Hovius Joinery, Showroom & Factory
- Mr Colin Collits, CM Collits Pty Ltd
- Mr Tim Christian, Active Assessing
- Mr Clive Dale, Trumen Corp
- Mr Tim McCabe, G C McCabe & Co (Parkes) Pty Ltd
- Mr Brian Burden, Stuart Pty Ltd
- Mr Laurie Smith, Avoca Beach Building Pty Ltd
- P R Hart, S Monkell Pty Ltd
- Mr Peter Faulkner, Better Constructions Pty Ltd
- Mr John de Bijl, Barnsley Joinery Works Pty Ltd
- Ms Anne Colville & Ms Tricia Helyar, Constructive Women Inc
- Mrs Minh Huynh
- Mr Andrew Wilson, Country Kitchens Dubbo
- Mr John Tesoriero, TR Homes Pty Ltd
- G J Cooper Pty Ltd, Building Contractors
- Mr Simon Wilson, SL Wilson Constructions Pty Ltd.
- Mr David Lawrence, Archicentre
- P Van Zanten, Van Zanten & Scott Masterbuilt Homes
- Mr Graham R Turner, Tamarack Developments Pty Ltd
- Mr Leigh Sneesby, Tolmark Homes Pty Ltd
- Mr. Bob Tyndall, Bob Tyndall & Co, Building Contractors
- Mr M Rinaldo
- Mr. Phillip John Dwyer, Design Construct Complete
- Mr Lauro Fattore, Fattore Developments Pty Ltd
- Mr David Pryor, Inverell Shire Council
- Mr Brad Butlin, Butlin Homes Pty Ltd
- Mr. Vince O'Brien, Permanent Pest Control
- Mr Doug Martin, Trytan Pty Ltd, Doug Martin Builders
- LJ & MH Moss Builders Pty Ltd
- Mr Chris Books, Addbuild Master Builders Pty Ltd
- Mrs Tracey Freeman

- Mr John Fransen, B-FAIR
- Ms Janette T Nix
- Swimming Pool & Spa Association of NSW Ltd
- Mr Peter Anderson, Equity Constructions Pty Ltd
- Mr Grant Gorton, Housing Development Australia Pty Ltd
- Mr Wilhelm Harnisch, Master Builders Australia
- Mr Robert Fuller, Master Builders Newcastle
- Mr Michael Huntley, Royal & Sun Alliance
- Mr Neil Cocks, Department of Infrastructure, Planning & Natural Resources
- Mr Paul Naylor, Master Plumbers Association of NSW
- Mr Bob Black, Arden Constructions
- Mr Paul Bradley, Anglican Retirement Villages, Diocese of Sydney
- RE & JA Barnes, T/A Barnes & Beuzeville
- Southern Highlands Home Improvements
- Mr Mark Neumann, Mark Neumann Building
- Mr Geoff Sheldon, Master Painters Australia
- Mr Michael Mayhew, Build Sense
- Mr Zoltan Petri, The Pest Management Company
- Mr Ross Howard, Graph Building
- R McEwen, Association of Consulting Architects
- Mr Garry Cox, Garry Cox Builder Pty Ltd
- Mr Robert Benjamin, Law Society
- Mr Mark Jacobs, Charter Hall Holdings Pty Ltd
- Mr Colin Campbell, Morton & Harris Solicitors
- Ms Sue Robinson, NSW Urban Taskforce
- Mr Martin Lewis, FIAA Australia
- Mr Geoff Adams, Royal Australian Institute of Architects
- Ms Ingrid Pearson, Architects Network Upper North Districts
- Mr Gordon Clarke, Architecturalpools
- Mr John Cardamis, IPM Pty Ltd
- Ms Kim Burgess, Shield Fire Doors Pty Ltd
- Ms Caroline Pidcock, Royal Australian Institute of Architects (NSW Chapter)
- Mr Keith Atkins, Australian Bathroom and Waterproofing Association
- Mr David Turner, AON Risk Services Australia,

- Mr John Trowbridge, Suncorp
- Mr Kyri Frantzis
- Mr Robert Smart, Landscape Contractors Association of NSW Ltd
- Mr Ian Brown, Insurance Australia Group Ltd
- Mr Brian Seidler, Master Builders Association
- Mr Paul Stokoe, Master Builders Association
- Mr Brian Seidler, Master Builders Association
- Mr Mr Paul Crittenden MP
- Mr Wayne Merton MP
- Ms Kerrie Wilson, Housing Industry Association
- Mr Ken Collins c/o Ms Linda Scolah, Building & Swimming Pool Consultants & Technicians
- Mr Hugh Dougherty
- Mr Peter Draper MP
- A Alvaro, Alvaro Building Pty Ltd
- Ray Brown, Building Designers Association of NSW Inc
- Mr Ron Bracken
- Mr Peter Dale, Riverina Regional Development Board
- Mr John Lenders MLC, Minister for Finance
- Mr Adrian Piccoli MP, Member for Murrumbidgee
- Mr John Wheeler, Stokes Wheeler Pty Ltd
- Mr Gary Tisdell
- Robert K Jackson & Co Pty Ltd
- Mr Clive Hughes, Bamburgh Properties Pty Ltd
- Mr Ian Armstrong OBE MP, Member for Lachlan
- Mr Andrew Connors, Home Warranty Action Group
- Mr John Eberhart, Maranatha Builders
- Mr John Skinner, Contracts Manager, Adhesive Engineering
- Ms Carol Kendall, Kendall Constructions
- Mr James F Allison, Managing Director, Sun-Greenaway Builders
- Mr Stuart Fathers, Sheargold Group, Developers and Consultants
- Mr Nick Vrabac, CTTT
- Mr Chris Bovill
- Mr George Lalich, Origin Constructions
- Mr Michael Colmer
- Ms Elizabeth Crouch, Housing Industry Association
- Ms Chris Bourne, B-Fair

- Mr Brian Burden, Stuart Pty Limited
- Mr Phil Dwyer, The Builders' Collective
- Ms Jane Wilson, Skeeta's Property Maintenance
- Mr Lawrie Kenyon, LJ & KM Kenyon Pty Ltd
- Mr David Cornwall, D&L Cornwall Constructions Pty Ltd
- Mr Ian Westlake
- Mr Lees Smith, Lees Smith Pty Ltd
- Mr Lionel Buckett, B-Fair
- Mr Lance Beevers, South Coast Builders
- Ms Kay Ransome, Consumer Tenancy & Traders Tribunal
- Mr Wilhelm Harnisch, MBA National

Appendix 3 - Home Owners Warranty Insurance in Australia

Private underwriters support the home warranty schemes in New South Wales, Victoria, South Australia and Western Australia.

The ACT and Tasmania have established industry schemes, and Queensland is the only State with a government run scheme. A high level comparison of the schemes is included in the tables below.

New South Wales	
Minimum Insured Value	\$12,000 (raised from \$5,000 after HIH)
Policy Limit	\$200,000 for non-completion claims to a maximum of 20% of the contract value indexed to CPI project home plus legal costs
Deposit Limit	Legislation limits deposits to 5% for contract value over \$20,000 and 10% of contract value \$20,000 or below
Period of Cover	6 years from completion for structural defects and 2 years from completion for non-structural defects
Excess	\$500 - Excess does not apply to non-completion claims
Warranty cover to homeowner	Yes – as last resort scheme
Average claim	Warranty claims- \$5,000 Insolvency claims - \$25,000 Overall average - \$10,000 (in 2000-01)
Incidence of claims	Around 3 per cent of total number of policies (in 2000-01)

Victoria	
Minimum Insured Value	\$12,000 (raised from \$5,000)
Policy Limit	\$200,000 for non-completion claims to a maximum of 20% of the contract value (raised from \$100,000)
Deposit Limit	Legislation limits deposits to 5% for contract value over \$20,000 and 10% of contract value \$20,000 or below
Period of Cover	6 years from completion for structural defects and 2 years from completion for non-structural defects
Excess	1 to 3 months – Nil 3 to 12 months - \$500 12 months to 3 years - \$500 max 3 to 5 years - \$750 max 5 years + - \$1,000 max Excess does not apply to non-completion claims
Warranty cover to homeowner	Yes – as last resort scheme
Average claim	Warranty claims- \$5,000 Insolvency claims - \$25,000 Overall average - \$10,000 (in 2000-01)
Incidence of claims	Around 3 per cent of total number of policies (in 2000-01)

Queensland	
Minimum Insured Value	\$3,300
Policy Limit	\$200,000 or replacement value, whichever is the lesser
Deposit Limit	Legislation limits deposits to 5% for contract value over \$20,000 and 10% of contract value \$20,000 or below
Period of Cover	6 years and 6 months from payment of the premium or the date of contract, whichever is earlier
Excess	No excess applies
Warranty cover to homeowner	Yes – as a first resort scheme
Average claim	Overall average \$10,000 (in 2000-01)
Incidence of claims	Approximately 4 per cent of policies (in 2000-01)

South Australia	
Minimum Insured Value	\$12,000 (raised from \$5,000 after HIH)
Policy Limit	\$80,000 or contract value, whichever is the lesser
Deposit Limit	Legislation limits deposits to costs of up-front costs to third parties plus \$1,000
Period of Cover	5 years from completion
Excess	\$400
Warranty cover to homeowner	Yes – as last resort scheme
Average claim	Not available - no reporting requirements
Incidence of claims	Not available - no reporting requirements

Western Australia	
Minimum Insured Value	\$12,000
Policy Limit	\$100,000 or contract value, whichever is the lesser amount
Deposit Limit	Legislation limits deposits 6.5% of the contract value to a maximum of \$13,000
Period of Cover	6 years from completion
Excess	\$500 - Excess does not apply to non-completion claims
Warranty cover to homeowner	Yes – as last resort scheme
Average claim	\$10,000 (in 1999)
Incidence of claims	400 claims averaging in a market of 23,000 new homes

Tasmania	
Minimum Insured Value	\$5,000
Policy Limit	\$50,000 or cost of building work, whichever is the lesser
Deposit Limit	3% of the contract value
Period of Cover	6 years from completion
Excess	\$500 - Excess does not apply to non-completion claims
Warranty cover to homeowner	Yes – as last resort scheme
Average claim	Not available
Incidence of claims	Not available

Australian Capital Territory	
Minimum Insured Value	\$5,000
Policy Limit	\$85,000 or cost of building work, whichever is the lesser
Deposit Limit	\$10,000 maximum
Period of Cover	5 years from date when a Certificate of Occupancy under Section 53 of Building Act is issued
Excess	\$500
Warranty cover to homeowner	Yes – as last resort scheme
Average claim	5 year average is 22 claims per year \$12,000.
Incidence of claims	5 year average is 22 claims per year

Northern Territory	
Minimum Insured Value	No minimum
Policy Limit	\$80,000 or cost of building work, whichever is the lesser
Deposit Limit	No limit
Period of Cover	10 years from completion
Excess	\$500
Warranty cover to homeowner	Yes – as last resort scheme
Average claim	\$6,400 (in 2000-01)
Incidence of claims	43 claims (in 2000-01)

Source: *Public Benefit Test - Queensland Building Services Authority Act 1991 and Regulations, Economic Insights Pty Ltd, August 2002.*