

**Submission
No 57**

**INQUIRY INTO REGULATION OF BUILDING
STANDARDS, BUILDING QUALITY AND BUILDING
DISPUTES**

Name: Professor Marton Marosszeky

Date Received: 25 July 2019

Mr David Shoebridge
Chair
Regulation of Building Standards Inquiry
NSW Government

Dear Sir

HOME WARRANTY INSURANCE IN NSW

In this brief submission I focus on Home Warranty Insurance (HOW) and submit that the failure of the system of HOW in NSW has been a critical element that has led to the decline and dysfunction of the NSW home building industry.

I am a retired professor from the University of NSW, where in my later years I was the Multiplex Professor of Construction Innovation. While at UNSW I was the director of the Building Research Centre and then the Australian Centre for Construction Innovation. In these capacities I spent some 20 years researching and advising in relation to the home building industry in NSW. I am still active in the industry as a consultant. As a part of my work I have:

- researched quality and safety issues and published the results in reports for industry, this work was funded by the NSW BLB, the NSW BSC and WorkCover NSW;
- investigated the BSC's handling of several claims as a part of the Dodd Inquiry;
- for 7 years, after the 1992 Gyles Royal Commission into Productivity in the Building Industry in NSW, I chaired the Deed Monitoring Committee which was established for the unions, employers and government agencies to meet 'in camera'; and
- from 2002 to the present, I have represented NSW government in a range of substantial home warranty claims.

I attach 2 reports, the first was written by Daniel Smith and the second by Daniel Smith and Cameron Lucas, and both are in the public domain. They were presented to Australian Institute of Actuaries in 2005 and 2016. They run a critical eye over home warranty insurance across all states in Australia.

The two reports, among other things, show that from a government cost perspective, changes to HOW over the past 3 decades have reduced the cost to the public purse, and this on the surface appears efficient. However, the state of the industry shows that this is a short term and superficial gain.

I am concerned about the following critical issues in relation to the HOW system:

- the process is very dysfunctional, often taking a decade or more to resolve matters while homeowners are put through significant inconvenience and often hardship;
- the changes over the years have diminished the protection afforded to homeowners, even in buildings under 3 stories as it is a system of last resort insurance, activated only upon the financial failure of the builder;
- homeowners in buildings above 3 stories have no protection and must rely on litigation to press their claims;

- while the current system may have reduced government's direct costs, overall the system is inefficient in financial terms as the work created for consultants and lawyers does not add value to the community, and equally importantly it provides no incentive for improvement of industry capability;
- the mechanism for improving industry capability (quality and efficiency) is very weak—in other words, the feedback loop that drives capacity improvement is ineffective;
- the insurers have no incentive to reduce or manage the risk, they simply pass the increasing cost of inefficiency onto the industry and ultimately to consumers; and
- the total cost is high and increasingly borne by homeowners.

I would draw your attention to the Decennial system of insurance liability which originated in France, and today is in operation around the world. Major global insurers such as AXA, HDI, Global, and HFW offer this insurance in over 40 countries.

The main principles of Decennial insurance are the following:

- The insurance applies to the supply chain for a development.
- The insurer takes on a Quality Assurance (QA) responsibility, the cost of which is covered by the insurance premium. The cost of the premium reflects the insurers assessment of the risk it is underwriting, as well as the insurer's QA costs to manage that risk. This takes account of the:
 - supply chain's experience with the specific type of undertaking;
 - supply chains track record in the specific area of work;
 - financial viability of the supply chain; and.
 - necessary QA cost to assure the outcome.
- The insurer underwrites structural defects for 10 years as well as project completion.

Essentially the insurer is placed into the role of an active participant in a virtuous system of management and improvement rather than simply being a party judging its risk on an actuarial basis, and passing those costs onto the ultimate consumer, the public.

Put simply, the current system of HOW insurance does the following:

- it minimises government cost and risk;
- it does nothing to assess individual risk or reduce risk; and
- assuming the system is sustainable, it simply passes the cost of the risk on to the ultimate consumer.

The current retreat of insurers from the Australian construction market indicates that the current system of insurance as well as the current system of industry governance is unsustainable.

Among the many questions facing this inquiry, and I recognise that there are many, is the central question: Will simply the increase of checks and balances and red tape create a sustainable system of industry governance? In my opinion the answer is clear: It will not.

Compulsory Decennial insurance offers the following as a part of an overhaul of the industry's governance structures:

- it is a self-regulating market mechanism that is sustainable;
- it relates to the entire supply chain, not just the builder, it captures the developer within the risk envelope;
- it creates an efficient feedback loop, driving suppliers to become more competent as they grow, and protects smaller/newer suppliers from taking on unrealistic risks;
- it is a virtuous system in that reliability in terms of quality are rewarded by lower insurance premiums;
- parties that are unable to provide reliability in quality cannot get insurance and cannot practice;
- new entrants into construction must start small to get insurance, making the insurer a gatekeeper on risk that is ultimately passed on to the community;
- as the capability of suppliers increase, the size of their projects is allowed to increase in a controlled manner; and
- the cost of inexperienced and incompetent suppliers is not distributed across the sector as an overall inefficiency levy.

I submit that a system of Decennial insurance should be considered as a part of industry reform in NSW. It is a virtuous system as the insurer, through a changed role, will drive capacity building and reliability into the industry's processes at every level. Furthermore, it is a first resort system rather than a last resort system, in that it manages and reduces quality related risk, thereby reducing the overall cost of those risks. This is in contrast to the existing last resort systems which simply clean up the mess after a builder has failed.

While in this submission I have focused on HOW, I am aware of the numerous weaknesses in the NSW home building construction sector, but time does not allow me to make a more comprehensive submission. Also, I am aware that numerous interested parties will make submissions on other matters, and other changes are required. However, I consider that an effective system of HOW based on the Decennial model is the keystone of an effective system of industry self-governance. I believe that a comprehensive system of Decennial insurance will drive many of the other changes in capacity and behaviour that are required to transform the industry towards a sustainable model.

I would be pleased to meet with the inquiry should it wish to pursue these matters further.

Your sincerely

Marton Marosszeky
Director
Marosszeky Associates