

**REPORT OF PROCEEDINGS BEFORE
STANDING COMMITTEE ON LAW AND JUSTICE**

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

At Sydney on Thursday, 8 August 2002

The Committee met at 2 p.m.

PRESENT

The Hon. R. D. Dyer (Chair)

The Hon. P. J. Breen

The Hon. J. Hatzistergos

The Hon. J. F. Ryan

IRENE ONORATI, President, Building Action Review Group (BARG), Unit 6, 102 St Georges Crescent, Drummoyne, P.O. Box 503 Drummoyne 2047, sworn and examined:

CHAIR: In what capacity are you appearing before the Committee?

Mrs ONORATI: As a consumer advocate for building consumers, BARG members and consumers at large.

CHAIR: Did you receive a summons issued under my hand in accordance with the provisions of the Parliamentary Evidence Act?

Mrs ONORATI: Yes, Mr Chairman, I did.

CHAIR: Are you conversant with the terms of reference for this inquiry?

Mrs ONORATI: Yes, I am.

CHAIR: Could you please briefly outline your qualifications and experience as they are relevant to the terms of reference of this inquiry?

Mrs ONORATI: My qualifications, as I say, I am a consumer and I am the president and the founder of BARG, the consumer advocacy group. We represent the voice of building consumers. We are a non-funded volunteer group incorporated and existing for about 12 to 13 years now. I am very well versed, as I have been through several amendments of the Home Building Act, and I can go as far back as the Building Licensing Act in 1971 which I am quoting here, so I have seen many many different insurances going through.

CHAIR: Mrs Onorati, if you should consider at any stage during your evidence that in the public interest certain evidence or documents you may wish to present should be heard or seen only by the Committee, the Committee will be willing to accede to your request. However, the Legislative Council itself does have a right, if it chooses, to override any decision we might make in that regard.

Mrs ONORATI: Thank you.

CHAIR: You have not made a written submission to the inquiry.

Mrs ONORATI: No, sorry, I did not have the time. I would have loved to.

CHAIR: That is understood. Could I invite you, as quickly and conveniently as you can, to present the material you have there by way of an opening statement?

Mrs ONORATI: Yes.

CHAIR: After which we will ask you some questions.

Mrs ONORATI: Mr Chairman, Honourable Members, thank you for inviting us to address you on behalf of BARG and building consumers. I believe we do not need to introduce BARG as it is well known it is the only voice of building consumers since 1998.

The purchase of a home is the most significant purchase a consumer makes in his or her life time. It involves a large outlay of funds and a financial burden over a great part of a person's life. In recognition of the onerous financial burden and the difficulties associated with the home building and builders in particular, in 1971 Parliament passed the Builders Licensing Act, which established mandatory insurance provisions to protect consumers. Without going into a detailed history, we have seen over the years many amendments of this Act strengthening consumers' protection, but alas, it is with great concern that the recent amendments to the Home Building Act affecting home warranty insurance were announced and implemented without any consultation with consumers.

In the package that was intended to help insurers stay in the market, it has been left up to premium paying consumers to make almost all sacrifices. In 1996 the Carr Government introduced a number of significant reforms promising increased protection for consumers, and I quote:

The changes will ensure that consumers are provided with even better protection against faulty and incomplete work.

Unfortunately, consumers still today realise that this was just cold comfort. There is no doubt that today's amendments have weakened consumers' protection. Since the insurance provision commenced there has never been such a regression. Consumers are outraged.

Why is this happening? There are several reasons as to why the private insurance scheme is not working. The home warranty insurance cannot be blamed in isolation. There are numerous other related problems and essential issues why the private insurance group has failed. Nobody is blameless, from the single builder's misconduct to the largest project home builder and/or developer non-complying with the Building Code of Australia, Australian Standards, conditions of building approval, local council, private certifiers, and more importantly, the Government and statutory regulatory authorities, that is the Department of Fair Trading, the Fair Trading Tribunal, the triangular contest, the Master Builders Association and the Housing Industry Association conflict and of interest, last but not least, the home warranty insurers who are subsidiaries of the building industry associations.

In any case, as mentioned above, the core problem with the previous Government insurance scheme and private scheme has been, and still is, that relevant laws are not effectively administered and rigorously enforced by the regulatory authority, that is the licensing authority's failure to perform the statutory obligations to assess thoroughly the suitability, fitness and competence of licence holders, investigate thoroughly and properly builders' misconduct, discipline offending builders as required under the legislation. I could go on and on.

There are definitely problems with the insurance system scheme as it is presently operated and those problems have been touched by Professor Percy Allan in the representation made by BARG in that inquiry. I have had only an opportunity of skimming Professor Percy Allan's report and we need to make these additional comments.

Home Building (Insurance) Amendment Act. It is to be noted that recently the premiums have increased from about \$400 for the average residential project home and they are now about \$800. For this premium the cover extended to consumers has been reduced in a number of important respects.

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

BARG notes the comments of the Department of Fair Trading who claims that they have powers to engage another builder to complete the work when a licensed builder refuses to complete or rectify. However, even if they have these powers, for some reason or other they have clearly rarely, if ever, used them. We have seen no evidence of a new culture in the Department of Fair Trading in dealing with shonky builders since the new insurance scheme was introduced or since more recent amendments were made to the Home Building Act. For a start, they have only 11 building investigators to cover the whole State of New South Wales. It has been the experience of BARG that it takes months before an inspector will come to the site to investigate a shonky building complaint. Even then, if they can write off the complaint as a contractual dispute between the home owner and the builder, they simply refuse to intervene.

Most recently, an example that BARG had is the lady Ms Narelle Peters of Seven Hills, who lodged a complaint on 1 May 2002. When she rang the other day the department investigator after three months, she was told that they have not even decided whether they are going to investigate her complaint or not. Please note that this lady lives in an incomplete house with plastic walls, leaking roof, cannot lock up her doors, no kitchen sink or cupboards, with her 82 years old mother and daughter. She is waiting for a tribunal hearing date, as the new mediation system did not work in her case. She only contacted me a week ago. She is here today.

BARG notes the comments of the Department of Fair Trading claiming that the new procedures introduced in February 2002 for fast tracking building disputes by mediation in the Consumer Traders and Tenancy Tribunal have resulted in faster resolution of disputes for consumers. We also note the further evidence that the previous backlog of the former Fair Trading Tribunal has been reduced. Indeed, the figures are not encouraging. The number of disputes being registered with the Consumer Trader and Tenancy Tribunal as compared to the Fair Trading Tribunal has increased substantially. At the same time, only some small percentage of disputes have been referred to the new Building Dispute Service and many of those return to the tribunal for a full hearing, like Narelle Peters that I mentioned above, this causing only a further delay.

2. Cover is limited to a maximum claim of \$200,000 or 20 percent of the contract price of the complete work. BARG is outraged by the evidence of witnesses speaking on behalf of the Royal and Sun Alliance Insurance and the HIA before this Committee that this was a term added to the conditions of home warranty insurance, therefore was not essential for the security of the private insurance scheme. Apparently the New South Wales and Victorian Governments, as a means of "harmonising" the home warranty insurance scheme across Australia, introduced this part of the package. BARG notes from the same evidence given by the insurance company representatives that they have no intention of harmonising premiums for the scheme. We see no justification in reducing consumers' benefits for mere administration tidiness.

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

For example, some of the past cases you may have heard are Jashuan Chen, Lindy Trang, the Vogels and many more. They were in dispute with their builder for more than 18 months. During the dispute the sites were left unattended, deteriorating further. Although, they received the maximum payment of \$200,000, which was barely enough to rebuild their homes, leave alone their legal costs and the cost of demolition, they had contracted for a two storey home and they are left only with a vacant block of land to show for. Some more dramatic cases are the Nicolls, Walter Tinyow, Ann and Steve Vukovic, Carrol Frantzis, Narelle Peters, Helen and Graham Eather and many many more. The situation is getting worse and worse.

Although the consumer pays premiums for \$200,000 worth of cover, this cover becomes limited to 20 percent of the contract price for work left unfinished. This leaves virtually nothing for the cost of pursuing the builder in the last resort scheme. There will be nothing left to meet the cost of paying the additional mortgage or rental costs during the inevitable long delay in the project until their home is rectified or completed. There will be nothing to compensate the consumer for the additional cost of engaging a new builder. Often builders charge extra provisional sums for completing somebody else's work because this work is more complicated and can involve more risk.

A further constraint is that this sum gives little allowance for impact of inflation over the period of a dispute, which could be one or two years, or a period of even five or six years when the full extent of building flaws are revealed. \$200,000 looks to be adequate cover for such defects in 2002. It may be totally inadequate to retrofit a defective structure in 2005 or 2007. See today many consumer victims of the former BSC legislation when there was insurance of \$100,000 maximum cover, as mentioned above, Mr Tinyow and Mr and Mrs Vukovic, and many many others who are still suffering today and could never even begin to rebuild their house with the \$100,000 insurance.

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

cover runs out in two. Does this increase appropriate consumer protection?

Recommendations - I would have liked to say a lot more but I confine myself because of the time. BARG prefers to see New South Wales adopt a home warranty scheme that is similar to that which operates in Queensland. However, in the likely event that the New South Wales Government will not adopt that course of action, BARG makes the following recommendations to the current scheme:

- (1) The insurance cover for unfinished work claims is restored to the full amount of the sum insured.
- (2) That the recently added distinction to insurance cover between structural and non-structural claims should be abandoned.
- (3) That the State Government should have a scheme to compensate home owners who suffer at the hands of a licensed builder for legitimate catastrophic claims which amount to more than the sum insurance limit of \$200,000.
- (4) The State Government must fully implement the recommendation made by the recent Select Committee on the Quality of Building. If the Government is serious to protect consumers, it must carry out this recommendation, otherwise inquiries are a waste of taxpayers' money, and, I will add, a mockery.
- (5) We must reiterate that prevention is better than cure. That was the initial BARG motto. The success of the home building warranty insurance scheme depends largely on containing insurance claims by having regulatory authorities effectively administer and rigorously enforce the relevant laws and provide a mechanism for quickly resolving disputes.

BARG can demonstrate that the problem cases are not in the minority as stated by the Housing Industry Association, one percent only. No data has been made available to support this statement. Finally, even if it is one percent, we have how many builders? 156,000 licensed builders, without counting the subbies and everybody else. What is one percent? 1560 only on that number. There are too many families, too many citizens of Australia, honest citizens, who are being really destroyed on the biggest purchase of their lifetime.

SALVATORE RUSSO, Pro Bono Solicitor, Building Action Review Group, 12 Swans Road, Arcadia, sworn and examined:

CHAIR: Did you receive a summons issued under my hand in accordance with the provisions of the Parliamentary Evidence Act?

Mr RUSSO: Yes, I did.

CHAIR: Are you conversant with the terms of reference of this inquiry?

Mr RUSSO: Yes, I am.

CHAIR: Could you please briefly outline your qualifications and experience as they are relevant to the terms of reference of this inquiry?

Mr RUSSO: I have been a consumer advocate for consumers who have had problems with builders for in excess of ten years and I have acted in litigations, mediations, arbitrations and all levels of dispute resolution relating to building disputes, insurance claims, both for consumers and for builders, for at least ten years, and I have also assisted and provided pro bono advice to the Building Action Review Group for at least five years. I have sat on the Home Building Advisory Committee for 12 months.

CHAIR: Mr Russo, if you should consider at any stage during your evidence that in the public interest certain evidence or documents you may wish to present should be heard or seen only by the Committee, the Committee will be willing to accede to your request. However, the house itself does have a right if it chooses to override any decision we may make in that regard.

Mr RUSSO: I accept that.

CHAIR: Could I indicate that any question that I or my colleagues might ask may be responded to by either or both of you as you choose. You will be aware that the amending legislation introduces a distinction between structural and non-structural defects and it sets different periods of cover for each, six years in the case of structural defects and two years in the case of non-structural defects. Could you tell the Committee what your view would be as to the impact of that reform or change on consumers?

Mrs ONORATI: As I said, in my long experience of 15 years in consumer advocacy, I have never seen such regression. There has never been a six years insurance cover for structural work. It could be increased but not decreased. Some of the cracks in my particular case did not appear until after six years.

CHAIR: It was seven previously.

Mrs ONORATI: Yes. No, what I am saying is that six is inadequate, and two years for general defects I believe is also very inadequate and will disadvantage consumers.

Mr RUSSO: Could I just add there that one of the problems I think that we find in the reduction in insurance periods is that consumers do not have the expertise to determine whether or not in fact defects are either structural or of a general nature. Whereas a consumer may think that a crack in a wall may be a non-structural matter, unfortunately what happens, they then find out at a later stage that there is a major structural defect. This is a problem which arises in the overall system that we have, as opposed to just a question of the amount of time that defects will be looked at under the insurance scheme. The concern that we have is that the insurance period should be as long as is necessary to ensure that the building which has been constructed is structurally sound and that the defects which might exist in it have been rectified.

CHAIR: I think you would agree that it is in the nature of statutes granting rights to consumers that limitation periods are prescribed. Certainly, historically that is the position regarding the law generally. Given that legal and historical background, what limits do you think are appropriate?

Mr RUSSO: I think the real issue is that if we had a common starting point for buildings when they were completed, that is that there was what they use at the moment, the final certificate, if we had a situation where each building was signed off at its completion, then it may well be that the statutory limitations could apply. The problem is that we have a situation which exists where there is no real starting point for a lot of buildings. In a number of the cases that BARG has been involved in structural defects do not emerge for quite

some considerable time or, alternatively, until there has been some investigation, such as the excavation of piers and footings. Until such time as that has occurred, it is not evident in fact that the engineer who provided the certificate had provided it falsely. So what happens is we are then outside the statutory period and of course the consumer is the one who loses at the end.

So we have a problem with starting point. The statutory period may be appropriate if we can get an appropriate system to ensure that at the time from which the statutory period runs, there is a series of certificates or a signing off on the individual building which can ensure that the building complies with all of the relevant statutes and has been built to a particular standard.

Mrs ONORATI: I concur with Sal, and what I would like to add is that the final certificate should be the point of limitation, because all these people here, Mr and Mrs Yukovic, with their house sliding down the hill, they do not have a final certificate. That means that the house has not been certified. So I think that is a very important point and I thank Sal for bringing it up.

The Hon. JOHN RYAN: Just out of interest, Mr Tinyow's house which has allegations of structural difficulties, my memory is that that was a house built before 1996, was it?

Mrs ONORATI: Yes, definitely, because it is a BSC insurance. It was under the previous legislation.

The Hon. JOHN RYAN: And as I understand it, it is only in recent months that excavations under the house have discovered that piers that should have been installed is not present.

Mrs ONORATI: I can advise you now that recent excavation that were carried out just before the Current Affair - Current Affair did not cover it very well - two points were excavated and we found tree roots of 450 millimetres diameter under this slab and no compaction of soil, voids, bricks. It is a very visual thing. I do not know whether this Committee is interested or how I am going to organise it, I would like a conference on site, because what we experience as consumers is that there are too many consultants. The builder brings his consultant.

Mr RUSSO: Just hold on, otherwise we will go into other terms here.

Mrs ONORATI: It is important, if the Committee is interested to come.

The Hon. JOHN RYAN: The point I was making is that that is a well established structural problem.

Mr RUSSO: He has already gone four years down the track, if we take the traditional interpretation of when the statutory limitation period is to run from. It is our submission to the Committee that the statutory period should not run until such time as there has been a final certificate, because until such time as the building has actually been finished, then that gives everybody the opportunity to say, "I have completed the work", it gives the council the opportunity to say, "We have issued our final certificate", the engineers to say, "We have satisfied ourselves", everyone at that point in time can be said to have signed off on the building, and what we say is that the statutory period should run from that point of time, not from the more traditional period, that is from the point of time that the defect is found out.

The Hon. PETER BREEN: Is that not what the legislation says though?

Mr RUSSO: No, it does not.

The Hon. PETER BREEN: It says six years after the completion of the work or the supply of a kit home, et cetera.

Mr RUSSO: "Completion of the work" has a very wide interpretation. If I put a slab down and the slab is defective, the slab is complete at that point of time. The fact that the rest of the house is not complete is not part of the definition.

The Hon. PETER BREEN: But if you have a builder whom you have engaged to build your house, I assume that putting down the slab is one step in the process.

Mr RUSSO: That is correct.

The Hon. PETER BREEN: You put down the frame, you put in plumbing, you put the roof on, tiles,

walls, and then it is finished, it is complete.

Mr RUSSO: Yes, but in order to get to that completion stage, as Irene has indicated, many of the people behind us, and other people who have been represented, find it can take sometimes many years to get from slab to completion.

Mrs ONORATI: But the completion of the full house, I think we have got to define that first, and, secondly, why council does not issue the certificate. There is something wrong with the house; they are not happy. I have contacted Ku-ring-gai, or whatever council to check with them. I don't know what area.

CHAIR: Willoughby.

Mrs ONORATI: Yes, and I asked them for a re-inspection, like we did with the other people, different councils, and now they have written letters, as I presented to the other inquiry. So the house is physically completed by what the builder says, but is not really appropriately certified to prove that the house is okay. So how can we start counting years if we do not know whether the house is really well or not? It is like human health; it is not healthy.

The Hon. PETER BREEN: But is it not the case that if someone moves into a house, then it is completed?

Mr RUSSO: No, not at all. There are deeming provisions in the contracts which are entered into, which deem consumers to have accepted the home once they take possession. What you have to understand is that in the percentage of cases that go wrong consumers are faced with a situation where they have contracted to build a home, it has gone wrong for whatever reason, most of them are in fact renting premises, paying a mortgage as well, because they are paying their builder off, and so financially they are put in a very difficult position and they go to the limit. What happens is that they reach a point where they can no longer fund both the rent and the mortgage, particularly when you get to about the 85 or 90 percentile of payments to the builder. You pay a couple of hundred thousand dollars to your builder, you are paying mortgage payments of maybe up to \$1400 a month, plus rental of another \$1400 or \$1500 a month. You really have put an enormous amount of pressure on the family. The families are then forced into a situation where they just have to move in to survive.

Mrs ONORATI: They are desperate.

Mr RUSSO: The deeming provisions in the contracts then force people to accept the buildings as they actually are at that particular point in time.

The Hon. PETER BREEN: But that is a separate question. The question we are considering is the question of structural defects and the point at which they ought to begin to become obvious for the purposes of the limitation period of six years.

Mr RUSSO: Not only structural, but the question I understand from Mr Dyer was the different periods of cover for structural and non-structural, and what we are saying is both periods should begin to run from the point of time that the house is actually complete.

The Hon. PETER BREEN: But someone has to make a decision about when it is complete, otherwise the legislation is inoperative.

Mrs ONORATI: Isn't that the council, the local government that issues the final certificate? Isn't that compliance with the Building Code of Australia, the Australian Standards? If a house does not comply with the conditions of consent of the council, how can you say the house is complete? Why does council determine an application subject to the conditions of --

The Hon. JOHN RYAN: The legislation does not say "the house"; it says "the work". So you could be moving in after the work was complete.

The Hon. PETER BREEN: I do not know what the main Act says, I haven't got the main Act here, but I assume there is a definition in the main Act of "completion", isn't there?

Mr RUSSO: No.

Mrs ONORATI: No, there isn't. It is very loosely worded.

The Hon. PETER BREEN: Maybe there ought to be a definition.

Mr RUSSO: The problem, of course, is the Local Government Act says completion is on that certificate, contracts say completion is on provision of all the certificates by the builder, and so we have differing periods in terms of when actual completion occurs. We need to clean that up.

Mrs ONORATI: I am not a lawyer, but what about the contract? The contract states that a final certificate must be obtained and the conditions say that consumers should not move into the house unless they have got a final certificate.

The Hon. PETER BREEN: But if people move in, the council will not issue a certificate. It is a stalemate.

Mrs ONORATI: They believe the builder and they are so desperate, like Sal explained, they do not know, they do not read the conditions, they are not given conditions as I told the other inquiry. They do not even read the contract because the builder says "Sign it". I know there is a cooling time now, but if you ask these people, the builders tell them "Sign it" and take the contract away and then they mail their copy after and some of them do not even receive the contract. The contract has a certain legal value I would say. So if the contract says that a house is not completed unless the final certificate, I think that should set the time too. I do not know about the legislation. I agree with Mr Breen that there should be a definition.

CHAIR: Before we proceed further, perhaps for reason of clarity I should say that this is not a generalised inquiry into the building industry. It is a very specific and focussed inquiry on the recent amending legislation that largely deals with the insurance aspect.

Mr RUSSO: That is where we see the problem - when does completion occur? The two statutory periods would work well if we had a completion date which was generally accepted by all parties as being the completion date of the building, and we say that that is the point of time that the insurance cover should run from, not any earlier period, otherwise we have a problem with non-structural defects and that liability period running on, say, plaster walls in circumstances where the building is only three quarters complete and it takes another 18 months or two years to complete the rest of it. There could be further defects from a faulty roof which do not emerge until two or three years later, which causes undue pressure on plaster or something cosmetic.

CHAIR: Could I ask an insurance related question. One of the principal aims of the Government in introducing the recent amending legislation was to stabilise the home warranty insurance market. The evidence that has been given to us would certainly indicate that the insurance industry has not historically, certainly over recent years, seen this as an attractive part of the insurance market. So the Government would like to introduce new insurers to the market. Insurance Australia Group, formerly known as the NRMA, have given some preliminary indications that they are interested in entering this part of the market. The Master Builders Association have also indicated in the evidence they gave recently that they are at least considering setting up a form of indemnity scheme, which the legislation allows, and the Swimming Pools and Spa Association has also given evidence to the Committee they have a similar interest. They are giving some attention to examining the feasibility of setting up an alternative indemnity scheme. If any of those events were to happen, namely, that IAG or the swimming pool people or the MBA were to enter the insurance market in one form or another, would you see that as beneficial to consumers?

Mr RUSSO: Yes, we do.

Mrs ONORATI: Definitely.

Mr RUSSO: One of the reasons from our experience, particularly my experience with insurers, is that we find the insurers are very much at sea because of complications with contracts and problems associated between consumers and builders resolving their disputes. What we believe is that if this legislation were properly policed, and I think Irene has alluded to that, and that if the Government made a proper commitment to ensuring that the legislation was adhered to, then we believe that there would be a lot more insurance players in the industry, because we have a situation where the failure by the Government at this stage, and I should say there have been attempts by the Government and there have been attempts particularly by this Minister to try and fix the problem, and he should be applauded for that, but what we have is a situation where right at the very beginning of the problem, that is in the registration, licensing, investigating and disciplinary procedures, we are finding that there are too many that are going through the net.

Mrs ONORATI: Multiple victims from one builder is my biggest pain, starting from Henley Properties,

to all of them, even the Nicolls' case, which is a small company, has five. This is the reason why. If a person is punished, whether it is a builder, a driver or a child, we all know that it works, punishment, but builders are treated differently than anybody else and that is the biggest sorrow and this is why we are here today.

Mr RUSSO: We had hoped that the prerequisites that insurers have on builders would have weeded out quite substantially most of the operators who we did not want in the industry, but what we are finding now in most situations is that we have builders who cannot get insurance, are getting their customers to become owner builders or are using their sons or are using other persons to be able to get the insurance. So what has happened is we are getting a -

Mrs ONORATI: Encouragement to breach the regulatory -

Mr RUSSO: - totally new strata of builders who can circumvent the legislation and still build and still cause problems, and so what we are looking for is - we believe with the amendments which have been made, providing that the front end of the legislation, that is the Home Building Act, is enforced, these changes can only be for the benefit of consumers, but if you do not enforce the front end, these changes in large part are a nightmare for consumers because they give consumers even less protection and they deprive consumers of being able to, as Irene said, complete their homes, to have proper cover and so forth.

Mrs ONORATI: I have got to state this, I am sorry, I feel very strongly. I have many meetings and I was speaking very highly of the Honourable John Watkins because I believed he was co-operating, but BARG has opposed the amendments because we believe the legislation that existed was not too bad. It was the implementation of the Home Building Act, of the Local Government Act and all the regulatory authorities not performing, and we wanted the inquiry to really investigate, and from what I have seen in Professor Percy Allan's report, he asked the the Joint Select Committee to investigate because it was not in his terms of reference, and the Joint Select Committee could not investigate because it was not, I think, in their terms of reference. BARG suggested this two years ago, if that had been heard we would not be here today and a lot of families would have been saved.

All you need is to investigate thoroughly. When an inspector goes to a house and spends half an hour or an hour and goes away, he does not do a proper and thorough inspection, and first of all he does not even go for three, four, six months, and when a consumer pays a structural engineer to do an assessment, he is paying two days two people and they do a forensic investigation, putting core holes in concrete slabs, investigating and exposing piers. These are proper investigations.

The report refers to compliance and non-compliance with the Building Code of Australia, the Australian Standards, conditions of consent. Why are not those reports taken into consideration, and they just criticise this man and spend the consumers' money, and they send other consultants for builders. I really feel strongly that with the independence of consultants it is carried out thoroughly and properly, there will be no problems whatsoever. Builders are not perfect. We are always going to have some builders that make mistakes, but how do you repair these mistakes, who does it and how quickly?

The Hon. JOHN RYAN: Can I ask a question relating to the changes to insurance. A couple of areas where I would appreciate some evidence is with regard to the \$200,000 cap on policies. What sort of information are you able to give us, particularly Mr Russo? Are there going to be complications arising from that?

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

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

Mrs ONORATI: \$190,000.

Mr RUSSO: \$190,000. The maximum he got was \$100,000. What we were able to do for him is to at least get the basic structural defects fixed so his house at least would not collapse and he could get an expert certificate from council, but all of those non-structural defects he has been left to have to deal with himself. He does not have the money to complete it. They are the two areas that we have problems with. One is that the \$200,000 limit does not take into consideration delays that might be occasioned over many years, and I suppose the proof is really in the pudding, Mr Breen, in terms of your question, and that is that if the current legislation was working these people would not be here.

Mrs ONORATI: It would not take that long, five - six years.

Mr RUSSO: And that is the problem.

The Hon. PETER BREEN: Can I also say though that if there was a completion date defined in the legislation they would not be in the courts, because defining the completion date has the effect that your chances of getting access to the courts is limited to that specific date, whereas if the date is open you can argue a case that the completion date has not begun because of certain events or the house is not finished or whatever, at least you get a run in the courts. If the completion date is in the legislation, you do not get a run at all.

The Hon. JOHN RYAN: The other area is this, now that the insurance is a last resort scheme -

Mr RUSSO: That is a disaster for consumers.

The Hon. JOHN RYAN: Would you like to explain that?

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

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

The Hon. PETER BREEN: Is that why the Housing Insurance Association supports the legislation that we have?

Mrs ONORATI: That is right.

Mr RUSSO: I think so.

Mrs ONORATI: Definitely.

The Hon. PETER BREEN: They think it is a win for them.

Mr RUSSO: Absolutely, because you have got a situation where most builders are far more affluent than the consumer, and consistently what we found in the old system was that the builder would delay and delay and delay and of course would retain solicitors who would continue to seek adjournments, directions for preparation of cases that would go on for many many months, and of course what would happen then, the consumer, not being able to fund that and having to pay mortgages, pay rent and everything else, gives up, accepts the building in its current form and accepts deed of settlement and takes the building.

Mrs ONORATI: Deed of settlement - you remind me of something. What builders do, they ask consumers to release not only the builder but to give up their home warranty insurance rights. Now, I felt that

that was illegal and I have a case where the tribunal has also put the blessing and their -

The Hon. JOHN RYAN: They have made an order.

Mrs ONORATI: Yes, and that is very upsetting to me. I am not a solicitor, I do not know the repercussions, but I know now one of these men is finishing off the house himself as an owner builder and he will sell it, but he did not complete what Mr Frasca's report has said. We have a letter here which is the response from the builder that he would not settle unless he releases also the building warranty insurance.

The Hon. JOHN RYAN: Can I go to another problem or another issue that may affect consumers, which is the fact that the current arrangements now, in the case of non-completion of a house, limit the amount of cover to 20 percent of the contract price.

Mr RUSSO: We go back to the whole issue of completion, and this is the problem. Why should a consumer be prejudiced in circumstances where assuming the house is 95 percent complete, it has 70 percent defects, and we have seen many houses where we have got a situation where the house is so bad that it probably has to be demolished. Now, if we have not reached the completion stage and we have not got our certificate, we are again prejudiced by the fact that an interpretation of the legislation might suggest they are only entitled to 20 percent of the cost of construction, incomplete work.

The consumer is forced into a situation where we do not have the protection that we need, and what is happening is these changes in our view are for the benefit of builders and for the benefit of insurers and not for consumers because the consumer is faced with limitations. This just puts more fences around the blocks and stops the consumer from obtaining some sort of redress against either the builder or the insurer and getting reasonable compensation, because what is happening here is we are limiting the nature of the compensation and the time for the compensation to be paid.

The Hon. PETER BREEN: Is the consumer worse off under this legislation?

Mr RUSSO: Yes, he is.

Mrs ONORATI: Definitely, it has never been that bad. We are getting from bad to worse. I am getting so upset. I feel I have given to the consumers 15 years for nothing.

CHAIR: If on the other hand there were no insurers left in the market because they found it totally unattractive, the consumers' interests would hardly be served then.

Mr RUSSO: Yes, but we see the problem is not at that end of the market. What we see is that the reason the insurers are having such a problem is because the legislation is not being properly administered.

Mrs ONORATI: That is the core problem.

Mr RUSSO: If the legislation was properly administered, then you would not have as many builders getting through the net and you would not have as many claims.

The Hon. PETER BREEN: That has always been the problem ever since the old Builders Licensing Board.

Mrs ONORATI: And now the Department of Fair Trading.

The Hon. JOHN RYAN: With reference to the Queensland legislation, other than Government ownership, one of the distinct differences I see between the Queensland situation and private underwriting is that in the Queensland situation there is a provision for a payment under the insurance scheme on termination of the contract. That will not be available in a last resort scheme as it operates in New South Wales. Can you explain to the Committee whether the termination provision is one which is going to affect consumers?

Mrs ONORATI: Again, I am not a lawyer and I think it is very important legal technicalities. If you have a builder that does not build properly, and we have many cases of that sort, he has in his contract unlimited delay clause - it is something I have never seen ever before in any contract - what would you do with that builder? Why one should be unable to terminate the contract if the builder has been there on the job two years and done nothing, just excavated and brought a few bricks on site? Why should not the consumer have the right to feel free to terminate somebody that does not perform under the contract?

The Hon. PETER BREEN: My argument as a lawyer would be that they do have a right to terminate the contract.

Mr RUSSO: Yes, but it is a very brave lawyer that terminates a contract. This is always the problem in building cases, unlike other cases, and that is why it is such a specialised field. The average solicitor does not have the expertise to understand building contracts and therefore what happens is when they terminate contracts, they do not understand that there are a whole series of consequences.

The Hon. JOHN RYAN: What I am referring to is the difficulties that may arise when it might be considered to be reasonable for the consumer to terminate the contract because for example the builder refuses to obey an order of the Consumer Claims Tribunal, because the builder's conduct is outrageous and so on. If I may just read a sentence of Professor Allan's report:

Where the builder is still trading and refuses to obey a dispute tribunal's ruling, the consumer may have no alternative but to terminate the contract ... or to trigger the insurance.

That option is not available in New South Wales. What impact will that have on consumers if that remains unavailable? Are there a category of consumers that are going to find themselves in difficulty? If so, could you describe them to us?

Mr RUSSO: There are two issues here. The first is that we have seen almost a similar situation arising under the current legislation, and that is that what happens when a person terminates a contract with a builder and makes a claim on the insurer, there is a provision in the insurance contract whereby the insurer has the right to nominate the builder who is going to undertake the rectification or completion work. In the first instance what happens, and as a means to a negotiated settlement, the insurer on some occasions says, "I am going to re-nominate the builder that you just terminated", and so what happens is you find an escalation in the acrimony between the builder and the consumer because they have already attempted to try and resolve their matters, they have not been able to and so what happens then is that with the builder going back onto site, the dispute usually worsens.

A similar situation would arise in the circumstances that you have indicated, where what would happen would be inevitably the only way that the consumer would be able to complete his home would be to force him to take back the builder, because we are then faced with a situation where there are insufficient funds to have a third party complete the work. You must remember, consumers buying homes normally purchase homes that are beyond their means, and so for the first few years they do not have the capacity even to put curtains up, and in new subdivisions you will consistently see people who put linen up as curtains and so forth.

What we believe is that that will force consumers to have to take back builders and force them into a situation of having to accept substandard buildings and to settle claims in circumstances where they will have no alternative other than to do that.

The Hon. JOHN RYAN: If there is something that occurs to you afterwards, if you would like to make a written submission to the Committee afterwards, please feel free to do so, as long as it is within a reasonably short period of time.

Mrs ONORATI: I would love to. Unfortunately, I am one person.

The Hon. JOHN RYAN: We have had a reasonably brief period of time with consumers.

CHAIR: If you were to make a submission in writing, it would have to be urgent because we have a very short reporting date and the report in its preliminary stages is being written now, so anything you supply would have to come in very quickly.

Mrs ONORATI: I apologise very deeply because I have provided voluminous submissions to the other two inquiries, but this time it has been too close to each other, overlapping, and I have a lot of work to do besides just the advocacy, like the round tables, we have another consultative committee.

(The witnesses withdrew)

PERCY ALLAN, Principal, Percy Allan and Associates, 10 St Marys Street, East Balmain 2041, affirmed and examined:

CHAIR: Did you receive a summons issued under my hand in accordance with the provisions of the Parliamentary Evidence Act?

Professor ALLAN: Yes, I did.

CHAIR: Are you conversant with the terms of reference for this inquiry?

Professor ALLAN: Yes, I am.

CHAIR: Could you briefly outline your qualifications and experience as they are relevant to the terms of reference of this inquiry?

Professor ALLAN: The most specific qualification is that I conducted the national inquiry into home building warranty insurance on behalf of the National Ministerial Council on Consumer Affairs, which comprises all the consumer affairs Ministers around Australia.

CHAIR: Again, could I thank you for agreeing to assist our inquiry. Could I invite you to take us through your material for the purpose of briefing us on your own inquiry, which is of course of Australia-wide significance and what conclusions you came to?

Professor ALLAN: Thank you, Chair. I think you have a handout for this purpose and it is probably easiest if I go through that handout. It is of course difficult to summarise the report which I have got in my bag.

CHAIR: Do you mind as you take us through that material if we ask a question?

Professor ALLAN: Of course not, Chair. This is the actual report itself. I think it is about 130 pages or thereabouts. I will try in 15 to 20 minutes to very quickly walk you through this report, the main parts of it.

The Hon. PETER BREEN: I certainly have a copy of it.

Professor ALLAN: Good, you have the actual report. I will just try to summarise what I think are some of the key things. You may have read it. I think that forms a good basis for discussion and certainly for questioning.

Just starting off, in very simple terms, and I am summarising, I had about 75 meetings with organisations during this inquiry. I received 85 submissions, so I met hundreds of people, builders, consumers and insurers and also, of course, Government officials. The main complaint I heard from home buyers - and I was a little disadvantaged here because except for New South Wales, where Irene Onorati has an organisation, the other States do not have organised home buyer groups. Those consumers I did speak to tended to be consumers who had got into trouble in the system with their home buying, because those consumers who had a happy experience did not come before the inquiry. Those who had a bad experience, their views, if I had to summarise them, were neither insurers nor the law came to the rescue if the home was incomplete or defective. They wanted essentially consumer justice when the building process goes wrong. Again, I am distilling a lot of evidence down to its very essence. The builders' main complaint was that it was difficult to access adequate home building warranty insurance and they wanted accessible insurance so that they could build a sufficient number of homes to make a living. This was particularly true for small to medium size builders and less of a problem for bigger builders. As for insurers, their complaint was essentially that they had only made losses on home building warranty insurance since its inception. I am talking about private insurers here. They wanted a sustainable insurance scheme that allowed them to make a profit. You would be aware that most of them have withdrawn and there is only one large one left.

The next chart shows the home building process. As I got into this, and I have to say that at the beginning when the Council asked me to do this, while I had some understanding of the building industry as I was once chief finance officer of the Boral Group here and internationally, and I have built homes myself and so forth, I was not an expert in this area so I was on a steep learning curve. It became clear after a while that to understand warranty insurance it is necessary to appreciate that it is just one link in a long chain that makes up the building process and if anything goes wrong in any of the other links in the chain, it can result in an insurance claim. So if we want to fix warranty insurance, we really need to strengthen the whole chain. As part

of this I broke the building process into essentially 10 steps. I will not go into that here in detail but starting with builders' licensing, the process moves through building standards, building advice, building contract warranty insurance and so forth.

When I gave evidence to the Joint Select Committee on quality of buildings, they ended up using this process which I had developed and kindly acknowledged that in their report, because I think it is important to think of building as a process, to understand where warranty insurance or any other aspect fits in. If you just look at one aspect, like building advice, or licensing, or building disputes in isolation, I think you will get it wrong. You have got to look at this as an interconnected part. I think that anyone who has got into this would recognise that.

The next chart on home building warranty insurance schemes in Australia is an attempt to summarise a complex situation. Australia, unlike other countries we looked at, has mandatory home building warranty insurance in each State and Territory and until recently half the States and Territories insisted on a first resort insurance scheme (a little like, I suppose, car insurance or burglary insurance, where if something goes wrong you put in an insurance claim to the insurance company) and the other half had last resort insurance. Now a clear majority have embraced last resort insurance. The reason for this, and I will come to this in a moment, is that I think first resort has been a fiction. It has not existed in Australia under the private insurance, and, indeed, even with the Government insurance scheme in Queensland, I would call that a second or third resort scheme because no home builders warranty insurance in Australia offers the consumer first resort, in the sense that if something goes wrong you simply go straight to the insurance companies.

The private insurers expect you to really exhaust every other avenue before you put in a claim with them. In Queensland you are also expected to go through two stages, where you first try to resolve it with the builder, and then the insurance company sends a letter to the builder and the consumer, and tells them to try to resolve it between themselves before the insurer steps in. Overseas, the four countries we examined all generally have voluntary rather than mandatory schemes. The exceptions were three provinces in Canada and two States in the USA. Ontario and Quebec, have a monopoly provider of insurance, a little like the Queensland scheme, and British Columbia, Louisiana and New Jersey in the United States have a contestable market like most of Australia. In all the other jurisdictions (the other provinces and states in Canada and in the UK and in Germany) it is basically voluntary insurance like burglary insurance. It is not compulsory. Like house, building or contents insurance, you do not have to take it out, although in some of the jurisdictions we looked at close to 90 percent of people did take it out even in a voluntary setting.

The Hon. PETER BREEN: Can you say whether the Queensland scheme is better in Australia than the other schemes, the voluntary schemes?

Professor ALLAN: Yes. You will see in my report that I found a number of strengths in Queensland but I think the strength of the Queensland scheme is not just because it is a Government scheme. I think the strength in Queensland is that they reformed the building process I spoke about, back in 1999, whereas the rest of Australia, because of the insurance crisis are really just now getting around to reforming it.

I think that the strength of an insurance scheme, whether it is Government or private, has to be the strength of the building chain. If you have got a weak building chain, then a Government scheme will not succeed, because insurance is a little bit like the last tray where you put all the problems, and so if you have a building process that generates problems, they will end up with an insurer, whether it is Government or private. So the only way an insurance scheme can succeed is if you can minimise the number of claims to a manageable level. Queensland, I think, has been successful, more successful, than other first resort States at doing that.

CHAIR: Professor Allen, in referring to the Queensland situation, have they approached the problem by expediting or improving the approvals processes essentially. Is that the key to it?

Professor ALLAN: I will come to a little bit of evidence about Queensland later in terms of their premiums and their costs and frequency of claims and you will see that they are better than other first resort States, even though they have a more generous scheme. Queensland offers subsidence insurance, it is no fault subsidence insurance so if your home subsides, whether it is the fault of the builder or it is an act of God, you get automatic insurance. No other State offers that. In other States you have to prove it is the fault of the builder.

CHAIR: Except in this State if it is a proclaimed mine subsidence area.

Professor ALLAN: You are right. There are exceptions to it. If suddenly the building subsides, in Queensland they offer basically a no fault insurance scheme and it is their biggest category of claims, with over a

third of their claims. The other States have minuscule claims in subsidence.

Queensland, notwithstanding that has, as you will see in a moment, lower premiums now and lower cost and frequency of claims than the other first resort states. Queensland had their crisis back in 1999 just like other States are having it now, or in the last year. As a result of that crisis Queensland claims also started getting out of control, under a Government scheme. They were having very big problems and their Government scheme got into trouble. They did a number of things as a result of the crisis. For one thing, in terms of dispute resolution they put in place a system where, if the home buyer and the builder cannot resolve the dispute, and they have them go through a number of steps in trying to do that, and they give them time lines. I have not got the exact data with me. The first step is the consumer puts a complaint or a claim in to the insurer. The insurer then writes a letter to the consumer and says would you please notify the builder and gives them two weeks to fix these matters. That helps resolve a lot of the issues, because they have to put it in writing.

If that does not resolve the matter and the consumer comes back to the insurer and says that the builder is not responding or doing what we have asked them, the insurer writes to the builder and the consumer and says "the two of you need to get together and try to resolve this dispute between yourselves. We will give you three weeks to do it. If you can't resolve it, then come back to us". Again, a large proportion gets resolved by people eyeballing each other. If at the end of that it is not resolved, then the Queensland Building Services Authority sends one of their building licence investigators or inspectors to the site of the building, to see what is the defect. Very practical, very practical stuff, and the consumer will say, "Look, I have got ten complaints here", and this investigator, who has to have some mediation skills, will sit them down and try to mediate an outcome.

If they cannot mediate it on the spot, they turn around and say, "Look, as an expert in building, I am going to say that seven of these problems do need fixing by the builder and now I am going to arbitrate on the spot and instruct the builder to fix those seven problems and in the other three cases, I think that the consumer is being a bit picky and frankly I am not going to arbitrate. If you cannot resolve that you will have to take it to court." In 90 percent of cases that resolves the problem. In ten percent either the builder or consumer appeal and they head off to a special tribunal as we have in New South Wales.

With that very early intervention before it becomes acrimonious and there is a total breakdown in trust, there is a feeling by both sides that somebody is going to step in, and fix the problem there and then. This is not just a call centre where you ring up and people tell you your rights, which has been the case in most States of Australia. That is very important because it reduces and keeps a lid on the number of claims.

I think some other things that Queensland has done well is, like Victoria, they have put out a technical notice, and I have the exact name in here, which helps these investigators or surveyors determine what is a defect.

The Hon. JOHN RYAN: That is like the Victorian standards and tolerances?

Professor ALLAN: Yes. Victoria has one and I think the Victorian one is better. At least they have something. I came to the conclusion, and I think that the Joint Select Committee on the Quality of Buildings came to the same conclusion, that the Building Code of Australia and its associated standards, which are not mandatory, are not really a basis for resolving building disputes and I think politicians need to recognise that.

If you send an arbitrator or mediator in, there needs to be a set of standards that they can refer to, otherwise it becomes discretionary. The builder can bring in their surveyor, who will side with them and the consumer can bring in theirs and there cannot be a meeting of minds. So you send it off to some civil court if there is not a specialist tribunal, where there is a group of lawyers who, with due respect, do not have building backgrounds in many cases. They rely on conflicting surveyor evidence being put before them and they have to make a judgment which is very difficult. Whatever judgment they make is not going to be technically based and so somebody is going to be upset and it really drags on. So that was another good thing they did in Queensland.

Another thing they did in Queensland was they said any builder who has been bankrupt cannot be re-licensed or re-registered for five years, because the biggest problem in this industry is insolvency of builders. It results in builders cutting corners and in some cases becoming dishonest because they become desperate. One situation I came across in one State was the apprentice of the year, a chap in the building trades, who decided to become a builder and within two or three years had become insolvent, largely because he was a perfectionist and was under-quoting. In the end he was cutting corners too and got himself into the very strife that he should have avoided, being the apprentice of the year. Technically he was excellent but because of financial circumstances he was cutting corners and causing problems. So that is another thing they have done in

Queensland, and then of course they have put in a tribunal, as New South Wales has done.

Those three measures alone have largely helped Queensland do better in first resort than other States. I believe there are other things that Queensland should do and all the States should do to improve the situation further, and I have said that in my report and recommendations, but even if you just do a few things, I think it can make a big impact, as Queensland demonstrates. That is not a sort of socialist versus capitalist model or Government versus private insurance. Whichever model you pick, that insurer will only stay solvent and be able to offer reasonable premiums if you can contain the level of claims, and that comes back to the fundamental things of having good builders, good houses and a good dispute resolution system. You have got to have those three things.

CHAIR: I think you said earlier in your remarks that the difference between a first resort scheme and a last resort scheme is in effect more apparent than real. Notwithstanding that, most jurisdictions in Australia have chosen, as New South Wales and Victoria now have, to have a last resort scheme. Why do you think that is, that the majority of jurisdictions have opted for that model, rather than for perhaps a Queensland style first resort scheme?

Professor ALLAN: There is a little section I have in the charts called "Stark realities", which I have also written about in my report, because I think if one is going to recommend reforms, as I was asked to do -

The Hon. JOHN RYAN: Page 15.

Professor ALLAN: My page numbering is slightly different to yours. What I have summarised here, if you go to the second point, there is a shortage of insurers, giving them the whip hand in setting insurance policies. In the States where there are private insurers, the reality is we are now down to one large private insurer, Royal and Sun Alliance. There is Reward, but they are very small. Dexta survives in New South Wales and Victoria only because the Government is underwriting their new insurance policies. There is a fourth insurer out there interested, but no-one knows whether they will commit or not. That is almost an open secret. I will not give their name. I think everyone knows them. But they still have not committed. So we have a situation where insurers have got the whip hand. I do not think Ministers around Australia have the whip hand here.

So you can pass legislation deeming that insurers shall do this or do that, but this is not a highly competitive market, for reasons that I have gone into in my report, and those insurers who are still operating can largely dictate their own terms. Because they have been losing money, they are saying, "We will only stay in this market if you roll back the benefits of insurance so we can actually start making money". The conclusion that I have come to in this report is that unless we actually fix the building process so as to reduce claims, the demands from insurers will simply be "Let's roll back the benefits in insurance". If we want more generous insurance schemes, then we have got to actually control the number of complaints that come through insurance, by having better builders, having better buildings and having better dispute resolution systems. Then one might be able to have Governments say "We think we ought to improve the benefits, such as let's cover high rise or let's cover insurance in excess of \$10 million". Present governments are being forced to step in and underwrite these things because private insurers have simply withdrawn.

That is a long way of saying that last resort insurance has been forced on all governments. The exception is Queensland, but even in Queensland's case, they had a crisis earlier. It was politically difficult getting through that crisis. The builders up there told me that something like ten to 15 percent of the builders in Queensland were ejected from the industry as a result of those reforms. The builders up there are now extremely enthusiastic about something which they originally criticised, because they looked at the alternative where this was not done in Australia. They were the first complaining back in 1999, "Why are we being singled out when in the rest of Australia it is easy getting insurance?" They realise now that if you do not get tough on building rules and building standards and dispute resolution, then it will visit upon them as builders with either very tight access requirements or very high premiums. They are now saying, "Do all the reforms they have done in Queensland in the rest of Australia because we know the alternative is worse".

CHAIR: Royal and Sun Alliance came along here and gave evidence, as did HIA Insurance Services. They certainly said to us that historically, and in particular in recent years, this has been an unattractive form of insurance to write, given that losses were sustained year after year. Royal and Sun Alliance has remained in the field. There seem to be indications that Insurance Australia Group, formerly the NRMA, have an interest in possibly entering the market. The Master Builders Association and possibly the Swimming Pool and Spa Association have expressed some interest in considering working up an alternative indemnity scheme.

Professor ALLAN: A sort of fidelity fund.

CHAIR: Yes. That is contemplated by the legislation that was recently enacted in this Parliament here. What do you think the likelihood is in this State of the insurance market becoming more competitive?

Professor ALLAN: I think it is good if the building process gets fixed. At present the premiums have gone up dramatically, and I have got some charts in the handouts on that. I think there will be opportunities for insurers to make a profit with the new premiums, providing claims are reduced and cost of claims are reduced through reforming the building process. If the claims just keep escalating, even the existing premiums may not be sufficient, and that is why I think new insurers are still very hesitant about getting into the market.

We have also got to see it in a global context. Insurance globally at present is not a popular industry. There is one chart in my report - it is not in the handouts - that shows the general insurance losses worldwide in US dollars. See page 116 of my report. You can see what September 11, the attack on the World Trade Centre did. The interesting thing with this chart is in most years natural disasters are far more important than man-made disasters. Indeed, if you take man-made disasters out, insurance claims have actually fallen in the last two years, but in the big picture of capital markets, they looked at this and they said, "Oh my God, if you go back, this thing is escalating out of control", and I think panic set in. What this did was cause a drying up of capital. The only re-insurers that now exist internationally are those with triple A ratings. It is very hard to get money for insurance, and that impacts on Australia. So in turn, of course, the local insurers, when they try to get reinsurance internationally, find it very difficult to get it.

I am sure this situation will calm down as long as there are not any more terrorist attacks or major natural disasters. We may get more insurers coming into this market, but I think the only way we can guarantee that would be to reform the building process, not just rely on higher premiums.

CHAIR: Before we go further, Professor, could I invite you to formally tender this presentation?

Professor ALLAN: Yes, I am happy to do so.

The Hon. PETER BREEN: Including the report.

Professor ALLAN: I am sorry to say this, but I have had a few copyright problems recently. If you want to use any of this, just source it, because the Commonwealth also has a copyright of my material, as I do.

CHAIR: We can absolutely give you that undertaking. You are placing a lot of stress, paraphrasing what you are saying, on fixing the system, fixing the approvals and certification process. That really is the key in your view?

Professor ALLAN: Yes. If you look at the bottom of page 17, as I mentioned, there are about 60 options in my report. I should stress these are not my ideas, but as I talked to consumers, builders and insurers, I pooled together all their ideas. I think the only unique contribution I made here was put it into a framework which links it all together, but otherwise the ideas are really ideas of other people, but I thought they were good ideas. There were 60 options. Of those I picked about 25 or 26 which I rated high or very high. I will go through those I thought were very high options. This is the 80-20 principal, what are the 20 percent of things that might make 80 percent of the difference.

There are four actions which I think are necessary. The first one is to introduce a realistic but fair and transparent insurance framework. That is simply just recognising reality, what private insurers are prepared to offer, unless Government are prepared to step in. They would have to in some respects, but most Governments I met around Australia did not want to get back into this game. Indeed, in Queensland where they had their own inquiry, it concluded that they should privatise the Queensland scheme. So the Queensland Building Services Authority is rather sensitive about this matter and that particular inquiry was sent back to have another look at it, because I do not think Queensland wanted to privatise it at this stage, and, indeed, my report concludes do not privatise it at this moment until the situation settles down.

The first thing is introduce a realistic but firm and transparent insurance framework, and there are a number of things in this. Recognise that the only insurance available is last resort. I have said in my report I think it is a cruel hoax to pretend governments can offer people first resort insurance, unless of course they introduce a Government scheme, and even then they would have to put a lot of money into it to offer first resort because it would be a loss making enterprise.

The second thing would be set the minimum value of work needing insurance at \$12,000, as Western

Australia, South Australia, New South Wales and Victoria do now, so as to rid the system of lots of small insurance claims, because the systems got bogged down with a lot of the smaller claims and some of the bigger claims are just not getting the attention they deserve. Shorten the non-structural cover to two years, as has been the case in the USA, Canada and Britain for a long time.

They are basically the things that private insurers are demanding to stay in this game. I think one has to accede to that at this point in time to settle the situation down and prevent them from walking out on insurance.

The other things would be to underwrite single claims over \$10 million, as is now done in New South Wales, Victoria, Western Australia and South Australia, and high rise, which is only now done in New South Wales, and that means the Government stepping in effectively as the underwriter. Also ask APRA, the Australian Prudential Regulatory Authority, to collect and publish data on insurance premiums, claims and payouts, so that the outcome of any reforms can be gauged. At present there is no data other than that which I have gathered and it was very hard obtaining. Two of the four insurers in the market did not provide me with the data. Without data you do not know whether the risks or the crisis is abating or getting worse. So that would be the first thing.

The second thing is eject cowboys from the building industry. On the next page, tighten the builders' registration requirements, including setting minimum financial criteria and stopping bankrupt builders from practising for five years, as has been done in Queensland, and develop a centralised builders rating system based on each builder's finances, track record and complaints, as has been done in Ontario, or if governments are not prepared to go that far, at least introduce something that Alberta did, which is a "Builders Choice" award, where you get the consumers, the home buyers, when their home is completed, to rate their satisfaction with their builder and the 50 percent of builders who do best get the award and the others do not. In Alberta they had no consumer protection laws, but that measure alone largely cleaned up that industry, because consumers could then very quickly ask a builder, "Have you got a Builders Choice award", and they might say, "In the last five years I have won a Builders Choice award three out of five years" or they might say "I won it five out of five years". If they say, "We have never won a Builders Choice award", they just do not get work, or very little. So they now all compete to get awards and that has worked very well in Alberta.

The Hon. PETER BREEN: Can I ask a question about builders? I have had a couple of complaints from builders who say they have been persecuted by a particularly vindictive owner and as a result the builder has lost his licence, his livelihood and so forth, in what he regards as a legitimate problem but he does not have proper access, and he makes similar sorts of complaints that the consumer makes.

Professor ALLAN: I think that is true.

The Hon. JOHN RYAN: There are only three builders have lost their licence in New South Wales. It could only be one of three people.

Professor ALLAN: You have told me there are consumers from hell like builders from hell.

The Hon. PETER BREEN: I think there are builders who have had a problem with a consumer and it is such a big problem that they just say, "This is too hard", and they do not apply for their licence. They do not appear in the figures, but nevertheless they are the subject of perhaps an unfair interpretation of the legislation in particular cases. I just want to know if it is a general problem.

Professor ALLAN: I found as I went around, consumers and builders themselves said 10 to 15 percent, I heard in Queensland, that sort of figure bandied around, 10 to 15 percent of builders are either dishonest or they are incompetent or they are on the verge of bankruptcy. Most of the problem seems to be they are on the verge of bankruptcy, they do not know how to manage their funds, they under-quote. They are actually the biggest trap for consumers because a builder who is on the verge of insolvency is desperate to get any money, so they will deliberately under-quote to win the job so as to stave off bankruptcy. They are the very builder who will attract a naive consumer, and a lot of consumers are naive because this is their first experience with a home, and that is where the problem really starts. So when I talk about "cowboy builders", and I use that term deliberately, it is not just shonky or incompetent builders. I think that is more a minority problem. It is more a finance problem but people with financial problems often become shonky because that is the only way they can survive when they become desperate. So it does require through the registration system to shake out that 10 to 15 percent of builders, as was done in Queensland.

I should have also mentioned another reform in Queensland was they brought in financial criteria for builders, probably the most important measure in Queensland. That acted as a course front end filter, and I am

saying the same should be done in other States. I know the insurers are being very tough now, too tough, but I think a day will come again where, if they start making money, new insurers will come in and they will relax that financial criteria, and that boom gate, which is very high at present, too high, will be made too low and the cowboys will come back into the industry. Having gone through all the pain of expelling them, and not only expelling cowboys but expelling legitimate builders, the cowboys will come back.

So yes, the answer to your question is there are bad consumers and there are bad builders, I do not know what proportion. When you look through the human population, I think maybe 10 to 15 percent of people are people who are dishonest or they seem to have great difficulty with conventional practice, put it that way. Builders have great problems often with payments, just getting paid.

The Hon. PETER BREEN: Getting paid when they deserve to be paid.

Professor ALLAN: That is another thing I recommend in my report, that there be a schedule of payments for building, so that it is not left up in the air and that is it in the contract, which I suppose brings me to the other point. It is necessary to recognise realistic insurance schemes. That is the quick fix if you like. The things that are going to be more medium to longer term things but which need to be done, because the quick fix will only last so long, are to eject the cowboys from the industry so we are left with good builders. The next one is to set very clear building rules and enforce them, and the last one is to intervene and resolve disputes early.

They are the four points in my action plan, having talked to everybody. Under the point "set clear building rules and enforcement", adopt something like a single standard contract and specifications for all building work between \$25,000 and \$200,000. There are standard contracts already put out by governments. There are also some put out by builders which I do not think are really neutral documents. I think they are designed more for builders than consumers.

The Hon. PETER BREEN: There are standard contracts but there are lots of standards.

Professor ALLAN: That is right. I really think, in this case, particularly for work under \$200,000 governments should look at adopting one contract and having also a standard set of specifications, a bit like the Natspec document. That is a private organisation that has put out a set of specifications. So it can be done, or if that is not done, at least issue official building defects guidelines that can be used to resolve disputes, as has been done in Victoria and Queensland, because I have concluded that the Building Code of Australia does not really prescribe minimum standards for resolving disputes. It sets some standards and then says as long as you can find an expert who can say you can do it another way, that is okay. Of course, if you have got a builder who has not done the right thing, they will find somebody who will say that is okay. I think governments need to come up with something that will help resolve disputes, not just be a kind of handbook for builders.

CHAIR: In regard to some of these reforms you are suggesting, how do you see them being enforced or administered? What I am mulling over in my own mind is that over recent decades in New South Wales there have been a variety of models, Builders Licensing Board, Building Services Corporation, now we have an insurance model, and pardon me saying so, but your successors and the central agencies of Government, by which I mean the Treasury, the Cabinet Office and Premier's, have adopted this current model, as have the other States.

Professor ALLAN: Sorry, this might have been?

CHAIR: The insurance model.

Professor ALLAN: The first resort or the -

CHAIR: The last resort.

Professor ALLAN: The last resort, yes.

CHAIR: Many of the things you are saying appear to be very reasonable. However, there was a Building Services Corporation, there was its predecessor of the Builders Licensing Board. One or other, I cannot remember which, had a gold licence scheme.

Professor ALLAN: Building Services Corporation. It became a meaningless document.

The Hon. JOHN RYAN: Because everybody had one.

Professor ALLAN: It sounded good.

CHAIR: You are talking about a builders choice award to encourage excellence and performance.

Professor ALLAN: Yes.

CHAIR: A lot of these ideas are good, but do you have any particular structure in mind to deliver these?

Professor ALLAN: Yes. You will see on the last page or second last page "Watchtower Group". With regard to that builders choice award and so forth, in terms of carrying this forward, and this is now being done in New South Wales, a consultative panel has been set up, which I have been asked to chair. I hope other States go down this route as well and establish such a consultative advisory panel of builders, insurers and consumers to reach mutual agreement on a suitable package of policy options and monitor ongoing issues in the home building process.

In Alberta one insurer had the builders choice award. It became so popular that it won 85 percent of the insurance market. That was a very clever marketing gimmick but because it was done honestly and genuinely, people only wanted to deal with the insurer who handed out these awards. I think that idea could be applied through the Government doing it or through this watchtower group surveying every home buyer when their home is finished. In Alberta they also surveyed them again after the defects liability period was over, so they actually did two surveys. If you could just survey when practical completion or final completion is done and ask the consumer, "Were you satisfied with your builder" and on a range of criteria such as price, the quality of the work, on fixing things and so forth, give them a rating of one in ten or one in five, you could very quickly identify those builders, the 10 to 15 percent, who have problems with every consumer, from those who do not consistently have problems with consumers. You do not have to give the poor builders a wooden spoon award; you simply need to give the others a builders choice award, because the absence of such an award in Alberta immediately signals to the consumer stay away from builders who can never win such an award. It is a small mechanism, but I think it was a "silver bullet" in the case of Alberta.

I think a group like this could oversight that. It would naturally have to be serviced by Government, like the Department of Fair Trading which services the present consultative group. It is a very good question actually, because if I turn to the first action point - introduce a realistic, fair, transparent insurance framework - you simply do that by legislation or regulation. All of those measures, because they are things insurers do of their own accord, do not require much administration. With a mandatory scheme, you say it is going to be last resort, have a minimum threshold of \$12,000, two years non structural, and that simply gets written into the regulations. That is how you implement that one.

The second one about ejecting the cowboys, yes, it does mean bringing in a different kind of registration requirement, which would bring in financial criteria like Queensland has. It would also mean bringing in a centralised builders rating system. At present we already have public records on builders but they are very scant in their information, and, yes, some resources would have to go into doing that, or if you did not do that, bring in the builders choice award or do both.

The next one is having building rules and enforcing them. I really think the easiest thing here would be to just take the Victoria standards and tolerances guide, if they do not have a copyright on them, and say from tomorrow we will apply those in New South Wales or Western Australia or South Australia or wherever. It does not require a lot of administration. Next setting maximum progress payments for each stage of construction. Victoria does that; Germany does that. Again, I think the Victorian model could be adopted, if the Victorians agreed to that, but there is a document there that could easily be implemented. Require independent on site inspections of each critical stage of construction. This is now proposed in the Northern Territory, their draft legislation. Again, there is a model you can work from. Regularly audit the performance of both private and local government certifiers, as is done in Victoria, and now New South Wales is introducing that, so the work has already been done.

The fourth action point is intervene and resolve disputes early; set time lines for each stage of dispute resolution. This is already done in Queensland, and Canada does this too. So there are models you can use. That really just requires regulations. It, of course, also requires setting up a mechanism for intervention, as Queensland has, when a dispute is not resolved at the end of a particular stage, like mutual negotiation and mediation. There are triggers when things have to be done, like arbitration. Broadening the role of official building licence investigators to inspect and validate building defects. That is done in Queensland, also in

Western Australia where I felt it was under-resourced, and now it is being done in Victoria. In New South Wales it is also being done now, but New South Wales seems to have stopped short of arbitration; it just wants to stay with mediation. My personal view is you do need arbitration if you want to resolve most of the disputes.

Finally, establish an independent panel to hear complaints from builders about insurance rejections or restricted turnover caps. Royal and Sun Alliance has proposed such a model and they want to run with it. All I am saying is let them run with it. The last one is accept the recommendation of the Insurance Council of Australia to request the board of the General Insurance Inquiries and Complaints Scheme to broaden its charter to cover complaints against insurance over home building warranty insurance. That is simply a matter of writing to the board and asking them to change it. I do not think it is a big administrative thing. The hardest part, you are quite right, would be setting up a centralised registry and also sending inspectors on site. That requires resources. But, again, there are models you can copy here. You do not have to be the first inventor of it. There are other jurisdictions, either in here or in Canada, who have done it where one could copy it and improve on it.

The Hon. JOHN RYAN: Can I just ask you a couple of details about your report. One section of your report - not the presentation, I am referring to your report - contained some discussion where you have suggested that there is an option to lower the maximum sum insured to \$100,000, and as you say, it is currently set at \$200,000. We have had evidence where consumers have been able to, I think, argue quite credibly that there are a number of catastrophic loans that go above even \$200,000. I notice that you have rated it as being a medium priority. Are you seriously suggesting that that should be entertained, given the potential impact it would have on consumers?

Professor ALLAN: In a number of States it is around \$100,000 or even less. At the stakeholder meeting in New South Wales, one of the building groups put this up and I was not entertaining it seriously, but at the time, if I remember rightly, a number of consumers said that might be acceptable to them. I have to go back to the notes. That surprised me a little bit. It would certainly reduce costs - well, it would dampen down the costs of claims. The reality is I think it would dampen expectations more than anything else because most insurance claims are somewhere under \$100,000. In fact, the average home only costs about - leave out the land content, right, just look at the home, the average home I think is about \$120,000 or something like that to build. Most of these defect claims do not involve the entire house. They may in some cases, but in most cases the actual repairs come in under \$100,000, but you are right it would leave some exposed. I did not give it high or very high priority, but because a number of builders and consumers said it was acceptable, I thought if it would help abate the present insurance crisis it may be worth entertaining. I think a number of things need to be done at present to calm the situation, and then once the situation is calmed, if that figure proves a problem it could be increased. I do not think for most homes you need \$200,000 insurance.

The Hon. JOHN RYAN: You would not want too many homes to be knocked over, of course, but you would understand if you were the consumer and you have had a particular difficulty with a builder in which you lost not only the home but considerable cost in pursuing the builder, usually when we have to limit underwriting, we tend to limit it at the smaller end of the claims, not the larger end of the claims, and unlike some of the attempts to reduce, for example, pain and suffering claims on workers compensation and motor accident insurance, where some of those may seem to be a bit optional, I think if you have lost your whole house as a result of a builder who has gone pear shaped you are in a much more catastrophic position than others.

Professor ALLAN: Yes. Certainly, in the States I visited which had under \$100,000 - in South Australia \$80,000, Western Australia \$100,000, Tasmania \$50,000, ACT \$85,000, Northern Territory had no stipulated figure - it did not seem to be a big problem because the overwhelming majority of claims are under \$100,000.

The Hon. JOHN RYAN: But then you said you had not met with any consumer groups in those areas.

Professor ALLAN: No. I asked consumer departments in Government "Do you get many complaints about it". It did not seem to be that the ceiling was not high enough in those States. I suppose I am entertaining that idea here because I think there needs to be a two stage approach at present, which I think governments are following, particularly New South Wales and Victoria, that you have first of all got to calm down the insurers, because they are walking away from the table. If private insurers walk away the Government has to step in with a fully fledged Government model, and I do not think any of the finance and treasury departments in Australia favour that, or the Ministers of Finance or Treasury. So I do not think it is politically realistic at this point because governments want to try to avoid becoming the underwriters, unless they absolutely have to, as they now have in some particular cases, like the 10 million dollar excess.

At present the insurers are almost an endangered species who have to be calmed down. Once they get calmed down, governments can start talking to them reasonably about what insurance limits and other things

should be. Anything to calm the situation at present would help, and I think reducing the insurance ceiling to \$100,000 would help, but it is not one of my high or very high priorities for the very reason that you have stated, that some consumers would get hurt if you did that.

The Hon. JOHN RYAN: The Building Action Review Group in the submission they just made prior to this have made some suggestion that perhaps, given there is a need to calm down insurers, that another option might be as is occurring with regard to 10 million claims and high rise, the Government is underwriting the scheme. There would be nothing in your recommendations that would exclude potential for the Government perhaps to look at what insurers say are about a dozen claims a year, where an amount of \$200,000 is involved. There would be nothing stopping the Government from perhaps deciding to indemnify those for the purpose of making the private insurance market manageable.

Professor ALLAN: Not legally, but every time the Government steps in - with the ten million we still do not know what that is going to cost, or with the high rise - it does expose the Government and that is the reason why insurers do not want to get into these things. They are the high risk end of it, and the Government I think has to be very careful that it does not end up with all the high risk and the insurers with the low risk making the money.

The Hon. PETER BREEN: There is a suggestion that one developer in Sydney has a number of buildings which are potentially at risk.

Professor ALLAN: Perhaps so. I think there are some problems in the high rise area. The reason I have recommended the Government do step into high rise is because the private insurers just will not touch it at present. Part of it goes back to some experience - I think it was in British Columbia - where there was a major crisis with a single provider of insurance, a bit like Queensland, a mutual provider of insurance, and there was major water leakage in the buildings at stake, which resulted in the loss of something like a billion dollars. It bankrupted the scheme and the Government actually brought in a contestable private model after that. It lost a lot of money over it. So I think one has to be very careful about what governments are going to underwrite here. It could prove very expensive for them.

In a sense private insurers do look at risk, and they have not been very successful to date, but they try to calculate the actuarial risk involved and they then try to adjust the premiums to reflect that risk, and that immediately signals of course if a problem arises. If a problem arises, either they withdraw from it or they increase their premiums. If the Government steps in, I do not think that solves the problem. They have got to resolve why is there high risk in that area? What can we do in terms of building rules or dispute resolution that will minimise the numbers of claims? Because if you get claims down, you get the risk down and then you get insurers back into the industry, whereas if you just put in an insurance safety net, there is a risk that the claims will just continue escalating and the Government will pay.

The Hon. JOHN RYAN: Is there any realistic action any government can take to deal with those few occasions where a builder does something absolutely catastrophic to a consumer?

Professor ALLAN: Yes, well, the whole report is about - when you say catastrophic -

The Hon. JOHN RYAN: I am talking about an instance for example I know of, but the Building Action Review Group have used similar instances - Mr Paul Vogel. He had a renovator come to his house. It required taking the roof off the house to construct a storey above a single storey; a dispute occurred; the house was left exposed to the elements. The entire lower storey of the house was completely lost and the whole house had to be demolished. The amount of available insurance was \$200,000. It is not a surprise to discover that more than a quarter of that was used in demolishing the existing building and carting it away. There were legal costs involved in suing the builder. So \$200,000 did not even get close.

Professor ALLAN: I think the measures in my report, at least the very high priority measures would address that. Let us just take that as a case study. What would happen? First of all, in terms of registration, it would be interesting to know whether that builder was a builder who, like in a lot of these cases, was facing financial problems and cut corners. So if there was a decent registration scheme that excluded builders who do not have the capital to support the building they are putting up, it would get rid of those builders who cut corners because their finances were shaky. The next thing is if there was a proper contract, a standard contract and specifications that actually went through what should be covered when putting a roof and walls in, then if a dispute arises we can at least go to a document and sort out who is right, the builder or the consumer. Was the consumer paying for a Volkswagon and expecting a Rolls Royce? A lot of these contracts and specifications do not give you any guide when it comes to a dispute, and then it becomes only what he says and what she says.

You have got to have some original agreement, something in writing, before you can resolve the dispute. Furthermore, if one had a centralised rating system, for instance, that person could have checked beforehand has that builder got a good track record or not. He might have made a different decision about hiring that builder. If we had the guide to standards and tolerances and we had inspectors coming in if a dispute arises, to resolve the dispute they could then refer to the guide to standards and tolerances and ask the builder are you within the tolerances or not if it is not in your contract and specifications. Also, if there were inspections of each of the critical stages of the building, those problems should have been picked up earlier by certifiers who are independent and not in the pocket of builders, but are truly independent. If there were time lines set for each stage of dispute resolution, there would be early intervention with these problems so they do not drag on.

I think each of the things I have recommended, if they were in place, should prevent such a problem arising. There is no perfect system. There will always be some things that slip through, but if you think of these measures as really checks in a process, if they are not picked up in the first check, they should be picked up in the second or the third or the fourth.

The Hon. JOHN RYAN: At the very least your suggestion comes as a package, does it not?

Professor ALLAN: Yes, it comes as a package.

The Hon. JOHN RYAN: You cannot implement the insurance measures without the licensing dispute resolution measures and so on, they must be a part of the package?

Professor ALLAN: Absolutely.

The Hon. JOHN RYAN: And it would be fair to say that the New South Wales Department of Fair Trading has essentially said to this Committee and others that that process of reform is complete and in place. You probably take the view that there are still some things they need to look at to improve that process, notwithstanding recent legislation passed last year.

Professor ALLAN: I am chairing a panel at present of stakeholders. Our first meeting is on 14 August. To be fair to the Department of Fair Trading, my understanding is that they are looking at my report and they have already started implementing certain things in it. As I said, most of my ideas are from other people, and other States than New South Wales are also implementing them. Department of Fair Trading are also looking at the quality of buildings report and the Minister is expecting the stakeholders panel to come up with a package of measures that he can consider.

The Hon. JOHN RYAN: I am just referring to the evidence that the Department of Fair Trading has given this Committee. I am summarising a bit. They said, "We did all of that last year and there is little need to revisit those", and they have said that this has been very successful, but certainly with regard to the arbitration system you have referred to and other things, we are certainly not at that stage in New South Wales.

Professor ALLAN: No, I think you are right. They have not gone as far as arbitration. My view is that they should go as far, as Victoria has done, Western Australia and Queensland.

The Hon. JOHN RYAN: Well, it is a modified arbitration system.

Professor ALLAN: Because of this report and the other report, they have said let us reopen the whole thing in terms of the measures. Indeed, they have been waiting particularly on my report because they wanted something that pulled all the ideas together. I do not think they have a closed mind on it. That has not been my impression.

The Hon. JOHN RYAN: You have some discussion in your report about the disallowance of a contract trigger. In Queensland they do have a provision for insurance in situations where it is considered appropriate for the consumer, for example, to terminate the contract. Usually the reason is that the conduct of the builder has been so outrageous that the consumer should no longer have to push on with the process of pursuing the builder. In a last resort insurance scheme there is no process to push that button. Are there any measures that you would suggest that would overcome some of those legitimate issues, because it seems a bit unfair that a consumer, for example, has to continue to deal with a builder who has committed an act of violence or inappropriate behaviour on their premises and so on, and the only thing that triggers an insurance policy is until they are insolvent, even losing their licence would not be sufficient to trigger an insurance claim?

Professor ALLAN: As I have mentioned in here, it is the last of the options. I gave it a low priority

because I suppose if we move to a last resort scheme it becomes much clearer than first resort because you simply look for whether the builder has died, disappeared or become insolvent, which is a fairly black and white situation. I am not a lawyer but I would have thought it is fairly black and white. So that really becomes the only issue. With last resort, I perhaps should stress this, the kind of reforms that I am putting forward in this package are extremely necessary because you fall back on the good registration systems, good building rules and good dispute resolution systems. Because insurance is truly last resort, you have got to exhaust those other avenues, and if a builder has been violent I think that gets into an area of law I am not an expert on. I would be hoping if we had a last resort scheme we will have a registration system that will largely get rid of the cowboys.

The Hon. JOHN RYAN: What about in the instance of not even violence, the builder loses their licence?

Professor ALLAN: Well, if the builder loses their licence, then under last resort, effectively they go out of business.

The Hon. JOHN RYAN: Well, they might go out of business but they might still have assets and who knows where they are. The consumer is still left to chase that builder. Until the builder finally puts his hand up and says "I am insolvent", the consumer awaits the resolution of that dispute. It seems reasonable to me there should be at least, in those circumstances, the opportunity for the consumer to apply for the contract to be triggered, for the insurer to take over. Let's face it, they have far better resources to chase an insolvent builder than an individual consumer might.

Professor ALLAN: Yes. I did not form a strong view here, as you can see. One, I am not a lawyer, but the other reason, this came to my attention was because insurers were worried about it. They said, "We have a problem where consumers are deliberately tearing up the contract as a way of triggering insurance before they have tried to mediate this with the builder and we have somehow been caught under the law that they may be entitled to an insurance claim by simply tearing up the contract". I do not know the solution to this. On the one hand, if you do put a contract provision in, last resort allows the consumer virtually to get first resort.

The Hon. JOHN RYAN: I am not suggesting a discretionary one, but I am suggesting that there might be circumstances, which would be clearly defined, where it seemed to be appropriate to terminate the contract. In New South Wales in the inquiry work was under way in the Department of Fair Trading to set up exactly this by regulation. They were going to define the circumstances where it was appropriate for the consumer to say, "I have had enough", and they would include violent behaviour on behalf of the builder, failure of the builder to come and rectify faults after a significant period of time had occurred, total disregard for orders of the tribunal and in the final instance the fact that the builder had become unlicensed. In those reasonably defined situations, it seems not unreasonable for consumers to have access to an insurance policy, would you agree? They are not for the consumer to trigger themselves.

Professor ALLAN: I think the problem here is that if we do have last resort, where it is disappearance alone, the insurers will expect last resort and if we drag contract disputes back into it, they will simply withdraw. I would have thought the way to resolve this is if you have the Queensland system, the building registry investigator comes on site and says, "These defects, whether structural or non-structural, have to be fixed on pain of losing your licence". That will work.

The Hon. JOHN RYAN: It does not always. If the builder decides to do it, they decide they are going to go to the tribunal or whatever. By pursuing an inquiry, if the Department of Fair Trading, or whoever is looking after licences, discovers the builder has a number of these, they lose their licence. Where does the consumer stand? Until they have all ganged up and taken the builder to insolvency, which will take some time, those people are paying mortgage and rent, and they cannot recover from the insurance scheme until that occurs. Is that not a significant hole in the scheme of last resort, which in Queensland they filled by having appropriate procedures for the termination of the contract. Should we not have at least that? These are not things that can be engineered by the consumer. They are things beyond the control of the consumer, and if they are reasonably and clearly defined, then there might be some potential. I cannot see how insurers can reasonably run away from those things. That is what you insure for, in the event of those things that are beyond your control.

Professor ALLAN: You may have a point. I have to confess on this one I got only one submission. It was more a complaint from the insurers' side. I did not get complaints from others that this was a big issue, so perhaps I did not give it the attention it deserves. I just did not get complaints in this area and from what you have said it perhaps deserves more attention.

The Hon. JOHN RYAN: You have given on page 10 of your presentation a schedule of average premiums. I notice in New South Wales consumers are presently paying about \$770, which I think is now even higher than that, and by comparison to schemes which are operating in Western Australia and South Australia, as I understand it, with the exception of the total sum insured, the schemes in Western Australia and South Australia are fairly similar to those which operate in New South Wales. The only thing that is significantly different is the premiums. Do you think it would be fair that at least some time in the near future premiums in New South Wales and Victoria have got to start approaching that which applies in Western Australia and South Australia to ensure that insurers are not making unreasonable profits?

Professor ALLAN: It is a very good question and in fact I put the question to one of the large insurers, "On what basis did you decide these premiums", and they said, "On the basis of first resort". I said, "Well, now that the States have moved to last resort, will you adjust your premiums", and they then said, "Well, we might, depending on the claims experience". From the insurers' point of view, the way they see it at present, New South Wales and Victoria, the first resort States, have proved a disaster for them. The cost of the premiums and the frequency of the premiums is very high.

That comes through in a particular chart I have got in here. My page is a bit different but it is "HBWI claims frequency and average cost". You can see from this Queensland is higher than the last resort because they have got a general scheme and it was first resort. I called it second or third resort, but I know it is not last resort. But you can see here, whether you look at non-completion claims or defect claims, and I did leave out of this subsidence claims to put it on an equal basis - New South Wales, Victoria, Tasmania which had first resort have a higher frequency in non-completion claims than last resort states. Victoria has low average cost on that, but otherwise the other two are high. As you can see, it is medium or high. It is certainly higher than the other States with last resort.

I think the view of the insurers at present is, "We like the direction it is going in but until we actually see the results we are not going to adjust our premiums because we have been burnt in the past". I think what the insurers are looking for is not just a move to last resort, but also a move to some of these other mechanisms which I have spoken about in my report that exist in Queensland and to some extent in Western Australia, that would help abate the frequency of the claims and the cost of the claims. When that happens, then the only thing that will bring the premiums down is competition. It will require another major competitor coming into the market. Once one of the existing insurers starts making a profit, I think others will come in.

CHAIR: Royal and Sun Alliance when they gave evidence to us recently did suggest that a little later this year they would be reviewing their premiums and the expectation was that they might decline to some extent.

Professor ALLAN: They gave me a similar impression. I asked them about it. They said to me, "We will review them after some time". My personal view is that insurers are private businesses, they are there to make money. They have lost money. If they start making money, they will want to recover losses, and the only thing that will reduce premiums is competition.

CHAIR: Some time ago, responding to Mr Ryan's questions, you did use the expression of the need to "calm down" as it were the insurers. Would it be your view that as a result of this amending legislation having been enacted and effective from 1 July this year, that there would be a tendency to "calm them down", to use your language, for example because of the last resort aspect, a 20 percent liability cut?

Professor ALLAN: Yes, I think it will and I think it already has, but I think until the other measures are introduced or some of the measures, that there may not be new insurers coming into this industry. There is still tremendous nervousness. None of the private insurers have been able to actuarially calculate in the past what the risks were going to do. They have all had their fingers burnt. No-one has got it right. Until they actually see some abatement of the frequency and average cost of both non-completion claims and defect claims, they are going to be hesitant to enter this market. As a first step, what New South Wales and Victoria have done in terms of coming into line with Western Australia, South Australia and the ACT has greatly helped calm the insurers, but at the same time I think the insurers are also looking for a follow-through of other measures that will permanently reduce the number of building claims.

The Hon. JOHN HATZISTERGOS: You mentioned the re-insurance problem. That is not likely to go away.

Professor ALLAN: The international re-insurance?

The Hon. JOHN HATZISTERGOS: Yes, the international re-insurance problem. How far is that

impacting on the situation and how do you see that playing out in light of the reforms and also the capital requirements of APRA, which is a general problem with insurance?

Professor ALLAN: I think the capital requirements of APRA will help. I think it would also be of help if the National Ministerial Council asked APRA to start collecting data on home builders warranty insurance. In the past the total premiums were under 100 million. About a year ago they were around 75 million. My estimate is they are getting close to 160 million now. APRA seems to have a rule of thumb that any category of insurance with premiums of under 100 million does not warrant special attention. So it gets into the sort of "other" insurance basket and there is no dissection of data. When I spoke with APRA, they were prepared, if we could demonstrate, as the report has, that the premiums are now over 100 million, to collect this as a special category of data if they are asked by the National Ministerial Council. Mr Campbell on behalf of the Council the other day seemed to be suggesting that they would be doing that, pressing them to do it. That is just getting the data.

In terms of the re-insurers, the unfortunate thing that has happened is that besides HIH collapsing with FAI, there has been an international insurance crisis which came to a head with the attack on the World Trade Centre, and so capital has dried up in this market. Even if insurers want to come into this business, given that most insurers do not take all the risk themselves, they find other insurers they can share it with, they have to attract the attention of insurers around the world to the Australian market. Here we have got a market that -

The Hon. JOHN HATZISTERGOS: Australia is two percent of the world's insurance market, is it not?

Professor ALLAN: Australia is two percent of most things, so I will accept that as a figure. I did not investigate that, but I know it is very small, and we know that it is split into nine different markets, and we know that insurers worldwide are resisting or walking away from long tail insurance risks. They want short tail insurance risks, things where the costs emerge very quickly. In terms of home building warranty insurance, the non-completions part of it tends to emerge very quickly. The defect part can take years. That is why they are asking for the non-structural stuff not to be insured over two years. They do not like underwriting insurance policies where the costs may take many years to emerge, and we know with the defects insurance, it is not until the seventh year that you have got a rough idea of what are the costs related to the original premiums paid seven years before.

So internationally the re-insurers say, "We do not like certain categories of insurance and home building warranty is one of them, and in this market there are other categories of insurance where we can make good money, so we are going to concentrate on those categories. Secondly, to the extent that this is an area we do not like, there are bigger markets in North America and Europe which are easier to go into. They are voluntary markets. We do not have governments dictating things to us. We can set the policies ourselves. So why would we want to get into a market where politicians are telling us exactly the way we have to offer the insurance?" That is why, of course, governments embrace the last resort, if they are going to have a mandatory scheme, because if they insist on first resort there are no comers. So the fact that this area is not fashionable at present, and Australia in the world market is very unfashionable, having a mandatory scheme when others do not have mandatory schemes by and large, means that we have great difficulty in Australia attracting insurers into risk.

Now, in Queensland the Government is not taking all the risk. The Government scheme in Queensland re-insures 75 percent of its risk. Queensland I think had two things going for it. They had a crisis about a year ago where they made some losses. Their re-insurers stepped in and asked for a tightening of the scheme, which resulted in the re-insurers signing a new contract with them that would last three years. They signed it in June last year, a few months before the World Trade Centre attack. The interesting question is if that contract had been renewed after the World Trade Centre whether they would have got the re-insurance. I think they were very lucky.

The other thing that worked for Queensland was that because the Building Services Authority had existed for a long time they actually had the actuarial data, so insurers can have a look at Queensland and see the results. They cannot do that in other States. It is a fragmented market and no-one has been collecting the data. They can see their own insurer but they cannot see the whole picture. Having had that historical data and having the 1999 reforms put in place and tightened again last year, they had sufficient confidence in Queensland. I interviewed two of them, two of the big ones, and they said, "Yes, we think the premiums in Queensland and their risk profile has been sufficiently corrected to fix our problem". So they signed the contract in mid 2001 and of course September 11 had not happened.

So that was a case where they were prepared to come to Australia before September 11 and they were prepared to get in because there was data and they felt something had been done about the building process. I think we have got to learn from that. We cannot do anything about September 11 but we do need to do

something about the building system.

The Hon. JOHN HATZISTERGOS: If we do these reforms when does the re-insurance problem dissipate if we follow your recommendations?

Professor ALLAN: The quick fix is to move from first resort to last resort and do some of these other things, like lifting the threshold, which calm the insurers, and New South Wales and Victoria have done that. Tasmania I think is about the only one that has not moved now. I am not sure what has happened down there, but I think they are so small that the insurers are perhaps prepared to turn a blind eye to them. They do not turn a blind eye to Victoria and New South Wales. We are too big and we matter.

With the other measures, I believe they could be implemented reasonably quickly. If you had to put a time line on it, six months to a year would be the longest they would take to do. Many of them could be done within months. In terms of the beneficial effects, yes, that could take two or three years to flow through, but of course the sooner you start, the sooner you see the benefits.

I am saying in this report first of all do the quick fix, which is move to last resort and do some other adjustments to the insurance policies, then do the lasting fix, which is fix the bit about home builders, good buildings and dispute resolution. But just fixing that would also in the short-term give insurers the confidence that we are doing something about this problem.

The Hon. JOHN RYAN: Data capture is obviously very important.

Professor ALLAN: Very important, absolutely.

The Hon. JOHN RYAN: Because if you have got a decent data base, you can overcome the re-insurance problem.

Professor ALLAN: Absolutely. This data issue is a bit like asking someone to come around to your swimming pool and taking them up to a high diving platform and saying, "Dive into the pool", and then they ask you, "How deep is it", and you say, "I don't know. Have a look at it. You form your own judgment." If you look into a swimming pool, it could be ten feet, or two feet, it looks the same depth. If you do not have the data, an insurer has to be very brave to go into this market. I have heard you can buy certain data off the back of trucks and other things, but no-one has put the whole data together, and that is what these insurers want, because once they have got the data they can say, "If that is the kind of claim pattern, then we need this kind of premium to cover it".

Another problem with the data is, because there have been so many stops and changes to the system in recent years, we do not have the historical data. Even if we started now, let us say we got all the data from first resort, and that would be difficult too, because it is retrospective data, that will not tell us anything about last resort. When I went to one of the insurers, I said, "You used to be in Western Australia and South Australia and you were making money. Why did you come into New South Wales in 1996?" They said, "Yes, we were making good money in Western Australia and South Australia and we thought the behaviour of consumers in those States was the same as that of New South Wales, Victoria and Tasmania, but we found it was almost like a different nation, it was almost like a different group of people, different standards, and our experience has been completely different." They seemed to be saying that you cannot just take data from a State with a long actuarial experience like Western Australia and South Australia and apply it to a different jurisdiction, even though we are all Australians, and project your costs and your premiums and work out a profit. It is a totally different market. It is like going to Germany or Italy.

And so unless we start collecting data, and that could take a number of years before we have got enough data to pacify the insurers, I think that is going to be a big blockage to getting new people into this market, but at least if we start the process of reform and we go to last resort and do those things, that is the most we can do assuage the insurers. The other things take time, such as the data collection.

The Hon. PETER BREEN: Do you think that consumers are better off under the Home Building (Insurance) Amendment Act or worse off?

Professor ALLAN: I think much of the Home Building (Insurance) Amendment Act to the extent it moves to last resort is simply recognising the reality. In the report I have said it ends a cruel hoax on consumers.

The Hon. PETER BREEN: They do not have any rights when they thought they did?

Professor ALLAN: That is right. I think first resort put a label on a product which was last resort, and I think what this Act is doing is putting correct labelling on insurance. To that extent I think the insurer is better off.

The Hon. PETER BREEN: You mean the consumer?

CHAIR: You said the insurer.

Professor ALLAN: I meant the consumer is better off.

The Hon. PETER BREEN: A Freudian slip?

Professor ALLAN: A Freudian slip. I think the insurer will also be better off. That is clearly why they want it, in the sense that they may stop making losses. I think what the old system of first resort did was lift consumer expectations and generate a lot of claims which were costly to administer and in the end got knocked back anyway. I think under the new labelling, which is more correct, consumers will realise that they have first got to try to resolve the dispute with the builder and governments have to put mechanisms in place to help that. Yes, I think the consumer will be better off in the sense that they will know the product they are getting. As a result, of course, they have to be more wary of the whole process and not assume that there is a first resort safety net waiting to pick them up if anything goes wrong.

The Hon. PETER BREEN: You have emphasised these other measures that operate to supplement the Queensland scheme and you are recommending I think that those measures be put in place here, such as inspectors.

Professor ALLAN: A lot more than Queensland. I have taken stuff from Queensland, from Germany, from Britain. I have pulled out the best wherever I have seen it and tried to put it into a total package.

The Hon. PETER BREEN: In the Queensland scheme, I notice your report suggests, the number of claims are in some years twice the number of claims in other States. I do not understand that.

Professor ALLAN: That is because they have subsidence as well. That is their biggest category of payouts. It is a very generous scheme. Also, the Queensland scheme, because they have stuck with first resort, attracts, if I remember rightly, quite a high frequency of claims but I think the cost of payouts is pretty low because they resolve it pretty quickly.

The Hon. PETER BREEN: Pages 10 to 16 of your report.

Professor ALLAN: Yes, you will see in Queensland they got a medium frequency of claims on both non-completion and defects, which was still better than the results you got in New South Wales, Victoria and Tasmania generally speaking, but they had very low average cost of claims on non-completions and low on defect claims. The reason is that before it gets to insurance, the inspector who arrives on site from the building registry part of the BSA, tells the builder to fix it on pain of losing his licence. So it gets fixed very quickly and as a result the insurance costs are less.

The Hon. PETER BREEN: Yes, but it is still likely to be in the figures as a claim, is it not?

Professor ALLAN: Yes, that is why it comes through as a claim - because in Queensland you must remember it is all under one roof so when a person -

The Hon. JOHN RYAN: The complaint and the claim mean the same thing.

Professor ALLAN: They are all the same. If you think of the Department of Fair Trading lumped together with an insurer and a building commission like Victoria has all under the one roof, that is what Queensland has so a consumer will go to the BSA, (who is insurer, consumer complaints department, resolver, regulator, register of builders, the whole lot) and say, "We are putting in a claim". The BSA says, "Who, before you put in a claim you have to write a letter to the builder". That is stage one. Number two, if that doesn't work. They write to both of them and say "You two have to get together now and try to resolve it". Step 3, we are going to send in an assessor who comes on site and arbitrates an outcome on pain of the builder losing their licence. It still does not become an insurance payout.

I can see certain advantages with all this being under one roof, but I still think in our scheme, a private scheme, it is possible for the Department of Fair Trading to send someone on site to act in an arbitration sense and do exactly what they do in Queensland. But with that of course they also have to have a whole lot of other things to back them up. That would then reduce the number of insurance claims.

The Hon. JOHN HATZISTERGOS: Can you tell me how the Queensland scheme is funded? As you say, you have got regulation and insurance under the one head. It is different here because we have insurance private and regulations Government. How is it actually funded?

Professor ALLAN: I have got an appendix in the back of my report where I go through the finances and operations of the Queensland scheme and that is probably worth reading on its own.

The Hon. JOHN RYAN: I think they pay a premium like we do, do they not?

Professor ALLAN: Yes. They have got an insurance fund and a general fund. The insurance fund gets all the insurance premiums and the general fund covers all those things that deal with builders registration and consumer complaints.

The Hon. JOHN HATZISTERGOS: So that is through the licensing clause?

Professor ALLAN: That gets the licensing fee, the general part, and it also receives subsidies from the budget to deal with consumer matters. This was only sorted out a year or so back when this crisis arose. Queensland was going through a gradual stage of reform. Before that there was some mixture of these funds. It was not all that clear. Now they have actually separated the two, so you can properly evaluate the insurance operation, you can properly evaluate the builders registration and consumer affairs situation. They have also assured me that they have put strong Chinese walls between them, so that you do not fall into the trap that the old Building Services Corporation and the Housing Guarantee Fund in Victoria fell into where the inspectors did not know if their loyalty was with the insurance arm or the consumer arm or what they were with. In New South Wales the old system resulted in a complaint, if you read the Crawford inquiry report, that many of these inspectors were more interested in preventing insurance claims than trying to resolve disputes.

The Hon. JOHN HATZISTERGOS: How do licensing fees in New South Wales compare to those in other States?

Professor ALLAN: I did not go into that in detail. I started with what I thought was a home builders warranty insurance inquiry. Having quoted my consultancy on that basis, I soon found it was a whole home building process inquiry. I have never lost as much money in my consulting practice as I have on this deal. It dragged me into an enormous can of worms. So I had to at some point call it a day, so I did not go into the detail of that.

The Hon. JOHN HATZISTERGOS: One of the criticisms that we sometimes hear, the shock jocks and so on raise, all of this can be done, you can cut the benefits or entitlements of consumers and so on, but there is no guarantee that the premiums will fall or there is no guarantee that the benefits that you envisage would occur in the long-term will actually flow through. How do you meet that sort of criticism?

Professor ALLAN: If we look at the data, the reality is shown in my report. You look at this data here, and it is also true of the premiums, Western Australia and South Australia, because they have got less generous insurance schemes, than New South Wales, Victoria and Tasmania they also have lower premiums and generally lower frequency and average cost of claims. Clearly, if you advertise a less generous product, consumers expect less as well. If you say that your product offers first resort insurance and all these benefits, and it actually does not, do not be surprised if you get a lot of claims coming in expecting what you advertise. Simply pulling the scheme back to something which it actually reflects, as I said, correct labelling, I think that is good for consumers, telling the truth.

Of itself, I do not think that will solve the problem in the end for either insurers or consumers, because from a consumer point of view it will not protect them from all the contractual disputes and those disputes not related to the death, disappearance or insolvency of the builder. If you want to protect consumers from that and you are not going to do it through the insurance mechanism, you clearly have to do it through the consumer protection mechanism, such as better builder registration regulations, better building rules, better dispute resolution. That becomes your fall-back, and so it becomes very important as a fall-back to carry through these other reforms. If you just do last resort insurance, yes, you may get the results ultimately that Western Australia and South Australia have had, but you will leave the consumer exposed.

To be fair Western Australia does have the Queensland model for early intervention. However, I do not think Western Australia has resourced it adequately, but it does have that as a way of helping that situation. I think the way to properly protect the consumer, is to do these other things, otherwise you leave them exposed. Insurers would also welcome it, because unless those problems are dealt with in another court, many consumers who do not fully understand last resort, will still be knocking on the insurer's back expecting them to do something about it.

The Hon. PETER BREEN: And there will be broke builders as well.

Professor ALLAN: That is right.

The Hon. JOHN RYAN: The fact that it is a statutory scheme means that there must be some level of Government monitoring surely.

Professor ALLAN: You are talking about Queensland?

The Hon. JOHN RYAN: I am talking about New South Wales and Victoria. There will need to be some level of Government intervention, at least in terms of monitoring if nothing else, to ensure that exploitative premiums are not taken, because given that everyone who builds anything in New South Wales for more than \$12,000 has to have this level of insurance, the temptation for insurers to be a bit lazy in terms of competitive edge is clearly there.

Professor ALLAN: Yes. I have got a whole section here on what should be done with what I call "sustainable insurance", and I have gone into not only the data collection. I am concerned that APRA might just collect the data but not actually supervise the adequacy of reserves of insurance. As I say, it is not their job to divulge confidential information to individual State governments. If that is the case, and I think that may happen, I have recommended that governments themselves will have to monitor those reserves. I think it would be more sensible to do it collectively through the National Ministerial Council because these insurers are national bodies.

The Hon. JOHN RYAN: There is a bit of difficulty in monitoring insurers though, in that say for example an insurer like NRMA comes into the market, they tend not to hold reserves separately for the home warranty insurance scheme and the motor accident and so on. They are all one big pot. Usually what happens with regard to the motor accident insurance scheme, you are getting individualised statistics that relate just to the operation of that scheme. It has proven to be a little difficult simply because they do not think it of as an individual scheme. It is an arm of their business and they sometimes use the profits in one year to subsidise the losses in another and so on.

Professor ALLAN: There may be one way around it. All of these insurers do what is called triangulation exercises where they take a particular year's premiums and then they project out the emerging insurance claim costs related to that year. So in 2002 we have got so much in premiums, we then calculate for the next ten years how the defects might emerge and the non-completion costs. Of course, at the end of the day you are hoping that total insurance premiums in 2002 exceed the total costs that you have to pay out over the next ten years. I do not advertise particular groups, but I know New South Wales is using Trowbridge at present. Any of these expert insurance actuaries could have a look at those triangulation exercises and say, "Do they look realistic?" We know the evidence coming out on HIH and FAI is that any expert who had looked at the triangulations could have seen that they were not realistic. So I think you can get experts in to say you supply your triangulation results and because we are privy to all of them, but we will not share in-confidence information, we think you as an insurer are, according to the expert opinions, making adequate provision on the best information available. On the other hand, on the case of a particular insurer, we are rather concerned that you seem to be out of alignment with every other insurer. Demonstrate to us that you have adequately provided for these costs.

While I am on that, you mentioned the MBA is coming up with a fidelity fund. They have had some success in Tasmania and I think in the ACT with this. One thing that has made other governments a bit hesitant about it is that with these fidelity funds, they are not really insurance schemes, as APRA told me, because the only guarantee is that you pay out the moneys you have collected in those funds, whereas an insurer has to meet their total exposure. So legally these kind of mutual schemes, if you undercharge premiums, once you have exhausted the pool you are under no legal obligation to pay any more. If you want to go down the fidelity route, that is fine, but other governments other than the ACT and Tasmania have said, "Whoa, you better assure us that you are going to put good reserves in place because otherwise the Government will be the final stop".

CHAIR: They are just described in the amending legislation as alternative schemes.

Professor ALLAN: Yes.

CHAIR: And that they are capable of being approved by the Minister.

Professor ALLAN: Earlier you were asking a question about Government exposure. With this area of the \$10 million and the high rise, one possibility for Government to minimise the exposure to itself is to get high rise developers into a kind of statutory developers fund. The Government could set it up and say, "You have all got to contribute to this and the liability really will be with you collectively", and I think that is something that is worth exploring in New South Wales, Victoria, because they were faced with an ultimatum from these insurers, "What are you going to do about this?".

The Hon. JOHN HATZISTERGOS: This is the high risk areas?

Professor ALLAN: These are the high risk areas, high rise and the \$10 million. In excess I think the Government has had little choice other than to say they are going to step in and be the re-insurers. I think it is possible now to think that through a little bit more and think about perhaps industry fidelity funds that might pay for that if private insurers will not come in. So you could set up a Government type scheme.

The Hon. JOHN HATZISTERGOS: A bit like a nominal defendant?

Professor ALLAN: Yes, or the one that is done in the tourist industry for travel.

(The witness withdrew)

(The Committee adjourned at 4.50 p.m.)