REPORT OF PROCEEDINGS BEFORE

STANDING COMMITTEE ON LAW AND JUSTICE

INQUIRY INTO HOME BUILDING (INSURANCE) AMENDMENT ACT 2002

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At Sydney on Thursday 25 July 2002

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The Committee met at 10.00 a.m.

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PRESENT

The Hon. Ron Dyer (Chair)

The Hon. John Ryan

MICHAEL GERARD HUNTLY, National Manager of Royal and SunAlliance Warranty and Construction, 440 Collins Street, Melbourne, and

DAVID TURNER, National Manager Warranty, HIA Insurance Services Pty Limited, 70 Jolimont Street, Jolimont, Melbourne, sworn and examined:

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

Mr HUNTLY: Yes, I have.

Mr TURNER: I did.

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

Mr HUNTLY: Yes.

Mr TURNER: Yes, I am.

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

Mr HUNTLY: My experience is 20 years in the insurance industry in varying capacities. I am an associate of the Australian and New Zealand Insurance Institute, and have been the national manager for the warranty product for Royal and SunAlliance for 18 months.

CHAIR: Royal and SunAlliance has made a written submission to the inquiry, as you are aware.

Mr HUNTLY: Yes.

CHAIR: Are you happy to have that included as part of your sworn evidence?

Mr HUNTLY: Yes.

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

Mr TURNER: I have been the national manager of the warranty division of HIA Insurance Services in one form or another for the past seven years. I am a registered builder, both commercial and domestic, and have been in the building industry for 30 years.

CHAIR: HIA Insurance Services has made a written submission to the inquiry, as you are aware.

Mr TURNER: Yes.

CHAIR: Are you happy to have that included as part of your sworn evidence?

Mr TURNER: I am.

CHAIR: If either of 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 it was seen only by the Committee, the Committee will be willing to accede to your request, but the House itself does have the right to override our decision in that regard if it so chooses. In commencing the questioning, I indicate to you that both of you may answer questions if you choose or singly if you choose, although Mr Ryan or I may indicate at a given time that a question is directed to either one of you specifically. First of all, what is your general response to the reforms introduced by the Home Building (Insurance)

Amendment Act 2002 and which of the reforms contained in the legislation in your view might be of particular importance for insurers?

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

The Hon. JOHN RYAN: You have answered in general terms. Would you mind telling the Committee which of the reforms were essential and were lobbied for by the insurance industry? If there was a mix of others, I would be interesting to know which ones were yours.

Mr HUNTLY: I was talking, I suppose, from an insurance point of view. Our Royal and SunAlliance particular issues were in relation to the first and last resort issue, the cap and the exemption of high-rise multiunits. They were our three platforms. Anything else, I believe, came out of consultation with the insurance industry.

The Hon. JOHN RYAN: There is not much else, is there?

Mr HUNTLY: The indemnity period, six years, the structural and non-structural definitions, the 20 per cent contract value cap on non-completion claims. That was not one of Royal and SunAlliance but having seen it, I think it will be very helpful in its own right.

CHAIR: Mr Turner, could I ask for your general response now?

Mr TURNER: Certainly. We welcome the reforms. We have been lobbying, along with industry and the insurers for quite sometime, nearly up to three years, for reforms to assist in making sure this is a profitable environment for insurers and maintains adequate protection for consumers long term. So, we welcome the reforms, because we believe they will do that. Certainly they have done that in terms of the sustainability of the scheme in respect of the existing insurers and we hope they will encourage new insurers to the market in the very near future, and we are already seeing signs of that now in the marketplace.

In respect of specifics, it is important to understand that the 20 per cent cap that Michael just referred to was part of the harmonisation not necessarily lobbied for by industry but part of the harmonisation that already existed in the Victorian scheme and was seen as a reasonable reform to introduce into New South Wales. The other reform contained in the package of reforms that was not lobbied for was the lifting of the threshold to $12,000, but that was seen again as a realistic and acceptable reform given that other States around the country already have a $12,000 threshold. So, it was all about consistency and harmonising the schemes as much as possible around the country.

The Hon. JOHN RYAN: Who lobbied for those things, then?

Mr TURNER: The $12,000?

The Hon. JOHN RYAN: And the 20 per cent cap on the contract price for uncompleted work.

Mr TURNER: I think you will find that that was done as a result of the harmonisation of the schemes.

The Hon. JOHN RYAN: Pushed by whom, though?

Mr TURNER: I think you will find that the Victorian and New South Wales governments had a look at the other schemes around the country and established that they were reasonable reforms to take on board at the time.

The Hon. JOHN RYAN: Neither of those were things the insurance industry asked for?

Mr TURNER: Neither of those things, no.

CHAIR: Mr Turner, could I ask you specifically: I note page 3 of your submission expresses general support for the reforms introduced by the amending legislation and you say in particular:

> That the Act fundamentally alters the home warranty insurance scheme for the better.

Do you have any difficulties with the reforms or do you foresee any disadvantages for insurers?

Mr TURNER: No, I do not. I think the reforms have been taken on board as a result of the insurers' requirements, the existing insurers' requirements, to stay in the market. As I stated before, I believe they not only will achieve a sustainable scheme but will encourage new insurers to come into the marketplace. Whereas, prior to the reforms, it was evident there was a lack of interest from other insurers in entering the market and a lack of interest from those who existed.

CHAIR: Do you want to add anything to that, Mr Huntly?

Mr HUNTLY: I suppose the only thing to note with the lifting of the threshold to $12,000, from an insurer's point of view that took a lot of the non-insignificant amount of premium out of the warranty pool, which was a relatively good performing premium. There were not a lot of claims at that level of contract value. So, that was not a setback but it is a disadvantage to us and it does reduce the pool. The other reform that they have put through, they do give a bit more scope for consumers to claim more legal fees under the policy. The way they can claim them is being reduced as opposed to the old position.

CHAIR: I would like to raise a particular issue, that is, the possibility of new insurers entering the market, other than those currently in the market such as yourselves. It is certainly the case that one of the Government's stated aims in introducing the reforms to the legislation is to encourage other insurers to enter the home warranty market. Do you think it is likely that new insurers will enter the market as a result of the reforms? Do you have any view as to who they are likely to be? If that were to happen, namely, others were to enter the home warranty insurance market, what effect would an increase in the number of insurers in the market have on premiums? Can you try to address those issues?

Mr HUNTLY: Perhaps I will address that from an insurer point of view. David is a broker, and they will have been in the market actually looking for other insurers. From our point of view we obviously only have read media reports that the NRMA is considering entry into the warranty market. We are not aware of anyone else. All I suppose I can say from an insurance industry point of view is that the financial risk class of insurance, which warranty falls into, is still not an attractive class of business on a global basis. There is still a capacity squeeze on financial classes.

CHAIR: When you say "global" do you mean international?

Mr HUNTLY: Yes. In fact, a lot of our reinsurance support fell over at the end of last year on the back of parent companies withdrawing from this class. However, if I was looking in Australia and looking for a market to go into, what I would see is that the warranty market would be a relatively underserviced market segment, from an underwriting point of view. It is a market that appears to have got its pricing to adequate levels and it is a relatively stable environment looking to emerge. Given that set of circumstances, and if I could get the expertise to underwrite and handle the claims, then it would certainly be a market that would stack up favourably to enter into it.

The key thing I would be looking at now is the stabilisation of the political environment. There is still the issue of mutuals out there, not-for-profit schemes. No private insurer will compete with an entity that is not competing on a level playing field with a private insurer, and at this stage we have not seen any evidence that not-for-profit mutuals would have to be subject to the same regulatory environment that we are. Other than that, with the reforms coming in, the market appears to be stabilising. We are trying to address service levels, et cetera, which would further serve to stabilise the warranty market. Overall, I suggest that it will look like an attractive proposition to new entrants.

Mr TURNER: As Michael said, HIA Insurance Services is a broker for insurance products generally, not just warranty—my specific role is warranty, of course—and we have had more intimate discussions with the NRMA, quite aside from its public announcement. Although we cannot speak on behalf of the NRMA, it is our understanding that the NRMA is very clear about the fact that it will be entering the market as a direct result of the reforms that have been introduced. Obviously, the NRMA is a large player in our country as an insurer so we are encouraged by that. I think the insurers in the market today, and certainly ourselves, want competition in the market so that the scheme can be sustainable and offer choice to consumers and to builders. We think the reforms will do that and we think there is evidence that that is starting to occur already. Of course, it must be recognised that the reforms were introduced only on 1 July and it will take some time for the effect of the reforms to have an impact on any newcomers to the market place.

CHAIR: The legislation provides that the Minister may approve alternative home building indemnity schemes or some other arrangements. The Committee is aware that at least one industry body in New South Wales has been examining the feasibility of setting up an alternative indemnity schemes. I am referring to the MBA. There was a press report on 16 July in the *Sydney Morning Herald* canvassing the possibility that its interest might mature into creating some non-profit corporation to enter the field. What would be your views on that? For example, what impact do you feel any new alternative arrangements would have on the home warranty insurance market if a development such as I have foreshadowed were to occur?

Mr HUNTLY: One of the things Royal and SunAlliance has always said, and we maintain, is that it is never our desire to be left with as much of the warranty market. We always maintained, and still maintain, that responsible competition would be welcome into the warranty market from other insurers. Any competition is welcome as long as it is on a level playing field. So to the extent that we have stringent capital requirements put on insurance companies from the APRA and all the other regulatory matters with which we comply, any mutual or not-for-profit scheme, to our way of thinking, should be subject to exactly the same requirements.

We note with concern on the mutual side of things that experience overseas is not good for mutuals. For instance, Royal and SunAlliance has an asset base outside its warranty obligations that it can call upon in the event of a major crisis such as what is known as the leaky condo crisis in British Columbia, where losses are climbing through $800 million as a result of a design change on residential construction over there. We do not see that a mutual would be able to meet its obligations in those circumstances, whereas the full weight of a large private insurer would be brought in in that circumstance and we would meet our obligations. Those are some of the concerns we have with mutuals.

Mr TURNER: I just reiterate Michael's views.

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

Mr HUNTLY: The new APRA guidelines for capital adequacy.

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

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

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

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

The Hon. JOHN RYAN: One mutual organisation—the Master Builders Association, for example—has muted the idea that it might do such a thing. It has indicated to the Committee that it would only do it on the condition that it could get an underwriter. If it is underwritten, then I imagine that you would presume that it is—

Mr HUNTLY: Then it is just a mutual in name and not nature. Certainly, if it is not underwritten, one of the things I have trouble coming to grips with, if it is an industry mutual, is you effectively have the members of the mutual guaranteeing their own financial performance. I do not see how they can do that when the aim is to protect consumers against such a failure.

CHAIR: The press report to which I referred a short time ago mentions that the intention of the MBA is to offer discounted insurance to what it describes as select builders, subcontractors and developers who have exemplary records and sound financial practices. The press report says that all members of the Master Building Warranty Corporation [MBWC] would have to have prior building experience, trade qualifications, and be screened for solvency. I imagine that they would be very similar to the rigorous requirements any insurer would impose.

Mr HUNTLY: Yes.

CHAIR: I turn to the question of premiums. What are your views regarding the likely effect of the reforms in the amending legislation on premiums for home warranty insurance?

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

Mr TURNER: I think more generally that the reforms, quite aside from the insurers who are in the market at the moment, if the reforms have the effect of bringing competition to the market, then competition will drive premiums down. It will drive them lower by the pure nature of the competition. But the reforms have to have the effect of reducing the frequency of claims and the cost of claims, and that would have to have an effect in the mid to long term on the premiums charged.

CHAIR: I shall ask some questions of Mr Huntly in particular, although I do not mean to exclude Mr Turner if he wishes to add anything. I note that at page 7 of the Royal and SunAlliance submission the statement is made that it is estimated that premiums may reduce by as much as 20 per cent over the next two years. It appears to us that the submission implies that this reduction will be a direct result of the reforms in the amending legislation. Which reforms do you have in mind?

Mr HUNTLY: It is the three or four that I mentioned before. The move from first to last resort takes an element of uncertainty away from insurers and the lack of control that we talk about in the outcomes—for instance, it removes termination of contract issues from us and puts them back into a more robust environment with the new building tribunal arrangements. That is a saving. The $10 million cap removes some reinsurance requirement from us—we could not get it from the end of this year any way but at the moment there is a cost factor in reinsurance. At present negotiations are under way with the New South Wales and Victorian governments about the operation of the cap, and my understanding is that a cost factor will be associated with the cap that insurers will have to bear. However, at the moment it is difficult to judge the extent to which that will kick in.

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

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

CHAIR: The Committee was advised in evidence from the MBA's witness earlier in the week that Royal and SunAlliance does not intend to review its premiums until December this year. Is that a correct statement of the position?

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

The Hon. JOHN RYAN: How will you know that there are any benefits? Some of these things have long lead times—for example, the change from first to last resort will probably not be visible at all for at least two years because in most cases there will be litigation for one and a half to two years in the Fair Trading Tribunal. Will you see any difference?

Mr HUNTLY: We will be able to see the operation of the tribunals in the new environment. Victoria has set up a new mechanism for handling disputes at the front end. I am not sure whether New South Wales proposes to do anything new other than implement the recommendations of the Joint Select Committee on the Quality of Buildings. But we will be able to view that and see how it is working. The cap will be in place and we will be able to look at it. We will be able to look into a few items in the market.

The Hon. JOHN RYAN: You have not referred to the $200,000 cap on residential buildings. Is that included in the cap or is it another issue?

Mr HUNTLY: No, the indemnity limit on the policy stays the same. We are talking about a major insolvency. If a major builder collapses and the total loss from that builder exceeds $10 million we do not have protection. But the individual benefit of the indemnity limit on the policy still accrues to consumers; that does not alter.

The Hon. JOHN RYAN: What would you do if a major builder such as Henley collapsed with several hundred houses under construction? What would you expect to happen to policyholders under those circumstances?

Mr HUNTLY: There is no change for policyholders: they still have the full extent of cover. It is a question only of where the reinsurance protection cuts in. We had a situation where we could not secure reinsurance beyond $10 million for the coming year. So effectively we would have had to withdraw from those builders who presented an exposure in excess of $10 million. Both the New South Wales and Victorian governments did not think that was appropriate so they committed to introduce a cap under the scheme that the maximum liability from any one event is $10 million, and then reinsurance will pick up beyond that.

The Hon. JOHN RYAN: So there is no difference for a person making a $200,000 claim.

Mr HUNTLY: None at all.

CHAIR: It is stated on page 5 of the Royal and SunAlliance submission that the company increased its premiums substantially in New South Wales by an average of 170 per cent in February 2002. Can you provide the Committee—you may take this question on notice—with data about the level of premiums charged both in New South Wales and other States since Royal and SunAlliance entered the home warranty market?

Mr HUNTLY: I can give them to you verbally now and provide something in writing subsequently. I have figures from 1998, which is when Royal and SunAlliance started measuring. In New South Wales in 1998 the average premium was $140. At the end of 2001 it was $288. As at June 2002 it was $471 and we anticipate that it will be $770 by the end of this year.

The Hon. JOHN RYAN: That suggests that premiums are about to increase.

Mr HUNTLY: No. It is working through. This is a rolling 12-month number so a lot of the old premiums from the end of last year are still included in this figure.

Mr TURNER: They are affecting the average.

CHAIR: So there is a lag effect.

Mr HUNTLY: Yes. The increases from February that are just starting to flow through.

The Hon. JOHN RYAN: So a person paying insurance now would pay an average of $770.

Mr HUNTLY: Yes, in New South Wales.

The Hon. JOHN RYAN: I am pleased that you commenced answering that question now because it would be helpful for the Committee to have some idea as to the value of premiums collected over that period—for the industry; I do not expect each company to reveal that information. It does not seem unreasonable. This is a statutory scheme in which everyone is obliged to participate. The normal marketplace requirements cannot be expected to regulate premiums necessarily—as they do not with the motor accident insurance scheme. I do not think it is unreasonable to ask for the total value of premiums given that the industry, by its own admission, has obtained significant benefits by means of government statutory reform.

Mr HUNTLY: We have no objection to that. The reality is that we have provided full figures, full actuarial reports and a full rundown of our results to the New South Wales, Victorian, West Australian, Tasmanian, Australian Capital Territory and South Australian governments. We have also provided a full set of figures to the ACCC. We went voluntarily to the ACCC when we were looking at what the pricing implications would be given the state of the market at the time. The ACCC has all our data and I am happy to provide the same thing to the Committee. We have tried from day one to be as open as possible with everyone concerned so that everyone was fully aware of the facts of the matter, the real results, the real premium levels and what the real scope of the cover entailed. We are not shying away from that now. I am happy to provide the Committee with everything it needs from Royal and SunAlliance so that you can examine that information in the context of making your findings.

The Hon. JOHN RYAN: Did you give the Government some sort of briefing?

Mr HUNTLY: We gave the Government a full actuarial report.

The Hon. JOHN RYAN: Is it possible to make that report available to the Committee?

Mr HUNTLY: Yes.

The Hon. JOHN RYAN: Obviously if there is any level of confidentiality required you need only ask.

CHAIR: Mr Huntly, please take my question on notice and give us what information you are able at your convenience. Mr Turner, your submission notes that the reforms and this inquiry occur at a time of concern about the long-term viability of the home warranty insurance market. What do you believe is the long-term viability of that market and how do think the reforms might impact on it?

Mr TURNER: We were obviously extremely concerned in December about the long-term viability of the market. I reiterate my earlier comments: We believe the reforms that have been put in

place both in Victoria and New South Wales—this must be viewed in the national context not just in the context of this State—will achieve sustainability in the market through competition, adequate premium rating for insurers and profitability for insurance. We believe the reforms are a step in the right direction towards ensuring sustainability in the marketplace in the long term. I should add that any retraction of those reforms in any way could, in our view, jeopardise the future sustainability of the marketplace.

The Hon. JOHN RYAN: When you say "any retraction of reforms" do you mean all reforms or just the ones that the insurance industry asked for?

Mr TURNER: I think in the main the ones that the insurance industry asked for.

CHAIR: On page 4 of Royal and SunAlliance's submission the home warranty insurance market is described as "a difficult environment". The possibility of the company downsizing its participation in the market is mentioned at page 4 of its submission. Are you able to describe the difficulties that Royal and SunAlliance faces? Do the reforms alleviate some of these difficulties? I think you may well have averted to this matter earlier in certain respects. What is Royal and SunAlliance's long-term approach to its participation in the home warranty insurance market in New South Wales now that the reforms are in place?

Mr HUNTLY: I think the problems we had were the ones that I touched on before—the nature of first resort, the termination of contract issues, the Fair Trading Tribunal and the findings that it made or that it seemed to make in that regard, and our inability or our lack of regulatory clout, if you like, to get builders back on site. It is difficult to balance the needs of consumers and builders, the Fair Trading Tribunal and to have contractors get back and do what they are meant to do—that is, complete a job in a workmanlike manner. So those were the main difficulties. The reforms address all our difficulties.

As far as our long-term plans for warranty are concerned, on the back of the reforms we have committed extensive resourcing to our warranty operation. We have just invested heavily in setting up a second distribution operation. So whereas previously we solely distributed product through HIA Insurance Services we now have a capability to distribute product through a further 23 brokers around Australia. We have set up an additional office in Sydney. We were previously centralised in Victoria. Our staff numbers in the last 18 months have gone from 29 to 80. We have made a significant commitment to back up systems and the benefits of that will flow through the system over the next six months.

We have a significant commitment to the building sector in Australia. It is not just the premium we write in warranty; we also have an extensive involvement in the construction side of the residential sector in Australia. Strategically, our business fits with Royal and SunAlliance's strategy global, which is to become a specialist insurer in its selected markets. The warranty product gives us a product and industry specialisation to pursue. So it is aligned very heavily to what we, as a group, are trying to do. To that extent we are committed. However, the problem is that the warranty market has to perform in the sense of making a profit.

We have never made money out of warranty in its history in New South Wales or Victoria. The reforms enable us to better judge whether the market will make a profit, and we believe it can make a profit. All we ask is that we make a reasonable rate of return to shareholders for the risk we carry over the cycle of the building industry. We recognise that we will lose money in some years because the very nature of the building industry is cyclical and we will have heavy losses in one out of four years. But, over a five-year period, we simply seek to make a 12.5 per cent return on capital that we employ for the business. We are committed to the warranty market.

CHAIR: I think you indicated a moment ago that the reforms introduced by the amending legislation have more or less met the requirements or the needs of the insurance industry. Is it your view, though, that other reforms are necessary?

Mr HUNTLY: Yes. I think that the next step in this process is to actually attack the root cause of the problem—building standards, education and undercapitilisation of the building industry generally. The reason I say that is that there is no nice way to have an insurance claim. The minute

you have a claim you are having an inconvenience. It does not matter how quickly we get an alternative builder on site, he still has to go to the site, quote the work, order the materials and effectively start again. It is a delay. It is not nice, particularly when it is your home. If we attack the fundamental problems—what leads to the insolvency of builders and what leads to poor workmanship—the community will be better off.

Insurers will be better off because that will be reflected in a reduction of loss and we would again pass that on in premium savings to consumers. The preliminary recommendations of the Joint Select Committee on the Quality of Buildings, which saw some more press last week, I believe address a lot of the concerns that we have in other areas, as do the preliminary findings of the Allen review, which we support. So, yes, that is our opinion of what the next step is going to be.

CHAIR: I deal now with the difficulties that builders say they are experiencing in trying to obtain home warranty insurance. Both of you certainly are at liberty to respond to this question. This inquiry has received some evidence and a number of submissions from builders expressing a great deal of frustration about what they term an ongoing difficulty in obtaining home warranty insurance. Reference has been made to service delays. Earlier in the week the MBA referred, for example, to delays in getting responses. I ask you to comment on that. In particular, could you tell us why some builders may be having trouble obtaining insurance from Royal and SunAlliance and anyone in the field? Do you believe that the reforms introduced by the amending legislation will have an impact on the difficulties that are being referred to?

Mr TURNER: I am quite happy to start off by commenting on your question. There are always going to be difficulties with builders getting insurance to a degree. I guess that we should acknowledge that, over the period since the collapse of HIH, there have been some service issues. Those service issues have been directly caused by the collapse of HIH but, moreover, by the uncertainty of the warranty market going forward. There is now more certainty, as Michael said in his comments. Additional resources have been put into Royal and SunAlliance's business but also into our business as the distribution arm. We are now certain about the longevity of the warranty market and we have committed resources to look after those service issues.

Resources to look after service issues alone will not fix all the builder problems. A lot of builders suffer delays because they do not meet the underwriting requirements of not only Royal and SunAlliance but other insurers in the marketplace. We have examples of people that have actually committed to make paid-up capital into their businesses to meet the equity requirements of insurers. They have actually lodged those certificates through the Australian Securities and Investments Commission [ASIC] and they have provided share certificates, but they have not actually capitalised the business. They have not actually put the money into the business.

Because no audit is done by ASIC, of course, unless you are a public company, there is no way of policing whether a builder actually follows through with the requested requirement. We take it on face value that if they have a share certificate through ASIC then the capital injection has been made. Primarily, the underwriter is looking for a number of key indicators. One is net capital to relative turnover of roughly 10 per cent. So if you are turning over $1 million you must have a net worth in your business of $100,000. We are looking at residential market gross profit of about 15 per cent or above, with a net return to the business after overheads of somewhere between 5 and 8 per cent. They are reasonable benchmarks to achieve.

The difficulty is that builders are advised by their lawyers and accountants to protect their assets and minimise their tax, quite legitimately. There is nothing untoward about that. But, in doing so, if a builder presented a company that was worth $2 to an insurer and had not made any profit on paper, it is difficult for an insurer to stand up and say, "We are willing to insure you to the tune of $200,000 for every contract that you enter into on the basis of a capitalisation of $2." A culture change is required within industry so that builders understand that, when they seek advice from their accountants and lawyers about the structures of their businesses, one of the things they must take account of is their requirement to achieve eligibility in the warranty market.

Because the insurer is being asked to insure primarily against insolvency, the key indicator, of course, is their capital requirement and their financial performance. If they choose to take the line

of reducing or minimising their tax and protecting their assets by not holding capital in the business, then unfortunately they will always suffer as a result of an underwriter's eligibility criteria.

Mr HUNTLY: I will take up the service standard issues. As David said, a lot of that was created around uncertainty. For instance, whilst our company was putting a lot of resources into business to cater for the influx after the HIH collapse, a lot of it was temporary. There was a reluctance to make a major capital outlay, given the potential short-term nature of it. Post reform, we, as I said before, have certainly made a significant capital commitment to the business in the way of resources, equipment, office space, et cetera. We will continue to do that. The issue that David was talking about, the financial criteria, if you like, was part of an ongoing change process in the warranty market even prior to HIH collapsing. Our underwriting standards have not changed or become more onerous since mid-2000 which, I believe, was the last change to our underwriting criteria. The problem was that 35 to 40 per cent of the market had to learn about our rules in a matter of weeks, not over the course of a few years. So that created a lot of angst and concern in a builder community.

Recognising that, we did make some concession to the building industry when HIH collapsed in that we set up, effectively, a cover note system for 60 days so that builders could continue to build. We set up a fast-track-style application for smaller builders, sole traders and partnerships. We set up a facility for new builders so that they can enter into the building industry and grow their businesses in a responsible manner. So we are moving. I believe that a lot of it revolves around what should be embarked on as a major education process in the building industry. We are endeavouring to get more information to the builder community about what is required.

A lot of the other issues we get is that builders have a perception that we do not recognise their abilities as builders, we just look at what money they have in the bank and we want all of it. We are listening to all the builder groups, the HIA, the MBA, Be Fair and the Furniture Industry Association. We have talked to all of them individually. We are listening to their concerns. We are slowly getting around to all those associations to educate them about the requirements. We are looking at ways of building the full scope of builders' capabilities into our assessments. It is a learning process. It causes some angst among builders, but we believe that over next three to six months the level of education and information in the marketplace will solve any of those problems that are soluble. There will always be some builders who will not get insurance at the end of the day.

CHAIR: Earlier in the week the Housing Industry Association told us that its estimate of the number of builders awaiting assessment by the insurance industry for the purpose of home warranty assurance was in the order of 400. Would that estimate be reasonably accurate?

Mr HUNTLY: They are our numbers, yes.

Mr TURNER: We provided those numbers. That is accurate. That is for New South Wales only, of course.

CHAIR: Yes, New South Wales. We have heard considerable evidence of the problems faced by builders who have been required to provide deeds of indemnity or unconditional bank guarantees to insurers before they can obtain building warranty insurance. Could you tell the Committee the position of Royal and SunAlliance on obtaining deeds of indemnity? What is your practice?

Mr HUNTLY: Effective from 1 July, Royal made the decision not to take general deeds of indemnity any more. We seek to see the strength of the business itself. We take what we call job specific or developer deeds where there is a joint venture project under way. It is a methodology of bringing together all the joint venture project partners to be responsible for the outcomes of the project. Royal and SunAlliance has not had a particular focus on taking bank guarantees. We do take them in extreme circumstances where the strength of the builder would preclude the builder from getting insurance at all. We may take a bank guarantee in those circumstances. The only other time we will take a bank guarantee is when the builder is, possibly, overstepping his technical capabilities.

For example, if, all of a sudden, someone who had been doing brick veneer $100,000 contracts wanted to build a $2.3 million on the side of a cliff top we would want some protection for him to enter into that contract. That is our position. We are working with our existing customers who

already have deeds with us to build their businesses into a position where we can release the deeds, and we are working through the issues as they come up. The wiping of the requirement for deeds was a pretty big step, and we have to work through some of the issues that is bringing out. But we thought it was a major source of grief for the building community, or that was certainly the feedback we were getting. In light of the reforms we believe that the use of the deeds lessened to a degree in their value. We did not see any reason why we should keep asking for the deeds.

The Hon. JOHN RYAN: It would appear from the material tabled to us by the Master Builders Association at the hearing we conducted a while ago that, generally speaking, the ballpark level of capitalisation that insurers are requiring for builders is in the order of 15 per cent of the contract value of the project they handle. Is that a fair statement?

Mr TURNER: The guidelines are actually 10 per cent net worth relative to the projected turnover. The 15 per cent may come from the gross margin figure. One of the key indicators for insurers is a gross margin of 15 per cent, but it is a 10 per cent net worth. One of the difficulties we have is that a lot of companies are structured as trusts, and discretionary trusts at that. The pure nature of a trust is that it distributes to its beneficiaries, which means that it never holds capital. One of the areas the deed added value in was bringing some of that equity back into that business through an associated entity. You will find now that the only way to get some form of capital into a trust, or some sort of security for the insurer would be for the entity to provide a bank guarantee to the level of 10 per cent of projected turnover. But 10 per cent is the figure for Royal and SunAlliance. Our understanding is that that varies in the marketplace from insurer to insurer.

The Hon. JOHN RYAN: Dexta seems to require something a great deal heavier, judging by the documentation.

Mr TURNER: Quite possibly.

The Hon. JOHN RYAN: How does that compare with the scheme operated by the Government in Queensland in terms of the capital requirements on builders?

Mr TURNER: They have a different ratio. They run on an equity ratio, which is on a sliding scale depending on turnover. I am not sure. They do not publish the net capital versus turnover. They look at a net return on investment ratio. They work on different ratios to our underwriting guidelines. It is hard to compare the two. However, I would suggest that it is probably very similar. Once you do an analysis of the ratios your probably get a very similar result of the outcomes. The way that we express it is to give the builders and their accountants an idea of the capital base they need. It is not only ratio.

There are about 180 weightings behind the risk assessment model that bring in some of those equity issues and performance versus return on capital. It is very difficult, when speaking to a builder, to explain return on capital issues because they can become fairly complicated from an accounting point of view. We find the best way to explain it is that we need the net position in the business exempt of goodwill and all of those sorts of things because goodwill does not come into the net worth of the business. A straight net 10 per cent versus projected turnover is a very simple way of explaining it to the builder.

The Hon. JOHN RYAN: How would the builder have net worth in the business other than money in the bank? I am not a builder and I do not understand.

Mr TURNER: Assets less liabilities and paid-up capital. Their assets could contain loans from external entities, work in progress, and plant and equipment. Together with their liabilities that is their net figure plus their paid-up capital, which is their net result.

The Hon. JOHN RYAN: It is easy to see how a large project home company would be able to easily demonstrate assets, if only in the form of display homes and things they build. I imagine that they would be able to demonstrate quickly that they had some level of assets. If you are talking about Masterton Homes, for example, it appears to own a very significant asset at Warwick Farm, and it would have plant and equipment, capital, office equipment and things of that nature. But a much smaller builder who might build four or five houses in the course of a year tends to have only a truck

and some equipment. Such a builder tends to either hire or procure the equipment, or require subcontractors to provide some of equipment. How do they go about demonstrating a net worth in their business, other than the assets they have acquired personally?

Mr TURNER: It depends on the structure you are talking about. We find that, generally, small builders are either partnerships or sole traders. If they are partnerships or sole traders then they bring to the table within that partnership or sole trader their own assets. Generally, we find smaller entities that are partnerships or sole traders get across the line quite easily because their assets are on the line and, generally, they have well in excess of 10 per cent net worth of their projected turnover. Most of the builders we insure under $1.5 million that are sole traders and partnerships go along merrily without any difficulty at all. It is when they get advice to set up family trusts, discretionary trusts, unit trusts or complicated structures that it is harder to achieve that net capital result, or even a profitable position because they are minimising tax along the way.

The Hon. JOHN RYAN: But, invariably, it becomes impossible for sole traders of that size not to have their homes on the line to capitalise their business?

Mr TURNER: By definition a sole trader is the business, so the asset is on the line whether the sole trader likes it or not. That is the entity the builder has structured. The builder is not signing anything away, he is simply saying that is the way he is going to run his business, as a sole trader, and therefore all the assets he brings to the table are part of his business. Partnerships are the same. They bring the assets of the individual partners to the table. That is unavoidable. The reason they structure companies and trusts is to protect some of those personal assets. When they start to do that without adequately capitalising and without retaining profits they struggle to meet the guidelines set by the insurer. If you put forward a business that is not making a profit and possibly is in negative profit, and one that does not have capital then it is difficult to ask an insurer to underwrite the performance of that business against the possible insolvency when it does not look as though it is performing financially.

The Hon. JOHN RYAN: But it would be fair to say that under the current scheme in New South Wales quite a number of builders would expect that the worst thing that could happen is that they would lose their business, not their homes. If most of the work they had done had gone pear-shaped in some way or another, they would expect to still have a home over their heads but not necessarily a business. It is a significant cultural change to move from that to what you are now requiring?

Mr TURNER: No, I disagree. We are not requiring anything more than what we required back in mid 2000 or even in 1999. If you are a sole trader versus a company, whether you like it or not the structure you have chosen for your business puts your assets on the line every day that you enter into the market. If you choose to change that structure to become a company to minimise your tax and protect your assets then what comes with that is the responsibility to make sure that it is adequately capitalised and it shows a reasonable profit to meet the requirements of the insurer. If it does that in that structure then nobody is asking those individuals to put their assets on the line. Quite the contrary, the abolition of deeds has been the reverse. Insurers do not want individuals putting assets on the line. They want individuals to capitalise their businesses to a level that is acceptable and sustainable. If they do that then they will have no issues with achieving the required insurance.

The Hon. JOHN RYAN: Much has been made of the collapse of HIH and the requirement on the insurance industry to under price the product to compete with HIH. To what extent is that true? I have made comments in the Parliament and perhaps elsewhere about a builder, Rocco Vitalone trading as Vital Homes, who now does not have a licence. For a short time in 1998 he had difficulty getting insurance. When he wanted to get a couple of jobs to raise some capital to pay off some other debts Home Owners Warranty, as it then traded, invited him back to take up a policy of insurance. That is one example, but there may be plenty of others, of builders whose quality was questionable. As it turned out, every item he was insured for has resulted in a fairly significant claim. The insurance industry might have carried out underwriting practices that had nothing to do with HIH where they were taking inordinate risks for unscrupulous builders.

Mr TURNER: I cannot comment on that particular case, but it is fair to say that when the private scheme was introduced in 1996 to Victoria and subsequently in May 1997 to New South Wales, there was a requirement on the insurers in order that the industry was able to operate on the

day of the proclamation or implementation of the new scheme to what is commonly referred to as grandfathering all of the builders across and making sure that they were eligible under the new insurance criteria. As result of grandfathering in Victoria and New South Wales a number of builders, through one way or another, fell through the net and were not assessed adequately. That has been overcome. Since 1999 certainly home owners warranty and Royal and SunAlliance has been working extremely hard to ensure that all builders within their fold are adequately tested under the guidelines that exist today.

The Hon. JOHN RYAN: The focus though is largely on capital requirements. There would be little way in which you would assess the quality of their work, though, would there?

Mr TURNER: The assessment through the risk assessment model—and Michael touched on it earlier to say that we were looking to look more at their technical requirements and their claims activity but the assessment criteria we use is actually weighted some 80 per cent against their financial performance and 20 per cent against their other qualitative information, such as claims and complaints activity, adverse credit in the marketplace, et cetera, time of management in business. All sorts of applications to that assessment occur. The difficulty, though, is where a business does not perform well financially, that any benefit given to it as a result of its good management in terms of technical ability or complaints and claims management is put to one side because the 80 per cent performance overwhelms that. However, if they perform well financially, that 20 per cent criteria from claims activity, et cetera, will add value, if there are no claims, to an already strong existing business.

The Hon. JOHN RYAN: But that is only the history, as you know it, of the builder. Surely, the information database that is available in New South Wales on builders is simply whether or not they have a licence. You would not have access to much other information about complaints history other than what is publicly available, would you?

Mr TURNER: No. It is fair to say that the reliance given from a technical point of view is on the licence that the builder holds. If the builders have been able to achieve a licence we would presume they are competent to carry out the work that they are licensed to do.

The Hon. JOHN RYAN: Under the old BSC scheme that used to operate in New South Wales at least 60 building inspectors used to assess claims and assess builders. The two went together with the level of intelligence that the Government had and the level of expertise they had on the ground was reasonably significant. When the new privatised insurance scheme was developed, as I understand it there was an expectation that the insurance industry would employ some building inspectors to assess claims and get information direct from the building industry so they quite openly peeled back the number of building inspectors they had operating in the field. From information given to the quality of building committee the number of building inspectors available to assess the expertise and work quality of builders is in the order of 11 people as opposed to the previous 60. Would you suggest those figures would require a fairly substantial increase in the number of people physically looking at work in New South Wales from an agency such as the Department of Fair Trading or its recommended equivalent in the quality of building report?

Mr TURNER: Yes. I would agree that particularly given we are now moving to a last resort scheme that the responsibility of the BSC has now increased to giving directions to builders to rectify so that where an owner may have a difficulty with a dispute or claim against a builder and the builder is still trading, the responsibility for directing rectification or completion is on the department and they would obviously have to resource accordingly in order to make that commitment.

The Hon. JOHN RYAN: In correspondence I have received privately but from a person who made a submission to this Committee that basically said to me that they are concerned that there are different criteria for assessing the larger builders than for smaller builders and that essentially the belief within these smaller sole trader builders—and perhaps a stage or two above that—is that there is an attempt by the insurance industry to show more trust in the bigger conglomerates of builders and the bigger project home builders and less trust in the smaller traders. Are you able to suggest that that is not the case, that there is not some attempt to try to restructure the business into a number of easy to manage, larger builders and basically accept the view that a sole trader builder who builds four or five houses ought to be the exception rather than the norm in the industry?

Mr TURNER: All of our builders go through the same financial risk assessment model, which is weighted for all sorts of risk factors and the results of that model come out across-the-board. They are even to any applicant. They do not discriminate against small, large, sole trader company or whatever the structure might be. The model only looks at the extent of their performance. They certainly do not favour large volume builders. I would suggest to the contrary, that the risk factor at that level probably requires more scrutiny than at the smaller end of the market.

The Hon. JOHN RYAN: They put it elegantly and I can quote their letter to me. They suggest that I might consider asking insurers how is it that Henley Homes, for example, can continue to be provided with insurance cover, evident by the fact that they continue to build in other States and I understand they are about to start building in New South Wales—if they have not commenced already—while a small amount of average family builders with no claims and a credible work record are being put through hell?

Mr TURNER: I guess that presumes that the larger builder you mention has not been put through the same hell or has not been required to meet a level of criteria that is as onerous or more onerous than that of the smaller builders that you talk about. I can assure you that there is a requirement—and I am sure Michael will confirm this—from our insurer that large volume builders, because they pose a risk of a larger exposure level, are scrutinised at a higher level than smaller builders, certainly scrutinised at a higher level than sole traders and partnerships, dependent on their performance. Again we do not discriminate but if their performance indicates, both from a claims and complaints point view and a financial performance point of view that more scrutiny is required, then that scrutiny will be placed on those individuals regardless of their size or structure.

The Hon. JOHN RYAN: Some of these problems could possibly be solved in the event that scrutiny and the terms under which a builder might be accepted for insurance were published in a publicly available form and then any builder is able to work out, "Yes, I measure up. I know what I have to come to you with and if I know in advance that I measure up, I know I can easily get insurance." Is there any suggestion that at least Royal and SunAlliance might be prepared to offer such a service and, if so, what would be the time frame for its implementation?

Mr TURNER: We are developing right now, and have been for some time, what we fondly refer to as a builder's kit and an accountant's kit. This is off the back of concerns raised by government and industry that the requirements are not transparent to the industry. The builder's kit is designed to hopefully give the indication to the builder as to what is required in a very plain English form and if the structure becomes too complicated, then the step up is to the accountants kit, which is to be referred to the accountant for a detailed explanation as to what is required. The timing for those two kits is within the next fortnight. They will be placed on our web site so that builders and their accountants can access either one of those kits, which will lead them through the process of making application for eligibility.

Mr HUNTLY: I believe that there are plans afoot to examine a central database of all builders that insurers would make input into on the level and standing of the builder.

The Hon. JOHN RYAN: Is there any information that the New South Wales Government keeps at the moment about builders in terms of their licence that would be useful to insurers and which might allow you to have greater input into their quality?

Mr HUNTLY: I do not think there is a lot of data that we can get access to.

The Hon. JOHN RYAN: I realise that there is a lot of data that you cannot get access to. However, when banks are asked to loan money they have access to a database that is not publicly available except to the individual, who can access it. There is information that the Department of Fair Trading has in terms of complaints that is not published, for example if it results in a warning it is not necessarily published and there is historical data that is available. The builders have argued that they would like their good record to be available to you. In most instances the problem in New South Wales is that a good builder and a bad builder, as far as the public record, have the same record.

Mr HUNTLY: From our point of view, being insurers we are data animals. The more we can see the better quality decision we will make. On the question of the extent to which builders want their

respective records displayed or being touted, I think there have been a couple of attempts, one being our category methodology where it was thought that builders could say, "I am a category one builder so I am much better", but I believe that struck some hurdles in the builder community itself.

CHAIR: I suppose in the nature of things the good builders would be more than happy to have full disclosure and the indifferent ones would have a different attitude?

Mr HUNTLY: Exactly. It is a bit like the deeds question. Deeds are a problem. We waved the deeds and it is a problem.

The Hon. JOHN RYAN: Most builders would be able to access their own records themselves?

Mr TURNER: I think in certain circumstances we ask for that information. It may be that it is only triggered perhaps by a concern about an application or wanting to get further verification about an application. If an application looks on the surface to be a reasonable application, then there would be no need for that but if there is some question, we would delve as deeply as we could do try to find that additional resource.

Mr HUNTLY: I would like to comment on the question of the large builders versus small builders because that perception is close to my heart. One of the reforms should demonstrate how keen we are on riding the major builders. We really cannot cater for them. They are put under the most intense financial scrutiny, to the extent that we require them to get a major outside accounting firm to verify their financial records for us, and that is at considerable cost to that entity. Also, if, for instance, the builder you mentioned—and I came in at the tail end of the problems up here in New South Wales, but I know in Victoria that entity was able to resolve all complaints down there and whilst we did get an element of complaint against that builder coming into our organisation, we were able to sit down with them and go through them and we got a resolution to those problems.

They are under intense scrutiny and certainly as a target market, from Royal and SunAlliance's perspective, if we had our way you would find us dropping down to the smaller builder, which we see as a good customer base. That is one of the reasons why we set up Rapid Access and what we call Assess Express in the other distribution vehicle, to try to enable these people to get faster, quicker and easier entry into warranty insurance. The proposition that the bigger builders are getting an easier ride we reject.

The Hon. JOHN RYAN: I would like to quote a paragraph from a submission to the Committee by the Insurance Council of Australia and seek your comment. On page 5 of their submission they state:

> Builders should not be licensed under the various schemes unless they can meet minimum standards of financial viability. They should also be required to inform the licensing authority of any adverse and material developments in their financial situation, and the authority should have the capacity to suspend a licence until it is satisfied that the builder returns to a financially viable position. As such, it should also be clear that a builder's warranty policy does not cover a builder if the builder's licence has been suspended.

Is it useful for the Government to have a licensing scheme which includes financial viability? If so, would that not simply duplicate what insurers do anyway? What is its usefulness if you had one?

Mr HUNTLY: You are right, it is a duplication because we have our own financial assessments not only to establish the financial strength of the entity but to assess other aspects and then allocate it into a premium band, depending on that strength or weakness or whatever the case may be. The Government could do a basic test, I would suggest, but a more robust and complex test to decide premium categories and that sort of thing will always be done by the insurance company anyway, regardless of what government does. There would be an element of duplication, yes. As far as looking from a start-up phase, if you like, or for the licensing body to be having some sort of financial requirement, it could only help. I am not sure how we would work out how to go about doing it. I think one of the recommendations in the Allan review is that it does happen.

Mr TURNER: I agree with Mr Huntly, it would be a duplication. However, I believe that a minimum entry level would actually develop a culture in the marketplace that builders would know

what they needed to do. On the back of some form of transparency it shows them that this is the minimum standard they will need to require. If they want to get insurance or get a licence and if you then want to top up in order to achieve a different result then by all means do so. The paragraph you read out suggests that the department has the ability to suspend the builder when he does not meet those financial requirements until such time as he gets back to a level that is acceptable. I find that a bit obscure because if you were to suspend a builder and stop him from trading he would have no ability to get back to a level to trade adequately. If that was viewed as a thing to be followed up, it should be followed up on the basis that suspension of the builder will not to assist in achieving the desired result and some other mechanism would have to be developed.

The Hon. JOHN RYAN: With respect, you may have misheard. The Insurance Council of Australia wants to have a bite both ways: they want the Government to licence people on the basis of their financial viability but they do not want to be in a position that if the Government decided to pull the licence of a builder that would trigger a claim. They said, "As such, it should also be clear that a builder's warranty policy does not cover a builder if the builder's licence has also been suspended."

Mr TURNER: I am actually not referring to the trigger of a claim but to the comment in that paragraph that suggested that if a builder during the period of his licence did not meet the financial criteria at any time the builder should be suspended until such time as he does get to that level. The point I make is that it would be impossible to get back to a level if one were suspended from trading.

The Hon. JOHN RYAN: It would spiral downwards and you probably would get a claim?

Mr TURNER: Absolutely.

CHAIR: Mr Turner, as I understand it HIA Insurance Services is acting as a broker for Royal and SunAlliance. Is that the relationship?

Mr TURNER: HIA Insurance Services is a fully owned subsidiary of AON Risk Services which is a broking house. We actually broker the product for Royal SunAlliance, and broker on behalf of the builder to Royal SunAlliance.

CHAIR: Do you have any claims data available that should be reported to the committee?

Mr TURNER: We would replicate Mr Huntly's information.

CHAIR: Mr Huntly, on page 5 of the submission of Royal SunAlliance it states that insurance losses in home building insurance in this State have been greater than any other State or Territory. What are the principal reasons for that?

Mr HUNTLY: One of the more obvious reasons is the large policy limit which is $200,000. Its closest rival is $100,000 in Victoria and Western Australia so it has more capacity to experience a larger loss. The other contributors, I suppose, are large legal and administrative costs experienced in the New South Wales market. The operations of the FTT caused some problems for us in the findings they made which a lot of times we believed were fundamentally wrong, and we had to appeal to the Supreme Court quite regularly to have them overturned. The level to which work is essentially defective in New South Wales seems to be greater than what it is in other States. I do not know whether that is building methodology, which I do not think it would be, quite possibly location. Is Sydney geographically different? Is it more difficult to get things right in this environment? We do not know. We cannot drill down to find out to that extent.

There also seems to be a far more different environment in New South Wales, particularly Sydney. It seems to be a lot more "entrepreneurial" than in other places. We did, more often, experience losses to the full extent of the policy limit than in any other State. We had far more evidence of builder/consumer side deals, if you like: you lock me off the site, I'll go away and get the insurance company to fix it up. There is a lot more of that going on up here. Once again that is all anecdotal. They seem to be the main areas where we struggle in Sydney and the actual legislation which is also similar to Victoria in the first resort and the termination of contract issues that we experience up here.

Mr TURNER: One of the significant differences in New South Wales to other States is the way progress payments are dealt with or not dealt with, more appropriately. In my view there needs to be a review of how progress payments are dealt with so that an owner is not put in a position where they are making payments in advance of work performed. That is, they should be providing payments progressively commensurate with the work that is being performed. I do not think the legislation adequately deals with that issue. It does allow for some of the activities that Mr Huntly is suggesting, that is, where an owner might be persuaded or even willing to, for whatever reason, pay in advance of the work performed and that obviously causes larger average claims costs because it is very hard for an insurer to argue that the owner has paid in advance or whatever because it gets very detailed in the contract.

The Hon. JOHN RYAN: As I understand it, even under the previous scheme before the reforms, any monies paid in advance of a progress payment were not insured?

Mr TURNER: The policy limitation certainly allows for that but it is very difficult to determine whether, in fact, a payment has been made in advance. That is the difficulty and sometimes, I guess, where an owner found themselves in that position the insurer has to look at not only liability under the policy but also the moral implications of the decision they make. There are all sorts of issues under the policy in respect to the conduct of the builder and if those progress payments were derived as a result of the misconduct or breach of trade practices by the builder it could mean that even though the payment has been made in advance then there is some liability.

The Hon. JOHN RYAN: The general comment made in your submission is that the overwhelming bulk of the claims made in New South Wales and other places related to the insolvency of the builder. There seems to be a fairly minor amount relating to defects. Do those figures accurately calculate the level of defects, given in my experience, the difficulty in making a claim for defects under the old scheme? Percy Allen, in fact, referred to the old scheme as a hoax in terms of it being a first resort policy. I have certainly found that many of the constituents who approached me still continue to do so. Their capacity to make a claim prior to the insolvency of the builder was just about impossible and they expressed great belief that once the builder was finally found to be insolvent—often because they had a multiple number of defect claims that they were no longer able to face up to—that finally subsequent orders of the tribunal ultimately bankrupted the builder. As a result, you might record that in your statistics as insolvency of the builder, whereas the underlying cause was the fact that they were inclined to do defective work. Is it not the case that defective work might in fact be a much larger proportion of the statistics than your submission would suggest?

Mr TURNER: I think you need to recognise that we are talking about two different issues here: cost of claim and frequency. The frequency of claims attached to warranty-type claims is far higher than that of insolvency. The reverse is the case because the insolvency ratio in terms of the pay-outs is far higher than that of the frequency of the warranty claims. The frequency of the warranty claims are made up of a number of factors. They are made up of pure breach by the builder and contractual dispute. It has always been our contention, and the insurer's contention, that contractual dispute in its own right does not demonstrate a breach of warranty by the builder.

The breach of warranty has to be determined or made valid by somebody independent of the insurer. The insurer is not there to step in as judge and jury as to whether a breach of warranty has occurred where a contractual dispute is under foot. That contractual dispute has to be determined prior to the insurer knowing whether a breach has been committed and whether liability will flow from that. Once it is determined that a breach has been made valid by a tribunal or otherwise then the underwriter under the policy has the responsibility to give a direction to the builder to rectify that breach. The owner has a responsibility to make access available for the insurer to rectify the breach or direct the builder to rectify the breach.

It is my view that what happens in those situations is either the builder does not respond because of what Mr Huntly said earlier, that is, the adequate regulatory power for the insurer to get the builder back to rectify or because the dispute has got to a level where the owner and the builder are not getting on and the owner is denying access. They do trade out for a number of reasons and we say that if the right regulatory authority gives the direction to the builder then the owner should get an advantage from the new reforms as a result of that ability by the licensing authority to get the builder back to rectify the breach.

The Hon. JOHN RYAN: You have said that the driving force is that insolvency is a significant issue in terms of making claims. Do your figures with regard to insolvency under estimate the level of defects in that defective work is frequently the trigger which leads to insolvency? The Michael Hull-type situation is very rare where the builder appears to have become insolvent for some other reason because he appears to have been quite a high-quality builder with a great reputation for building good homes but suddenly he went bust. Frequently the sort of builder that goes bust goes hand-in-hand with being a defective operator. They have five or six houses afoot, all the claims trigger together and the Fair Trading Tribunal takes the view that this is not the sort of builder to return to the site. The tribunal makes money orders instead of rectification orders. The builder decides he is not interested any more because of the sum total of those money orders and declares himself to be bankrupt. Frequently he operates under a trust so he conserves his own assets and that triggers a claim of insolvency so the impression that you get is that insolvency is the problem whereas the route cause might be defective work?

Mr HUNTLY: We look at what the event is that causes us to pay the claim. The root cause may well be defects but he is ultimately insolvent so we have an insolvency loss. We also have our defect claims as a result of insolvency, which go into the insolvency figures, so they are in there. Then we have pure defect claims, where the builder is still trading and we pay out on those things. The extent to which any data is 100 per cent accurate, when you are relying on a lot of people to input the correct codes from time to time, there maybe some crossover between categories, like a defect claims could be in, the builder ultimately goes insolvent and that claim could remain coded as a defect claim in its own right and not a key effect by way of insolvency.

The Hon. JOHN RYAN: But your statistics would show that a builder who, as I described, had a number of defect orders issued against them by the tribunal in money terms and who then subsequently went insolvent, it would appear in your statistics as solely an insolvency issue, would it not?

Mr HUNTLY: Insolvency, yes.

The Hon. JOHN RYAN: You would not have any record of it being defects. What we are saying is you are being rather harsh on builders about the issue of insolvency whereas if there was a greater level of notice made about whether they are a decent builder or not, the issue of insolvency is unlikely to arise, or less likely to arise.

Mr TURNER: I think it is a generalisation, with respect. Generally, in my experience, what leads to defective work is the inability of the builder to manage the business financially, and shortcuts tended to arise as a result of lack of funds available to the business to manage its activities properly. The primary reason for the dispute and perhaps the defects, in my view, is the inability to manage financially. Sure, the defective work may be the catalyst for the dispute but I do not think it is the underlying issue with the builder's performance. I think the underlying issue with the builder's performance generally will come back to the financial capability of the business.

The Hon. JOHN RYAN: Can I pass on to how the consumers might react to the reforms. They have largely been left out, it would appear, of the equation. They have taken pretty much most of the hits except for some builders who need to demonstrate their capitalisation requirements. Essentially, the reforms overall have resulted in a substantially less level of cover for the consumers for pretty much the same premium. The best they have been offered is a 20 per cent reduction in premium which, by comparison to the cover they are sacrificing, appears in my view to be fairly modest. What research has the industry done to see whether the $200,000 of cover or 20 per cent of contract price is a sufficient level of cover to ensure that most consumers are decently protected?

Mr TURNER: I guess the research from our point of view as brokers and insurers comes from the average claims costs and activity. We maintain that if a builder and a consumer have a proper contractual arrangement whereby the consumer is paying commensurate to the value of work performed, then the losses incurred in the event of a policy being triggered would not exceed in any way the $200,000 cover afforded to then in New South Wales and Victoria. The example of that is drawn from Western Australia and South Australia—certainly in South Australia, where the scheme has been running for nearly 20 years now. They have a maximum liability under their policy of

$80,000, which is far less than the $200,000 afforded here in New South Wales. I think the reasoning for the $200,000 in New South Wales and Victoria is the inflated cost of building in those States. But, if you turn to the average claims cost in those States, they are not that different to those of the States like South Australia and Western Australia. So, they do not reach the level of $200,000 very often.

CHAIR: Can I indicate for comment or agreement that on the bottom of page 5 of the Royal and SunAlliance submission to the inquiry it is stated that the average claims cost in New South Wales in cases of non-completion is $31,406 and in regard to defect claims $8,150. Is that correct?

Mr HUNTLY: Yes.

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

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

The Hon. JOHN RYAN: My concern also relates to the 20 per cent cap. It has been put to me that to some extent from the consumers perspective purchasing home warranty insurance can be something of a pyhhric victory. The costs of documenting that the builder has failed on your premises can be in the order of $5,000 to $10,000 for legal and consultants' costs in a modest situation. I have seen plenty that far exceed that. Then there is the level of dispute. For example, you have described yourself that there are large legal and administrative costs than insurers had to bear before. One imagines in a last resort the consumer will be bearing those costs prior to making a claim. If that is the case, how are we able to ensure that the cost of making a claim, particularly when it is limited to 20 per cent of contract price, which could be as low as $30,000 or $40,000 for many people, will not overwhelm the cost of having the claim paid?

Mr HUNTLY: The 20 per cent only applies to non-completion losses.

The Hon. JOHN RYAN: Indeed, which are the most difficult claims to prove.

Mr HUNTLY: Which are insolvency losses. They are not difficult at all to prove. The builder is either insolvent or he is not. He is either dead or has disappeared.

The Hon. JOHN RYAN: From your perspective it may not be too hard to prove but I think we all know that before the consumer reaches that point a considerable amount of money might have been expended to demonstrate that the builder—the situation where the builder leaves the premises because they are dead, disappeared or just gone insolvent is relatively rare in my experience. Invariably, when the builder leaves the premises a whale of defective work is left behind that needs to be rectified and repaired before the project can even continue. You are limited to $30,000 or $40,000 for a claim—

Mr HUNTLY: That does not apply to the defect component.

The Hon. JOHN RYAN: It does if the defect component is the last thing that the builder did.

Mr HUNTLY: No, that is only the non-completion aspect. It is only if the builder has not finished. If there is defect work all the way through the project, the policy picks up 100 per cent of those costs.

The Hon. JOHN RYAN: Up to $200,000?

Mr HUNTLY: Up to $200,000, yes.

The Hon. JOHN RYAN: Including the costs of litigation, which sometimes can be quite significant?

Mr HUNTLY: If the consumers have to prove their loss by way of legal representation, they have cover under the policy for that.

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

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

The Hon. JOHN RYAN: But given that that just covers the cost of the claim, it does not cover any costs in documenting or recovering it—for example, some of the things a consumer might be expected to do is to pursue the builder into the Local Court for debt recovery, and so on. The builder could have left the premises as a result of the dispute and they might still have to go through the Fair Trading Tribunal and demonstrate the various things with regard to the builder. So, there will still be some recovery costs on the part of the consumer. If it was 20 per cent of the cost of the sum insured, at least it might more adequately cover some of those rather than the contract price which virtually allows nothing available for the cost of the recovery.

Mr TURNER: I am not sure that I understand. The 20 per cent only comes in if the insurance policy has been triggered. If the insurance policy has not been triggered, I would have thought it would be incumbent on the tribunal to place an order on whoever is responsible to pay costs. So, the argument of costs would only come in if the policy had been triggered.

The Hon. JOHN RYAN: So, I take my builder to the tribunal, fighting to the death as normally happens, and the builder has an order to pay costs, my legal costs, and to complete the work. Then the builder says, "Sorry, I am bankrupt." That is a very typical situation, I suspect. All the consumer will be able to claim is 20 per cent of the contract price, even though the cost of getting to that point will be far in excess of that, yet they will have paid a premium for which they will get a small amount of those costs back.

Mr TURNER: They will get 20 per cent of the contract price for non-completion. The legal costs I would refer to Michael. I am not sure what the legislation in its new form says about legal costs in that event.

Mr HUNTLY: If action has been taken by a consumer against the builder prior to a claim being triggered, that is the consumer's cost. Once the policy is triggered they have legal costs protection under the policy, as I understand.

The Hon. JOHN RYAN: Yes, but what is the point if the amount of money I can claim on a building that is left incomplete and which over the period of time that the dispute occurred the frame may weather, vandalism may occur, and so on? In addition to that, the costs may continue to spiral in the building industry itself. What happens is the consumer has a cost in pursuing the builder through all those tribunals. You intended this. You wanted it only to come to you as a last resort. So the consumer chases the builder through the tribunal. At the end of that the consumer chases the builder through the various debt recovery options available in New South Wales, all of which is at a substantial cost. Then they come to you with the claim which will only cover them for the cost of getting the work done perfectly the first time. None of those costs of recovery will be taken into consideration. It may well be that the sum they can claim from you is $30,000 or $40,000, because that is 20 per cent of the contract price, and I am certainly aware of plenty of consumers who have

paid $25,000 to $40,000 in costs in pursuing the builder. The whole point of having an insurance policy will be somewhat pointless.

Mr TURNER: No, that has not changed, with respect. The position before 1 July, if the builder was in dispute with the consumer and the consumer incurred legal costs as a result of that dispute, there was no direct ability on the consumer to claim those legal costs through the policy. Only where the insurer had denied liability and the consumer took the insurer to the tribunal and incurred legal costs and they were found to be correct in their argument were those legal costs covered under the policy. The responsibility for the insurer, in my understanding, prior to the legislative changes—

The Hon. JOHN RYAN: Whether it has changed or not, I am putting to you the point of view that if I am a consumer paying for a policy, I want to be able to recover the costs that I might reasonably lose. That is why consumers buy home warranty insurance, in addition to the fact that it is compulsory. I am putting to you that it is very common that the value of the insurance company will be so hopelessly inadequate to cover the cost of the process, which has now by your own admission been made all the more difficult because the consumer will have to come to you last and not first. Under those circumstances, will the level of cover be sufficient, particularly given that it is limited to 20 per cent of the contract price in certain circumstances?

Mr HUNTLY: It has been operating in Victoria for five years and I am not aware of a single problem with it. Time will tell in New South Wales.

The Hon. JOHN RYAN: I would not want to be the experiment.

Mr HUNTLY: It does not cause any problems anywhere else. The last resort nature of schemes does not cause problems to consumers that we are aware of in South Australia and Western Australia.

The Hon. JOHN RYAN: You said in evidence already that with a last resort scheme the insurers incurred a significant number of legal and administrative costs. They will not disappear. The process of resolving complaints is pretty much the same. Only 20 per cent of the people who have the front end dispute—first of all, at the moment the builder can opt out of the front end dispute so a particularly difficult builder can put the consumer through the whole process.

Mr TURNER: I think we need to go back to whether the insurer was even rightly involved in a dispute resolution process prior to the change. The insurer's position, I am sure and it certainly has always been my position, is that the dispute—there are two contracts afoot. One is a contract of insurance and one is a domestic building contract between the builder and the owner. The insurance is there as a safety net to protect the consumer against breach of warranty. The dispute between the owner and the builder in the tribunal has not yet determined whether a breach has occurred. Only when it is determined that a breach has occurred should the owner have the right to have a claim under the policy. What was happening under the old regime is that the insurer was being joined to each and every dispute, regardless of whether a determination had been made at that time, and spending lots of money on legal costs as a result of being joined. So there was an additional cost to the consumer in the big picture as a result of them being joined to that dispute.

Mr HUNTLY: They are our costs. The legal and administrative costs we referred to are our costs. The consumer is already bearing them because we are not paying their costs, and we are not paying the builder's costs. This is just another set of costs.

The Hon. JOHN RYAN: Why will the consumer pay for a policy that is hardly likely to be triggered in the event of insolvency because you people are now taking enormously more effort to make sure that the builder is less likely to become insolvent. The thing that really bugs consumers is having a defective builder on their premises, whereas previously they had some residual level of cover. That level of cover has just about disappeared because in order to get anything from a builder they will have a very long, difficult and arduous pursuit of the builder to every available tribunal to the point that you have to drive the builder insolvent or cause him to disappear, then they can come to an insurance policy they paid for and get cover.

Mr TURNER: I think that question must be taken in the context of the new ADR process that has been put in in New South Wales. The intention of that was of course to ensure that the consumers and the builders did not get into longwinded legal disputes in respect of the Fair Trading Tribunal. It must also been taken into context the fact that the BSC or the licensing body is to perform a more regulatory function in terms of directing builders to rectify problems where they have inspected them and found them to exist. Therefore, those two functions in my view will more adequately deal with that consumer's concern than automatically getting everybody involved in a Fair Trading Tribunal where we are inviting legal representation on everybody's behalf and spending a lot of money which can be cut off at the start by introducing alternative dispute resolution and proper direction from an authority that has the ability to give that direction and to suspend builders who are recalcitrant and do not follow those directions.

The Hon. JOHN RYAN: We have yet do see that in New South Wales. One of the other advantages of the Queensland scheme for consumers, I would have thought—and I would like to put to you that it might be of some value to the overall scheme—is that the Queensland Government is of the view that there are certain circumstances where the difficulty between consumers and builders falls between two stools. The Queensland Government provides for what it calls termination cover in which it essentially says, "Yes, it is reasonable for this contract to be terminated largely because of the conduct of the builder." Sadly, there are some builders whose conduct is so appalling that no consumer should be expected to continue with them.

Then essentially what happens is that the service in Queensland picks up the dispute at that point for the consumer, pays someone else to do the work and then obviously with a great deal more regulatory muscle it is able to take over the dispute and claim the costs from the builder. Expecting a consumer to do that is expecting the consumer to do that from a point of unbelievable weakness by comparison to a builder. Would it not be helpful to build that into the scheme either nationally or at least in New South Wales? If a consumer was able to take a dispute to the tribunal and the tribunal was able to terminate the contract, that might be a useful point at which triggering an insurance policy might be appropriate, bearing in mind that the insurer has the capacity to chase the builder—in fact, better so because there are now deeds of indemnity and other guarantees available for the insurer to claim against. That might be something which at least alleviates that concern of consumers.

Mr TURNER: No. I think that that function needs to be driven back to the licensing body. One thing we have said repeatedly is that the insurer should not be the regulator of recalcitrant builders in the market place. The regulator should be the licensing body. The licensing body conducts that function quite successfully in Western Australia and in South Australia, and it has for many years. We believe the only way the licensing body will come to terms with those builders who continue to be recalcitrant is to understand who they are and what effect they are having on consumers and the industry. They should be the body responsible for providing those directions and any form of recovery for the consumer.

The Hon. JOHN RYAN: Do you not see that as a service you could provide to consumers? There was some suggestion that there were attempts to harmonise all of the schemes. I have noticed that, with the exception of the $200,000 level of cover in New South Wales, all of the aspects of harmonising the schemes in New South Wales have been downwards, and it has been settling on the lowest common denominator. That appeared to be one item that might have been picked up by the insurance schemes. Nobody is suggesting the insurer would be the regulator. The insurer would simply provide the service in the unusual event that the consumer was able to demonstrate to a tribunal that their builder was no longer worthy of continuing with the job or in fact the builder might have lost his licence.

That will also be a significant difficulty to consumers but that is one area of assistance which insurers could give because their capacity to chase a builder for outstanding debts is obviously significantly greater than that of consumer. For example, the insurance industry is in a position to say to a builder, "Unless you pay back the money we have paid on this claim, you will not get any more insurance and your business is effectively finished." That would influence most builders to pay the debt. You have deeds of guarantee. That sort of service, for example, is offered in the motor vehicle claims service where companies like the NRMA agree that where there is an obvious capacity for the insurer to recover the costs they take over the service for the customer.

Mr TURNER: I will let Michael cover this, but my feeling is that there would be a difficulty to do that unless there is an insurance claim. I also go back to my previous comment that I believe it is the licensing body's responsibility, not the insurer's responsibility, to get the builder to follow the direction and to make sure that the builder makes good any orders that flow from a tribunal or any other jurisdiction. If the licensing body cannot police that, then perhaps there are penalties and other actions that should be taken from that licensing body under the current legislation which will influence the builder to do what he is meant to do—either rectify or provide—

The Hon. JOHN RYAN: What if I as the customer did not want the builder back on my premises? It is not unusual for builders to come back when they have rectification work and they decide to do it in a very long and ridiculous time frame. They want to turn up at unbelievably inconvenient times for the consumer. They have been hostile and in fact violent towards a consumer. There are circumstances in which the consumer should be able to say, "Look, I just wish to have nothing further to do with you." The licensing authority takes the view that, "If I take their licence that means that all these other people who have work underfoot by this particular builder will lose their capacity to have that work finished."

So this particular unfortunate consumer is held to ransom because nobody is prepared to step in and fix the problem, whereas commonsense suggests that the tribunal should be able to terminate the contract, calculate the amount of money as a money order and, in order to assist the consumer, an insurance policy pays that out, the customer can then get on with his or her life and you can, in a much higher position, in a much stronger position, pursue the debt from the builder. It would not be something that happened so often that the level of protection available to the consumer would be considerable.

Mr TURNER: That is leaving aside the fact that the insurance policy is a last resort and that was one of the underlying requirements of the insurance industry to continue operating in the warranty market and to attract competition. If you were to introduce such a result, then I think you would find that we were back to a position where the insurers would be uncomfortable with their position.

Mr HUNTLY: Termination of contract issues were one of our biggest issues in our ability to control those outcomes.

The Hon. JOHN RYAN: But that was largely because it was a dispute between the customer and a builder. I am referring to when an independent authority steps in and says that this is a reasonable circumstance to terminate a particular contract.

Mr HUNTLY: We would not want to be seeing it again. The Fair Trading Tribunal findings on termination of contract matters, if it made that finding, we would find ourselves looking at it again and we may have a contrary position to that of the tribunal.

The Hon. JOHN RYAN: I wonder why. Because the tribunal would have made a legally enforceable agreement against a builder, why would you want to look at it again? You have a capacity to recover the debt against the builder. Why would there be any need to look at it?

Mr HUNTLY: The extent to which we can recover against a builder is questionable anyway.

The Hon. JOHN RYAN: You have deeds of indemnity against builders worth much more than any one individual claim.

Mr HUNTLY: No, we do not have deeds on every builder and we are not taking deeds any more. And we do not have guarantees on every builder because we have not pursued guarantees. So the extent to which they are useful is questionable.

The Hon. JOHN RYAN: The policy product that is available in New South Wales is almost identical to what is sold in Western Australia, in South Australia and so on, with the exception of the upper limit for the sum insured. Why is it not reasonable to expect that premiums in New South Wales will very quickly become similar to what they are in other States? Why will it be only a 20 per cent reduction in premiums over two years?

Mr HUNTLY: That is indicative. That is what we can safely say would be a fair indication. If your scheme starts trending, as does Western Australia and South Australia, bearing in mind that they have $80,000 cover and $100,000 cover, they have very robust licensing and control systems in place and all manner of controls. Once you take out those elements there are all sorts of other elements in play in different environments, like the cost of housing in New South Wales, the environment, all those sorts of issues. These things will start to reflect in claim experiences over time. Competition will come in. We will look at our own outturns and premium levels again. It may be more than 20 per cent. Premiums may level out closer over time. They may do that in two years; we may see some clear indicators of what is happening in the market place in two years. We just do not want to raise any false hopes for people.

The Hon. JOHN RYAN: I have a final question about structural claims. Plenty of claims are maturing or coming to the attention of the old BSC in which the limit of liability is in the order of $100,000. The effect of six years of inflation on a structural claim against a home can sometimes mean that the cost of rectification is far in excess of the amount that was seen to be reasonable six years before. Given that you are covering buildings for six years and that, before this occurred, the Government expected the amount of $200,000 to be adjusted somewhat for inflation, what arrangements will be made to ensure that inflation does not again eat away at the value of consumer claims?

Mr HUNTLY: The regulators will have to look at the adequacy of the policy limit. If $200,000 were found to be adequate, a decision would have to be made about what level of consumer protection the State wants and what consumers are prepared to pay for that protection. If regulators want the limit to go to $500,000, we would have to go back and recast our premiums in light of a $500,000 limit—if we could get the data that would enable us to do that. Otherwise we would simply go back to the wet finger methodology of pricing, which we said we would never do again. It is something to look at from time to time in the context of the environment. I have no doubt that we will sit down regularly with various governments, the DFT and everyone involved to review all aspects of warranty cover as we go forward in time. We will have to keep tabs on what is happening in that environment.

Mr TURNER: My understanding of the $200,000 limit under the current legislation is that it is open to indexation. So it can be adjusted, I believe by the director-general, without any change to legislation.

The Hon. JOHN RYAN: I suspect that we will get complaints that it cannot be indexed because it is part of this package to keep the industry stable. Are you telling me that it is not part of the package and can be indexed?

Mr HUNTLY: At present we are allowed to issue a policy with a $200,000 limit. If a decision were made to index, we would look at it and consider it in the context of whether we would still issue a policy for $200,000 plus indexation at an agreed level or whether you would just lift the policy limit to cater for what level of cover you want the consumer to have.

The Hon. JOHN RYAN: As I understand it, $200,000 is the lower limit and that is what is offered. It is not a case of your being allowed to; you could obviously offer more, and I would be only too happy to see you do that in certain circumstances. However, at the moment it is $200,000 because that is the lower limit.

Mr HUNTLY: When we get some stability and profitability back into the warranty market we can start to look at those sorts of things. However, at the moment it does not warrant any move or extension of covers.

CHAIR: On the general question of structural defects, I note that the amending legislation contains an extended definition in section 57AC of the meaning of "structural defect". Do you foresee any definitional problems in determining what is a structural defect as distinct from a non-structural defect when administering your claims?

Mr HUNTLY: We have said that it appears to be reasonably robust. Once again, we have no precedent to test it or anything like that, but it appears reasonably robust and clear cut from our point of view. There should not be too many arguments about it in the future.

CHAIR: Thank you for your submissions and for submitting to our interrogation this morning. It is much appreciated.

Mr TURNER: Thank you.

Mr HUNTLY: Thank you.

(The Committee adjourned at 12.19 p.m.)