

To the question whether the current regulatory requirements to take out home building compensation cover provide an adequate level of protection to customers, having regard to other consumer protections for home building.

There are significant gaps in protections which are not afforded to homeowners for new high rise multi dwelling construction.

The most recent examples are :

1) the various NSW multi dwelling developments of the Ralan Group where individuals initial deposits were not protected from loss because of the insolvency of the developer.

This could be protected in future by regulating that all such multi unit development deposits be held in solicitors trust accounts or having an insurance policy cover same as part of the build process.

2) New Multi Dwelling High Rise developments also do not have any form of hbcf warranty cover to protect against defective works.

This is despite the current hbcf scheme providing structural alterations certificate cover for existing high rise multi dwelling developments so there can be a perverse outcome where new Mutli unit builds are not covered by the scheme yet a high rise office conversion to residential could be provided with cover.

It was known at underwriting levels that the Builder certificate portal did not flag or adequately refer such requests for insurance coverage.

3) The current progress payments under NSW residential contracts are often front end loaded by builders to assist their cashflow.

This means that at earlier stages of the contract the builder accesses more of the contract value than has actually been delivered and in the unfortunate event of a builder trigger event under the policy of insurance, the maximum non completion pay out is capped to 20% of the insured contract value.

This capping in the face of front end loaded contracts can often expose homeowners to uninsured losses at claims time.

Unfortunately the publicly reported claims data over the past 10 years of operation remains silent on the aspect of uninsured losses to homeowner but is worth investigating to see if a change in progress payments to prescribed maximum amounts per stage could improve claims outcomes.

It should be a recommendation for a prescribed change to the schedule of progress payments that for a new single home build no more than 65% of the contract value can be paid to the builder to the Lock Up stage progress payment. This should leave sufficient funds to complete the build for the final stages.

It should be noted that such prescriptive measures already occur in the Victorian Market.

¹ <https://www.consumer.vic.gov.au/licensing-and-registration/builders-and-tradespeople/checklists/taking-payments-for-building>

To the question in regards to the funding arrangements for any changes to consumer protection relating to the Building Compensation scheme having regard to the future financial sustainability of the home building compensation insurance market.

It is fairly obvious to experienced underwriters that the premium pricing has been used as a blunt instrument to manage the operating losses. It should be clearly noted to the reviewers that warranty premiums are simply passed onto the consumers as an input cost of the contract. The owners have little opportunity due to the information asymmetry to know if this is a low or high risk premium being charged. The Builders financial assessment rating is not published or provided for comparison.

Without specific changes that support the upfront increase in required minimum of paid up capital of residential builder companies before they commence operations and whilst they are going through a revenue growth spurt then the schemes loss cycle will simply continue.

The hbcf 3% minimum ANTA² to assessed open job turnover is blatantly insufficient and this is one of the predominant critical flaws that the scheme originated from.

Previous private insurers had minimum capitalization requirements more like 10% to the Turnover limit requested. In the private market insurers often requested Bank Guarantees to shore up possible recovery actions in the absence of the builder injecting the required paid up capital.

Some 60% of new builder company eligibility applications are declined on the basis that they do not meet the minimum 3% ANTA support. It should be that in the current publicly available and published Eligibility manual there is no specified minimum paid up capital requirement to obtain eligibility. This is a gap that needs to be closed in future underwriting manuals and instructions to the builder market.

A new building company can achieve this through \$2 of paid up capital and a Deed of Indemnity. According to the latest public data some 22% of NSW builders have had to provide a Deed of Indemnity. The deed is simply an unsupported document much like an IOU or promise to pay.

The hbcf annual reports and publicly available data show limited recoveries using these deeds.

Furthermore it is known that the recovery of claims paid using Deeds can be subject to legal challenge by indemnifiers. Recent specifically dictated underwriting measure changes reducing the level of annual financial assessments for many builders (“System reviewed Small Builders”) has again exposed the precarious recoverability position on these deeds in the event of a claim.

² ANTA = Adjusted net tangible assets

There is a patent conflict in the eligibility manual under Section 14.2
In conjunction with annual eligibility assessments, where Eligibility Deeds are a condition of eligibility, the need and value of existing Deeds are to be tested and new deeds executed.

As Deeds are taken to cover a perceived ANTA gap at a given point of time it would be contended that the indemnifiers position would be protected by the scheme attending to the regular annual financial review of the builder as per their published eligibility guidelines.

In these instances the scheme is therefore not underwriting these risks in line with its own published underwriting manual.

The scheme cannot continue to operate relying on annual taxpayer grants to maintain its loss making subsidization of undercapitalized builders.

The scheme could look to harmonise the maximum liability amount **in conjunction with both Victoria and Queensland Government warranty schemes** so that the development of a national homogenous premium and reinsurance pool could be developed for builders warranty.

In investigating and making recommendations, IPART should:

a) ensure that the scheme provides for incentives for risk management and encourages good business practices

Premium factors are not sufficiently focused to the financial solvency risk factors being equity, profitability and liquidity³.

The weighting of the current premium factors needs to be refocused.

The scheme currently provides insurance certificates to builders whose ABN is not registered for GST. This should be a key compliance area for any builder insured by the scheme.

The Building Contract Review Program needs to be investigated and reviewed to see how it can be adjusted to better suit what it was originally designed to do.

The upfront fee to service providers should be abolished and payments to providers should only occur after specified progress site inspections and with final payment only after Handover of the project to the homeowner.

³ Icare annual report 2019 HBCF expect to receive ongoing funding from the NSW Government post 1 July 2021 until all losses incurred before the establishment of risk-based premium rates which achieve full cost recovery are recovered.

Insured projects should only be closed off on the portal system following provision of the occupancy permit or final inspection notice so that actual completion dates can be loaded for actuarial purposes.

Provision of Bank Guarantees to support higher than normal certificate risks should be investigated so that rather than having to resort to recovery under a deed of indemnity then a Bank security is available. This will produce more accountability on behalf of the builder as they will want the bank guarantee returned.

Multi Unit developers should be required to sign a standard deed of indemnity in all multi unit transactions to assist recover options. We note the 2% Bond requirement in the High Rise area and believe that this should be the same in the low rise segment rather than continuing to increase premiums.

b) encourage confidence in the market for construction of residential dwellings

N/A

c) have regard to the costs and benefits of any proposed changes to ensure an efficient and financially sustainable outcome

N/A

d) identify any unnecessary regulatory or administrative burdens and barriers to entry

Private insurers are already subjected to APRA oversight and there is the SIRA Guidelines to be met. We note that these guidelines have not been successful in achieving a sustainable market. Having to meet the imposed SIRA hbcf parameters may restrict private insurer innovation in terms of premium settings, security being provided and IT offerings ie payment gateways, ability to part fund premiums, ability to close out jobs directly on portal.

Pricing competition may be an issue as there could be an incentive for the Government scheme to subsidise risks **to maintain market share** and relevancy.

There should also be the ability of a Builder to select a provider and not be held or locked up with broker channels if the brokers are restricted in only being able to deal with one provider.. **Freedom of choice of warranty provider via all brokers should be the aim.**

Data sharing with the existing scheme and any new private insurer could be problematic if the underwriting philosophy is not aligned and they openly compete for market share on premium alone.

This could be overcome with the provision of the full builder licence database to all newly approved insurers so they could directly market themselves to the builders.

Data sharing from Department of Fair Trading around licencing and NCAT and other compliance issues would be required in a timely fashion.

e) identify any impediments to private sector participation in the home building compensation scheme

There is no reinsurer appetite to be able to cover the large aggregated exposures to the Major Volume Home builders. The largest builder failing exposure far outweighs the annual premium pool of the scheme⁴.

The underwriting of these major Builders sets the tone for the whole portfolio. If all of these builders in that segment are fully compliant with the minimum required guidelines then this follows through the portfolio.

The Government could look to provide reinsurance at proper commercial rates⁵ to private insurers so that some of these major builder risks could be entertained in the private market.

f) Consider any other measures that are likely to contribute to the efficient and effective protection of customers.

Regulating set progress payments to prevent front end loaded contracts and minimize uninsured losses would be a good step to protect consumers and improve scheme outcomes.

g) Consider whether enhanced information collection in relation to builder progress payments, critical stage inspections and issuance of compliance certificates could be used to better mitigate insolvency risk.

More information should be collected on these items.

⁴ HBCF Annual report HBCF financials Note 2.3.5 Page 231 largest exposure \$315,000,000 Insurance Liability.

⁵ Previous such reinsurance was costed at 2% of the private insurer GWP for exposures above \$10M. This was known to be too low by commercial standards at the time.