HOME BUILDING COMPENSATION REVIEW – PUBLIC HEARING

29 September 2020

IPART is currently investigating the efficiency and effectiveness of the Home Building Compensation Fund (HBCF) in protecting homeowners who are currently covered under the scheme. We released an Issues Paper in May 2020, and a Draft Report in September 2020. We then held a virtual public hearing on our Draft Report on 29 September 2020. The public hearing is an important part of our review process and allows us to further consider stakeholders' views.

At the public hearing, IPART provided an overview of some of our findings and recommendations in the Draft Report. The slides from this presentation are available on our website.

We thank stakeholders who participated in the public hearing. We provide below a summary of the main issues discussed:

- Dispute resolution processes and a 'first resort' scheme
- The role of brokers in the scheme
- Barriers to entry into the scheme and the regulatory framework for providers
- Scheme coverage and inclusions.

We welcome further written submissions on the matters raised at the public hearing, or on any other matters in the Draft Report. The closing date for written submissions is 16 October. We will be considering all submissions and undertaking our own analysis before providing a final report to the NSW Government by November 2020.

Dispute resolution and a first resort scheme

NSW has a last-resort home building compensation scheme in place, where claims can only be made if the homeowner cannot pursue their builder (usually because they have become insolvent). Stakeholders discussed the merits of moving to a 'first resort' scheme, where the insurer pursues the builder for claims on behalf of the homeowners, and whether instead, the existing arrangements combined with an improved dispute resolution process would achieve similar outcomes.

A stakeholder expressed the view that adopting a model similar to the Queensland 'one stop shop' scheme could result in premium reductions and better outcomes for homeowners, noting that premiums in Queensland are lower than in NSW. Under this model, the insurance provider is also the building industry regulator and can enforce the building rules, which would result in fewer claims.

A stakeholder commented that the Taylor Fry analysis commissioned by IPART does not take into account the societal benefits of a first resort scheme – that is, homeowner confidence in the market, and the costs of homeowners participating in dispute resolution processes. The transitional expense of moving to a first resort scheme could be mitigated by moving builders gradually or limiting coverage initially. They recommended IPART undertake a full cost-benefit analysis of moving to a first resort scheme.

Another stakeholder considered that if there was a healthy dispute resolution process in NSW, it would reduce the need for a 'safety net' insurance product at all. They stated the Queensland system results in fewer claims because it has an effective dispute resolution process. A first resort scheme would be a 'bandaid' solution for a poor dispute resolution process.

The Tribunal asked stakeholders what characteristics are most important for effective dispute resolution. One stakeholder responded that good dispute resolution should be easy for consumers to access, be speedy in the resolution of issues and, if a builder does not respond to a monetary order, a claim could be brought under the policy immediately.

One stakeholder commented that introducing a first resort scheme would further deter new entry into the scheme, because of the increased administrative burden and costs.

The Tribunal noted that in our Draft Report, we made draft recommendations to improve the current dispute resolution systems by ensuring that Fair Trading and NCAT are sufficiently resourced and play a more proactive role in building standard enforcement to reduce defects in the first instance. This is what the NSW Building Commissioner is doing in the high-rise sector.

The role of brokers in the scheme

There was discussion about IPART's draft recommendation that the use of brokers should be voluntary under the scheme, instead of mandatory as is currently the case. Stakeholders expressed different views.

One stakeholder expressed the view that there would not necessarily be savings from making the use of brokers voluntary, because these costs would be transferred to icare who would have to employ extra resources to deal with customers directly. It may also provide adverse outcomes for builders who would have to rely on their accountants to advocate for them, rather than their broker and this would impose additional costs. Another stakeholder added that brokers have the specialist knowledge and expertise to provide professional services to builders in navigating the eligibility process.

A stakeholder stated that there is no commission paid to brokers, it is a fee-for-service model negotiated between brokers and clients. They added that they did not consider that icare has the resources to deal directly with builders to provide that eligibility service, which would not result in positive outcomes for builders.

The Tribunal asked icare for its views on this matter. icare acknowledged that it did not currently have the staff to manage the increased workload associated with managing builder eligibility directly. However, it considered that it would be within its capabilities to develop this

capacity for less than the costs to the scheme of employing brokers to perform this role (assuming an average cost of 15% of the contract price per certificate). It noted that credit assessment is generally a direct engagement, rather than a mediated process. In addition, outcomes and costs would depend on how IPART's recommendations around simplifying the eligibility process are executed.

The Tribunal also asked whether there was value in direct discussion between icare and builders in terms of resolving eligibility problems. icare agreed that more direct discussion would be beneficial, especially with larger, more complex builders, whether or not that involved a third party like a broker or accountant. However, icare acknowledged that our draft recommendation would allow builders to seek a range of solutions.

A stakeholder noted that IPART's recommendation on brokers should take into account new providers entering the market (ie, that brokers can assist in promoting competition through presenting all options to builders).

Barriers to entry and the regulatory framework

Barriers to entry by private participants

Stakeholders generally agreed that new entry into the market should be encouraged to provide a choice of provider and model of cover. They generally supported IPART's draft recommendations to reduce regulatory burden on new entrants.

One stakeholder submitted that there had not been good communication between SIRA and APRA about their related roles in regulating insurers in the industry, and it had been difficult to engage with SIRA about obtaining a licence.

One stakeholder commented that they were deterred from entering the NSW HBC market by the duplication of having a second regulator and regulatory regime in NSW, which does not exist in the Victorian market. This adds transaction and compliance costs, because APRA is already the national regulator for insurers and they should be adequate to regulate this product.

They noted that it is unusual for the Government to have such control over how a commercial entity conducts its business in a market, including underwriting products, setting premiums and managing claims.

Another stakeholder indicated that any new provider should be subject to strong prudential regulation because providers have perverse incentives when they collect a premium now with a promise to pay insurance later. Consumer protection is important in this regard. Fidelity funds are subject to different rules than insurers because they don't have to pay claims and are not regulated by APRA. All market participants should be viable and sustainable, because it is a long-term product.

Regulation of icare

One stakeholder stated that SIRA had historically allowed icare to increase premiums with little scrutiny.

The Tribunal noted IPART's draft recommendation for icare's premiums to be regulated more strictly. IPART's draft recommendation included that SIRA maintain its prudential regulation of non-insurer providers, while reducing these obligations on insurers, which APRA already regulates.

The Tribunal asked stakeholders whether its draft recommendations about the regulatory framework were a proportionate to the problems with the scheme.

icare stated that it had no objections to being regulated, but the regulatory process should encompass the whole claims and underwriting practice, because it is not possible to separate risk-selection (through the eligibility assessment process) from pricing. However, they noted that icare is already subject to a prescriptive set of guidelines on risk acceptance, pricing principles and conditions for a commercial insurer making commercial decisions. If too much of the decision-making is the responsibility of the regulator, there is not enough distinction between the regulator making a decision and reviewing a decision.

'Long-tail' of warranty period cover

Stakeholders agreed that being able to split cover between long and short-term products would be conducive to new entry.

A stakeholder stated that a claim for a defect occurring within 6 years, could be brought up to 10 years after project completion. So claims could be continuing for up to 15 years after commencement of the project. This would be helped by better dispute resolution that deals effectively with problems within the first 6 years.

The Tribunal asked for stakeholders' views on IPART's draft recommendation to require icare to provide split warranty period and defect period cover.

A stakeholder raised the concern that competitors are disadvantaged by having to provide $340,000 cover for each product, rather than $340,000 for the combined product. This requires providers to hold sufficient capital for the relevant period of time. The Draft Report found that if a claim was made under one product, then a separate claim was very rarely made under the other, and therefore the additional costs to insurers was minimal.

Scheme coverage and inclusions

Inclusion of pool and spa equipment in contracts

A stakeholder stated that the process needs to look at the risk profile of specific industries, rather than grouping them. Most of the pools and spas industry are less concerned about their premiums, than how it affects their eligibility. If the risk is low, then this should be reflected in the insurance product. There should be more engagement between the insurer and peak industry bodies where particular compliance issues have arisen.

A stakeholder considered that insurance for appliances and equipment installed under a residential building contract should be required because losses could arise if a non-completion occurs.

The Tribunal noted that our Draft Report recommends that SIRA should clarify some issues frequently raised by builders and industry groups, and asked for feedback.

High-rise buildings and the strata building bond scheme

In response to a stakeholder question, IPART clarified that high rise buildings were excluded from the scheme in 2004, because the cost of insuring these buildings was too high. The Building Commissioner has begun an audit program to reduce the cost of defects in high-rise buildings, which would allow private insurers to come into the market in future.