



# **HIA Submission Review of the Home Building Compensation Fund (HBCF)**

To the State Insurance Regulatory  
Authority (SIRA)

22 November 2024





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## Introduction

The Housing Industry Association (HIA) takes this opportunity to provide feedback on the Review of the Home Building Compensation Fund (Review) announced by the State Insurance Regulatory Authority (SIRA) in October 2024.

HIA acknowledges that this Review is to be informed by past reviews addressing matters within the scope of the Terms of Reference. Accordingly, HIA's previous submissions below remain relevant and will be referred to throughout this submission:

- [IPART Review of efficiency and effectiveness of HBCF](#) (HIA's 2020 Submission)
- [Home Building Compensation Construction Type Definitions](#) (HIA's 2021 Submission)
- [HBC Reform Discussion Paper](#) (HIA's August 2022 Submission)
- [Commonwealth Parliamentary Inquiry into Corporate Insolvency in Australia](#) (HIA's November 2022 Submission)

At the outset, HIA cannot emphasise enough that considering and examining reforms that would significantly improve the effectiveness, efficiency and sustainability of the Home Building Compensation Fund (HBCF) is absolutely crucial. As a quasi-regulator, the HBCF significantly impacts the operations of individual builders, the level of residential building activity, as well as housing affordability. Yet it continues to be regulated in a way that will lead to premium increases and further entrench its operations within Government.

For many years, HIA has submitted and continues to advocate, that there are two vital reforms that need to be implemented to secure the long-term success and viability of the HBCF:

- Firstly, a redesign of the warranty insurance product so that there is a shortened exposure period for major defects.
- Secondly, the HBCF needs to return to the commercial insurance market. Without a return to the private market, the Scheme must continue to increase premium to break even and will remain a burden on the NSW taxpayer.

As reflected in previous HIA submissions, while there may be value in exploring options such as increasing the amount of insurance for defects and non-completion claims and the value of the building work for which insurance is required, they simply reflect the pattern of *tinkering around the edges* of warranty insurance reform which has historically proven to have little tangible impact on the long-term sustainability of the HBCF.

Further, prior to making any changes regarding caps and limits, how claims are managed must be investigated. For example, the tendering process to carry out insurance rectification work and the level of 'claims leakage' clearly impacts the appropriateness of these caps and limits.

HIA elaborates on these matters and provides responses to the specific Terms of Reference in the Review below.



## General Comments

### **Insurance under the HBCF is a safety net**

HIA agrees that insurance under the HBCF is a key plank of the consumer protection framework in NSW acting as a safety net for homeowners whose builder dies, disappears, becomes insolvent or has their licence cancelled for failure to comply with an order from the NSW Civil and Administrative Tribunal (NCAT) or a court order. Reinforcing this is that the operation of the Scheme through its underwriting standards functions as a quasi-regulatory device to limit a builder's ability to trade. To go beyond this, to, for example, use the Scheme as a part of the dispute resolution system is at odds with the headline notion the HBCF operate as a safety net (as reiterated in HIA's 2020 Submission).

### **The private sector must be encouraged to enter the market**

Overwhelmingly various reports and inquiries have recommended that warranty insurance Schemes be run by the private sector. Competitive pressure is the best way of delivering the most cost-effective outcome for the home buying public.

The move by the NSW Government in 2010 to take over underwriting the Scheme was a significant development and probably reflected the disruption to financial markets stemming from the Global Financial Crisis rather than any underlying inability of the private sector to operate an effective warranty Scheme. However, moves between private and public operation are far from novel, for example, the privately underwritten Domestic Building Insurance scheme was introduced in Victoria in May 1996, replacing the previous government scheme administered by the Housing Guarantee Fund.

Private providers, industry, Government and consumers must also have confidence that those private sector entrants are appropriately regulated to ensure they can fulfil their statutory role. To that end, all of those seeking to enter the market should comply with the Australian Prudential Regulatory Authority (APRA) requirements. This would provide clarity, certainty, a level playing field and reduce duplication.

### **The current design of the product must be reformed**

Linking the basis of a claim over the defect 'tail' period (currently 6 years) to a breach of statutory warranty under the NSW *Home Building Act 1989* (HBA) is a significant contributor to the difficulties with the insurance. The high frequency of claims over that tail period caused by the nebulous nature of this trigger has been a continuing source of uncertainty for whoever underwrites the scheme including both government and the private insurer market.

HIA is aware that linking the claims trigger to a clearer definition of a defect and providing certainty for a shorter period of defects cover will encourage the participation of private insurers in the market and negate the need for Government involvement.

As outlined in HIA's 2020 Submission, while the ability to offer split product cover was a first step, the minimum cover requirements for each limb of \$340,000 coupled with these structural issues have discouraged any consideration of entry by private providers who are prepared to provide warranty cover across the entire home building spectrum from renovations through to low rise apartments.

### **Financial Viability**

In HIA's view this Review must consider the long-term financial viability of the HBCF.



Notwithstanding this consideration has not been called out specifically it underscores all, or at least most, of the Terms of Reference.

When reviewing the HBCF this is a critical consideration, noting that ever since HIA can remember it has been running at a loss, or just at breakeven. The Review should consider how this situation can be remedied over the long term.

## **Transparency**

HIA would like to see more transparency on the data collected by SIRA and icare. For example, providing a breakdown of the types of claims made, the number of claims accepted, etc. HIA understands that some of this data is no longer made available in icare's annual report.

HIA supports greater transparency and ongoing dialogue/consultation regarding the eligibility process, as well as assessment of icare's premiums (whether relating to premium calculations, formula or any relevant matters).

## **Impact of any proposed reforms must be first considered**

As discussed in HIA's 2023 Submission, any reforms that were to be adopted cannot be implemented in isolation. The impact of the changes to any proposals would need to be factored into future premium rates together with any changes in the HBCF costs arising from any proposed reforms that are to be adopted.

## **Small businesses**

It is important to analyse the impacts on any proposed reforms specifically on small businesses as they are more vulnerable to disruptions and unintended consequences due to their size, resources and ability to adapt. The need to account for the specific impacts on small businesses when introducing reforms to avoid disproportionately burdening them should be a key consideration.

A significant proportion of the residential building industry are small businesses. While HBCF reforms are intended to protect consumers and improve the quality of construction, the potential adverse effects on small residential builders should not be overlooked. Increased premiums, stricter eligibility criteria, higher administrative costs, and the potential for more claims could place significant strain on small businesses, reducing their ability to compete, grow, and remain financially viable. To avoid unintended consequences, reforms should balance consumer protection with the practical realities that small businesses face, ensuring that the regulatory environment supports both industry standards and the sustainability of smaller builders.

One way to achieve such balance is to thoroughly analyse the impacts on any proposed reforms on small businesses, and undertake Regulatory Impact Statement (RIS) and cost/benefit analysis specific to small businesses to ensure that the benefits of the proposed changes outweigh the costs, particularly for smaller operators with limited resources.



## First resort schemes

HIA is concerned that if any move towards a first resort model in NSW was strongly considered, this would require a dramatic shift in the regulatory framework and there is no guarantee such a move would result in better outcomes.

HIA would oppose any moves to a first resort arrangement. The Queensland first resort scheme is costly, inherently unfair, and not in the best interests of consumer, the residential building industry or the NSW Government.

Over 30 years ago the Inquiry into the NSW Building Services Corporation (the Dodd Inquiry) was highly critical of the current Queensland ‘one-stop-shop’ approach noting that such a system was rife with perceptions of bias and commenting that:

*“I believe there is an inherent conflict in combining the key function so industry regulation and consumer advice, dispute resolution and insurance. I also note that the management and administration of such disparate functions necessitates different structures and skills”<sup>1</sup>*

HIA believes this observation remains apposite and that members do not want a return to that type of scheme.

A focus on and lauding of the Queensland first resort style model of home warranty insurance reflects a serious misunderstanding of the detail of the operation of the scheme in Queensland and its financial structure.

Firstly, to categorise the Queensland scheme as ‘first resort’ is not entirely correct. A genuine ‘first resort’ insurance scheme requires that the insurer pay out on all claims and pursue builders through the courts, but without the power for the insurer to suspend or revoke builder licences, it is simply not sustainable.

Under the Queensland model the ‘insurer’ i.e. the QBCC is given the power to make decisions about rights that should be made by an impartial court or tribunal after a fair hearing. Administrative decisions to remove a business’s livelihood on the basis of an unresolved building dispute triggering an unchallengeable insurance claim treads very close to an inadequate separation of powers.

Secondly, the first resort nature of the QBCC insurance scheme positively encourages disputes to be sent to the regulator.

It is not uncommon for contractors to first discover that their client even has an issue only when notified by the regulator. There have also been occasions where the QBCC will be taking action against a contractor even though the contractor and their client are in Queensland Civil and Administrative Tribunal (QCAT) at the same time in dispute on the same issue. A common example is unpaid money. A builder will be pursuing the owner for unpaid money under the building contract through QCAT. The owner will then separately make a defective works complaint against the builder. The builder is forced to go through the defective works process, a punishment in itself, despite the matter being before the QCAT.

Thirdly, the QBCC combines the roles of insurer and licensor of builders. HIA considers that this process also involves a conflict of interest, not to say obvious moral hazard; any work the QBCC can force a builder to do is work that it will never have to pay out on one of its insurance policies.

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<sup>1</sup> Inquiry into the NSW Building Services Corporation (the Dodd inquiry), 1993 p. 46



This conflict of interest is further exacerbated since it is in the interests of its insurance arm for a potentially insolvent builder to attempt to trade out of their financial difficulties rather than go into liquidation and trigger insurance liability, while it is the duty of the licensing arm (and in the best interests of current and future home buyers) to suspend a potentially insolvent builder's licence immediately. This conflict of interest may result in the builder's eventual collapse being more costly, and involving more consumers, than would otherwise have been the case. Indeed, the QBCC's predecessor, the Building Service Authority, found itself allowing homeowners to contract with businesses **after** the QBCC had determined in-house that the business did not meet its own financial standards and was expecting to have to meet significant warranty claims. The business was allowed to continue taking on these new clients in the expectation of limiting the ultimate extent of insolvency claims for incomplete and defective work.

Finally, as reflected in Queensland today, a first resort style model results in a very high claims frequency as homeowners can effectively use the insurance to bypass their builder. The approach also distorts the dispute resolution process which is not in any parties' best interests and insurers frequently became entangled in contractual disputes between homeowners and the builders.

This feature of the first resort scheme also presents a significant disincentive for private insurers to enter the market and substantially adds to the premiums paid by homeowners due to higher legal costs.

The claims experience is also influenced by the claims trigger. In Queensland, the definition of a structural defect for the purposes of an insurance claim is much narrower and arguably clearer than that under the NSW system. To illustrate Schedule 6 of the QBCC Regulations provides that:

*structural defect, for primary insurable work, means:*

- a) *if the work is for a residence or related roofed building:*
  - i. *a defect in the work that causes or contributes to deflection or movement of the footing or slab of the residence or building so the residence or building no longer complies with the building assessment provisions under the Building Act 1975; or*
  - ii. *the work does not comply with a performance requirement under the Building Code of Australia, part B1 or part 2.1 for the residence or building; or*
  - iii. *a defect in the work that causes the residence or building to be uninhabitable or not reasonably accessible; or*
- b) *if the work is for a swimming pool—a defect in the work that allows water to escape through the shell of the swimming pool; or*
- c) *if the work is on or for a residence, related roofed building or swimming pool—a defect in the work that adversely affects the health or safety of persons who occupy or use the residence, building or swimming pool; or*
- d) *if the work is on or for a residence or related roofed building—a defect in the work that allows water penetration of the residence or building.*

In NSW a breach of the statutory warranties under section 18B of the HBA provides the basis for an insurance claim:

- a) *a warranty that the work will be done with due care and skill and in accordance with the plans and specifications set out in the contract,*



- b) a warranty that all materials supplied by the holder or person will be good and suitable for the purpose for which they are used and that, unless otherwise stated in the contract, those materials will be new,*
- c) a warranty that the work will be done in accordance with, and will comply with, this or any other law,*
- d) a warranty that the work will be done with due diligence and within the time stipulated in the contract, or if no time is stipulated, within a reasonable time,*
- e) a warranty that, if the work consists of the construction of a dwelling, the making of alterations or additions to a dwelling or the repairing, renovation, decoration or protective treatment of a dwelling, the work will result, to the extent of the work conducted, in a dwelling that is reasonably fit for occupation as a dwelling,*
- f) a warranty that the work and any materials used in doing the work will be reasonably fit for the specified purpose or result, if the person for whom the work is done expressly makes known to the holder of the contractor licence or person required to hold a contractor licence, or another person with express or apparent authority to enter into or vary contractual arrangements on behalf of the holder or person, the particular purpose for which the work is required or the result that the owner desires the work to achieve, so as to show that the owner relies on the holder's or person's skill and judgment.*

The difference has obvious impacts on costs.

The Queensland approach insulates the insurance scheme from payouts by either strongly incentivising builders to rectify works, whether or not such work is rightly one for the builder to fix, or, if the builder refuses to fix pursuing the individual for those costs. This is why the costs of the scheme seem lower and premiums less than elsewhere and it would be superficial to conclude that the scheme is more inexpensive than a last resort system. Any return to a licensing-plus-insurance type operation, along the lines of the QBCC, would be very expensive to set up and fund, both initially and on an ongoing basis.

The current triggers under the HBCF are adequate and a first resort style approach should be avoided at all costs. As demonstrated over many years including the previous NSW model, the first resort scheme failed to deliver a sustainable outcome resulting in loss ratios in excess of 300 per cent.

HIA considers that the only material difference between Queensland's so-called 'first resort' and NSW's so-called 'last resort' scheme lies in dispute handing, and that improvements in dispute resolution, separate from the insurance regime, in the NSW scheme will lead to a more effective outcome than adopting the Queensland model.



## Response to the Terms of Reference

1. **Review the operation of the HBC Scheme in respect of the following fundamental issues and recommend the actions, if any, that are necessary or desirable to achieve the objectives of the scheme in relation to:**
  - a. **the prevalence and nature of home building business insolvencies in NSW relevant to the HBC scheme;**

### **The Residential Building Industry**

The residential building industry includes detached home building, low, medium, and high-density multi-unit housing developments, home repairs, renovations and additions, along with the manufacturers and suppliers of building products and related building professionals. The industry has important linkages with other sectors, such as manufacturing, finance, real estate, and retailing, meaning its impacts on the economy go well beyond the direct contribution of construction activities.

The residential building industry contributes to the economy in a number of ways providing hundreds of thousands of Australians with jobs, generating billions of dollars of economic output each year and stimulating spending on housing services. Specifically, it is estimated that the residential building industry engages over 1 million people representing tens of thousands of small businesses and over 200,000 subcontractor businesses reliant on the industry for their livelihood.

The residential building industry is one of Australia's most dynamic, innovative, and efficient service industries and is a key driver of the Australian economy contributing over \$100 billion per annum to the economy and accounts for 6.9 per cent of Gross Domestic Product.

The Federal Government has committed to building 1.2 million homes over the next 5 years. NSW has a significant role to play in reaching that target. However, based on the current levels of housing activity, NSW faces some challenges in delivering on these housing commitments.

NSW commenced construction on 5,470 new detached houses in the first quarter of 2024, down by 5.4 per cent on the previous quarter. This is forecasted to have declined by a further 4.8 per cent in the June Quarter 2024 to 5,210, producing a financial year total for 2023/24 of 21,070. This would be 18.8 per cent down from the previous financial year, with a further 0.8 per cent decline forecast to 20,890 in 2024/25.

This would mark the trough in the cycle for detached housing, and the two weakest financial years since 2012/13, before bouncing back to 23,160 in 2025/26 and reaching a peak of almost 24,000 by 2027/28.

However, the desire to slow the economy through higher interest rates will end the current building boom. Sales of new homes are falling; loans for new housing have retreated to pre-pandemic levels and along with other leading indicators, this shows a market slowing.

### **Construction industry insolvency**

The construction industry is admittedly largely represented in the overall number of insolvencies.



In the 2021-22 financial year, 1,282 construction companies entered into external administration and controller appointments, more than any other single industry and the construction industry, particularly the residential building industry, is often subject to extensive media coverage in the event of an insolvency.

NSW has the largest share of overall insolvencies, taking up about half of the national figure. This is due to the same narrative above, all due to the shrinking pipeline of work.

This to some extent is a natural reflection of the size and number of construction industry firms operating in the economy. As will be elaborated below, the residential building industry is characterised by a large number of small firms and a small number of very large firms.

However, HIA challenges the proposition that there has been a 'surge' in construction industry insolvency. The volume of insolvencies within the building and construction industry fell significantly during the pandemic. This could be partially attributed to the temporary change in reporting requirements but also reflects a period of government stimulus where demand for new homes and renovations grew rapidly.

Recent data suggests that insolvencies in the construction industry appear to be returning to pre-pandemic levels, with indications that they will continue to rise. This change has occurred since mid-2021 due to rapidly rising construction costs, combined with the restrictions imposed under Fixed Price Contracts, which saw builders of detached homes exposed to difficult trading conditions.

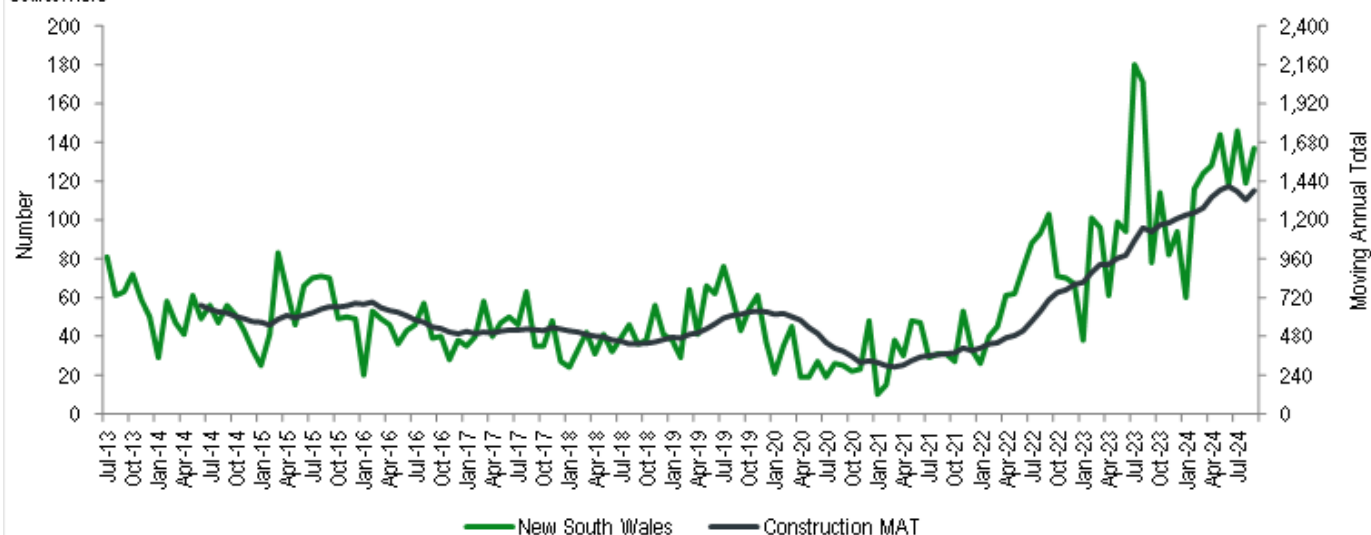
The data on insolvencies can be misleading. The graph below shows insolvencies across the construction sector, meaning all civil, commercial and residential businesses. The number of businesses is not evenly shared across each sector meaning the data hides the actual trends across each. For example, there are a large number of small sub-contractors in the residential building segment of the industry, compared to a very small number of large civil construction businesses.

With sub-contractors, civil contractors and commercial builders experiencing strong market conditions, the bulk of the insolvencies currently being reported are likely to be focused on the relatively small segment of builders and trade contractors involved in detached home building.



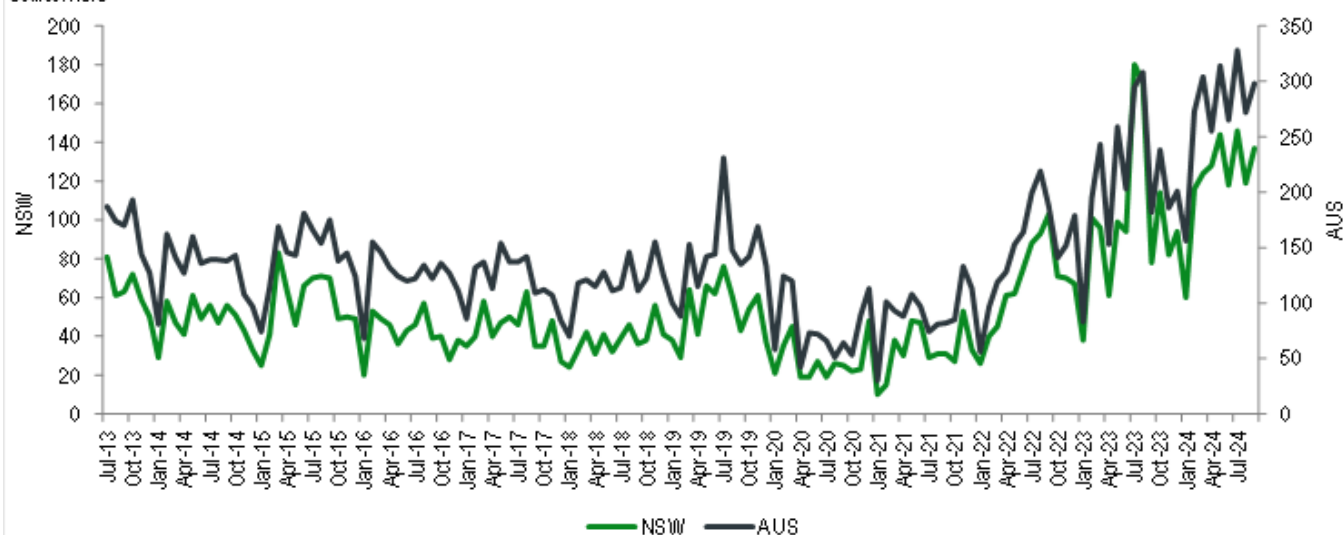
## Companies entering external administration and controller appointments data - Construction Industry, NSW

Source: ASIC



## Companies entering external administration and controller appointments data - Construction Industry, NSW

Source: ASIC



### Implication of the HBCF on industry insolvency

The operation of Insurance under the HBCF has two significant implications for the broader insolvency regulatory framework:

- Eligibility

HIA understands that this Review is looking into whether 'the eligibility requirements are restrictive enough'.



In HIA's view this question is problematic as it implies that the eligibility requirements are not restrictive enough as it is.

To obtain insurance under the HBCF, a builder must be deemed 'eligible' by icare. In determining eligibility, icare examines a range of financial and non-financial information provided by the business to assess the risk of potential threats to solvency.

An insurer reviews a builder's business history and finances to assess their risk. Insurers impose an annual turnover limit on builders based on their assessment of the value of works that a builder can prudently undertake given their financial position. In some circumstances insurers require financial security or an indemnity of some form before granting eligibility.

On this basis further restrictions would be undesirable.

- Definition of 'insolvency'

A claim can be made in the event of the insolvency of the builder. For example, in NSW, 'insolvency' can mean the insolvency of an individual under administration, a corporation that is being externally administered or the insolvency of any partners in a partnership. Additionally, if related to any loss that is subject to a NCAT order against the builder, insolvency includes the suspension of the builder's licence.

Unfortunately, the definition of 'insolvency' for the purposes of triggering warranty insurance is not the same across the country. Under the Queensland arrangements, 'insolvent' includes, 'external administration, including, for example, liquidation, receivership or compromise entered into with creditors, under the *Corporations Act* or a similar law of a foreign jurisdiction'.

Whether a builder is 'insolvent' may have a different meaning for a state-based consumer protection authority versus the Commonwealth insolvency framework. Or, and perhaps more complex, is that they may mean the same thing, however under a commonwealth arrangement there may be a mechanism to support the business trade through such an event which is not recognised at a state level for the purposes of warranty insurance. This outcome would effectively negate options for 'business rescue'.

### **HBCF Eligibility Manual**

It is important to note that once an insolvency event occurs a business will be prevented from getting eligibility and unfortunately, there is no discretion in this scenario – which again jeopardise the principle of genuine 'business rescue'.

Section 9.1 (Unacceptable risk scenarios) of [icare HBCF Eligibility Manual](#) identifies considerations for businesses that have a greater than normal reputational risk to icare HBCF, or businesses where mismanagement has caused homeowners, insurers, or creditors to suffer losses.

icare HBCF deems that some factors make a builder ineligible for insurance (both new applications and reviews) and should have an overriding impact on any Eligibility decision.

There are several factors which are considered as an overriding impediment for Eligibility and typically cause icare to decline Eligibility. This includes:

- 9.1.2: Losses to Creditors arising from business closures involving the Directors or Key Managers in the last 5 years.
- 9.1.8: Significant adverse creditor payment history involving the Directors or Key Managers in the last 5 years.



- 9.1.11: Key manager, Director or Principal of the Builder being reviewed has been a director or key manager of another business within nine months of that business undergoing a Business Closure.

As further indicated on section 12.1, new application can be considered when:

- at least 5 years has passed;
- there are no HBCF claims;
- and trade creditors were not impacted by the history event.

### **Eligibility issues must be resolved in a more streamlined and timely manner**

Broadly speaking HIA supports greater transparency and a more educative and consultative approach in relation to the eligibility process.

It is through the granting of insurance eligibility, that the Scheme significantly influences the ability of a contractor in the residential construction industry to trade, including the type of work they can carry out, the value of that work and the number of jobs that can be on foot at any one time. In that way the Scheme acts as, and is considered to be, a quasi-regulator. Decisions by icare affect the day-to-day livelihood of those in the industry and warranty insurance is consequently an emotive issue for HIA members. Eligibility limits can unduly restrict the growth of a residential builder and the imposition of risk mitigation measures to have such limits lifted (often through the piercing of the corporate veil) is needlessly excessive and onerous. The limits also impose significant hurdles for new builders entering the market.

HIA has previously agreed that icare and any other provider should be responsible for managing its own risks and permitted to have the flexibility to set their own eligibility criteria, to do otherwise would undermine the principle of encouraging a competitive market.

### **Review of eligibility assessment and determination**

HIA continues to receive feedback from members regarding the challenges with HBCF eligibility limits and maintaining work in the pipeline concerning lands that are awaiting registration. This is particularly exacerbated with the ongoing delays in land registration due to numerous well-known factors including infrastructure.

With the eligibility limits being used up for these lands that await registration (where constructions cannot yet commence), builders are restricted to take on more work in their pipelines (for example, a knockdown or rebuild, renovations, etc) as they would have gone over their eligibility limits/caps. This is notwithstanding that no actual construction is taking place.

For example, a builder with 200 home building contracts faced delays after only 11 out of the 77 unregistered lots of land that were meant to be registered got registered, highlighting the urgency for solution. As whilst the land awaits registration, the builders' eligibility limits will continue to be tied up, preventing them from securing more work in their pipeline (whether that is building new homes or doing renovations, knockdown rebuild, etc).

Whilst this live issue requires further exploration, perhaps consideration should be given to when it comes to assessing HBCF eligibility limits, to possibly exclude those projects where physical work has not actually commenced (and if needed, put into a different category of alternative eligibility limits) until such time physical work commences (i.e. the land is registered and construction can commence).



With the technology currently available, notification would be able to be generated when the land is meant to be registered, and icare and SIRA will be able to have access to this information. From that point, they can then make some adjustments to the builder's eligibility limits/premium at that point in time (as opposed to before.)

As outlined in HIA's 2020 Submission, HIA supports IPART's draft Recommendation 15 and 16 where icare should:

- Provide greater transparency in how it undertakes its eligibility assessments and how it determines individual builder loading/discounts used in risk-adjusted premiums.
- Provide information in plain language on how the information provided by building businesses was used to determine their eligibility profile and their individual loading/discount, including any conditions of eligibility.
- Provide information in plain language in the Builder Eligibility/Change application form or the Builder Self Service Portal, why particular information is sought and how it would be used in determining a builder's eligibility.
- Periodically updates the work undertaken by the Data Analytics Centre in 2016, to examine whether the factors previously identified and currently used, continue to be significant in predicting builder insolvency, and if there is scope to reduce the amount of information sought without necessarily increasing risk.

***b. the adequacy of the HBC insurance cover amount and future adjustments to it and, if necessary, how to deal with the impact on premiums of future adjustments;***

**Cover amount – Completed Work**

While HIA understands that construction costs have increased, it is important to investigate whether the increase would directly increase/improve consumer protection. This includes but not limited to:

- Exploring key factors:
  - Defining the gap between current coverage and the desired increase, and understanding what risks the increased coverage will mitigate.
  - Estimating the likelihood and potential financial severity of a loss event that would trigger the higher coverage.
- Quantifying the benefits of additional coverage:
  - Calculate how the additional coverage reduces potential out-of-pocket expenses in the event of a claim.
  - Use hypothetical or historical claims data to estimate how much additional coverage would cover in various loss scenarios.
- Compare the Costs vs. Benefits
  - Add up the total cost of the premium increase over a set period (e.g., annually, over the next five years). Compare this against the expected benefit of the additional coverage based on the risk exposure and potential claims.
  - Understanding whether the additional coverage reduce financial exposure to an acceptable level, and is it worth the extra cost.



### **Has cumulative impact be thoroughly assessed?**

HIA notes that the Survey Question asks whether the increase of maximum insurance cover from \$340,000 to \$540,000 would be of good value, taking into account that the average premium for a new house would increase by approximately \$800. This question underestimates the cumulative impact of this cost increase. For example, if one of the largest home builders build 1000 homes a year, that would mean a total impact of \$800,000 across just one business. Accordingly, the macro impacts must be considered, not just the individual project impacts.

As shown in the Survey Question above, it is evident that a change of this nature would result in a premium increase, as such any proposed basis for the amount of cover would need to be supported. While the Supporting Information attempts to provide cost benefit analysis, it is also important to evaluate the additional premium against the potential financial risks of insufficient coverage. Consider the size and complexity of the project, the likelihood of defects or contractor failure, and the financial impact of a claim. By assessing these factors, an informed decision can be developed about whether the added coverage is worth the increased cost.

### **Structural change is needed for genuine reform**

As HIA continues to advocate, accomplishing genuine reforms will be extremely challenging without further structural changes to the HBCF, which are needed to address financial sustainability, better align premiums with claims, ensure stronger protection for homeowners, and improve the financial viability of builders. By enhancing risk management, introducing more tailored coverage, and strengthening protections against insolvency, the system can be more effective in fulfilling its purpose. These improvements not only benefit homeowners but also contribute to a more stable and sustainable construction industry overall.

### **What are the impacts of keeping up with construction costs?**

Further, if the insurance cover amount is to continuously be increased to keep up with the increasing construction costs, this would mean that a continuous increase is inevitable. Continuously increasing the HBCF cover amount (potentially each year if one was to keep up with the increasing construction costs) could significantly strain the industry and particularly small builders, as rising premiums may become unaffordable, particularly for those with tight margins.

This could lead to reduced competition, as businesses likely be forced out of the industry and for smaller businesses who may be priced out of the market, resulting in fewer choices for consumers and potentially higher construction costs.

Over time, these increased costs will likely contribute to higher housing prices, particularly new builds and could force some builders to scale back operations, reduce staff, or exit the industry (which is already happening), which could negatively impact market diversity and innovation. While intended to enhance consumer protection, consistently raising the coverage limit may inadvertently create financial pressure on builders and raise prices for homeowners.

### **Claims management**

Apart from undertaking the above investigation, HIA continues to reiterate that further inquiry should be conducted in relation to claims management.

Average claims costs (which obviously impacts the appropriateness of caps and limits) are a direct result of the management and the prevention of claims leakage. This is caused by the acceptance of claims not covered under the policy, inadequate tendering, and the situation where a claim can be brought within 10



years of the completion of the property meaning that claims can continue to develop for up to 13 to 14 years.

Accordingly, the approach to claims management and claims costs should be examined prior to making any changes to the current caps and limits.

#### **Implementing 'excess'**

One way to manage claims particularly those that might be vexatious is implementing the need for 'excess' to be paid by homeowners if they wish to submit HBCF claims (similar to making other insurance claims, such as car, building, content, travel insurance, etc). Requiring an 'excess' as a condition to submit HBCF claim would also encourage homeowners to make calculated decisions when engaging/contracting builders.

#### **Frequency of the review**

HIA acknowledged that the Review is also looking into how often the insurance cover should be adjusted.

HIA's recommendation has always been that before determining the frequency, it is important to analyse:

- How often the construction price increases and by how much.
- How many claims reached or exceeded the current maximum cover of \$340,000.

Placing a time frame on this might be an inflexible approach as there may not necessarily be a pattern to guide this.

#### **Cover Amount: Incomplete home building work**

As set out above.

#### **Additional comments**

##### **Opt-outs**

HIA notes that in 2022, a proposal was put forward to provide 'opt-outs or premium caps for high value projects (Reform Idea 7).

First and foremost, it is well understood that regardless of the value of the projects, the maximum amount of cover is \$340,000. Premiums are not capped in the same way, and as the value of the project increases so does the premium. This means that even if the value of the projects exceed \$2 million, \$340,000 is the maximum amount of cover, yet the premium amount being paid would be higher. There are clearly some concerns with this outcome. In reality, where claims do occur for works valued at \$2 million or more, homeowners are more likely to suffer uninsured losses exceeding that amount and be out of pocket.

Therefore, there is value in exploring this option noting that if the 'opt-out' option is pursued:

- There is the possibility of parties opting in, which might create undesirable disturbances in the market with some properties being insured and others not.
- There would be an adverse impact on subsequent owners.



To further assess this option, it would be beneficial to obtain data on how often claims are being made on higher value contracts (such as \$2 million and above). Equally valuable is finding out how much are the premium costs on these high value contracts, on top of the contract price. Again, a RIS would serve to provide analysis on the cost/benefit of this option.

### **Premium caps**

Another alternative proposal was that should insurance remain mandatory for high value work on single dwellings, but premium prices are to be capped for work over \$2 million. HIA sees the value in exploring this option as it is important to understand the cost implications if this proposal is to be adopted.

### **HBCF Exclusions for certain works**

HIA has continuously advocate that it might also be worthy to consider excluding certain works from HBCF requirements. For example, in some jurisdictions HBCF only applies where the value of the building work is equal or over certain threshold amount and a building approval or permit is required under the relevant legislation. If such requirement is adopted in NSW, this would mean that if the building work is equal or over \$20,000 but does not require a building approval or permit, then HBCF will not be required.

### **Assessment of icare's premium**

HIA has always argued that assessment of icare's premiums should be made public (whether that is a requirement that should apply to SIRA or icare). One would argue that any determination would require some form of justification or reasoning.

Further, while in principle SIRA should also publish a statement about its assessment and decision each time icare HBCF's lodges a new eligibility or claims handling model, HIA reiterates the need to seek further information on the implication of this approach should private insurers enter the market.

## ***c. awareness and understanding of the HBC Scheme amongst building businesses and homeowners;***

### **Building businesses**

It is evident that members have high awareness and understanding when it come to the HBC Scheme. This is one of the top inquiries we receive from our members on a daily basis.

It is well-known that HBCF is often cited as a significant source of pain for residential builders in NSW, most due to reasons which are not novel and therefore, builders have been constantly challenged to develop their knowledge and acumen to navigate through the complexities of the HBCF system.

HIA takes this opportunity to reiterate those factors below:

- The cost of HBCF premiums is a substantial financial burden. While these costs are typically passed on to homeowners, they can erode a builder's profit margins, particularly for smaller operators or those working on lower-budget projects.
- As indicated in earlier section of this submission, the eligibility requirements and restrictions for obtaining HBCF can be burdensome. Builders must maintain a strong financial standing, and a history of reliable project completion to qualify for insurance. Any issues with past projects or a decline in the builder's financial health—such as a failure to meet previous obligations or contractor disputes—can result in the inability to obtain insurance for future projects, making it harder for builders to operate.



- The claims process associated with HBCF can create administrative headaches and delays for builders. If a claim is made under the policy (for example, in the case of defects or incomplete work), the builder may face disputes over the cause of the issue, the quality of their work, or the scope of coverage. This can lead to reputational damage, legal battles, and additional costs to resolve claims, even when the builder is not at fault. HIA understands that this could adversely impact on builders' current eligibility as well.
- The potential for large claims under HBCF, particularly in cases of structural defects or builder insolvency, exposes builders to financial risk. If the insurance provider decides to pursue legal action against the builder to recover the insurance payout, this can further complicate a builder's financial position, adding to their stress and risk.

While the HBCF is designed to protect homeowners, it places significant financial and operational pressure on residential builders, and inadvertently creates significant pain points for builders. The high costs, stringent eligibility requirements, risk of claims, and administrative burdens associated with the HBCF contribute to financial stress and operational challenges for builders. Without addressing these issues, the system can become a source of frustration and financial instability for many builders, particularly smaller businesses, which can have broader implications for the health of the residential construction industry in the state.

No doubt, this is one of the most heated/debated topics amongst HIA builders, all with the hope that the HBC Scheme can undergo genuine reform, addressing the roots of the structural problems.

### **Homeowners**

Homeowners carry some responsibility to ensure that they are properly covered. The mandatory Consumer Building Guide expressly states that *"HBC cover is required where work is worth more than \$20,000 (including labour and materials). The builder or tradesperson must give you evidence of HBC cover before they start work on your project or you pay them any money, including a deposit"*.

Accordingly, homeowners are responsible and should take the proactive approach to ensure that they obtain evidence of HBC cover.

Alternatively, further education should be considered to encourage homeowners understand the requirements surrounding their HBC cover.

#### ***d. compliance with insurance and HBC-related requirements by building businesses and help for homeowners who are unlawfully uninsured.***

### **Compliance**

HIA notes that there seems to be possible flaws in the HBCF data available, with various projects that have been insured not showing in the icare HBCF register/portal. HIA understands that several businesses have received notices regarding failure to have insurance when they do in fact have a certificate of insurance for those jobs identified. Many of these projects are on lands that were not registered at the time the HBCF applications were made, and likely the land details have not been updated in the icare HBCF portal once land with a lot number gets a street address upon registration. It also appears that the icare HBCF portal does not recognise unregistered lands. Oddly enough, even some of those properties that have been completed/registered do not show in the icare HBCF portal.



Accordingly, having access and understanding to the data found is extremely crucial to understand genuine issues surrounding compliance.

### **Unlawfully Uninsured/Uninsured losses**

HIA understands that the Review is also considering whether there should be help for homeowners who are unlawfully uninsured.

In HIA's view, progressing this proposal would create a moral hazard within the HBCF system by providing an incentive for builders not to obtain insurance knowing that the consumer would be covered.

With the pre-existing structural issue and the complex nature of the HBCF, the sustainability and affordability of the Scheme would only be further jeopardised if its coverage were to be expanded.

This approach would also reduce incentives for consumers to carry out their own due diligence to ensure that works are insured.

As outlined above under 'awareness and understanding of the HBC Scheme amongst building businesses and homeowners' section, homeowners are responsible to ensure that they are properly covered, and such responsibility should not just be placed on the builders. Homeowners should be taking a proactive approach that they obtain evidence of HBC cover, have not contracted a person they knew or should have reasonably known was unlicensed, or where there was no written contract for the work.

In the event that this reform option is pursued, there is no further elaboration on what would happen if unpaid premiums cannot be recovered due to various reasons (including the current HBCF triggers). This would inevitably lead to HBCF 'money pool' being used to cover those claims and unavoidably result in premium increases leaving parties that have complied with their HBCF obligations being 'punished'. This would be an unacceptable and unreasonable outcome.

This approach would also involve a prolonged claim process. This would simply add unnecessary complexity and further expose the fund with no justifiable outcome.

### **Additional comments**

#### **Remedy for homeowners**

HIA notes that the Review is also looking to propose whether homeowners should be able to get compensation for uninsured work from the directors of building businesses or developers that have not complied with their insurance obligations.

While HIA does not oppose this, this should be approached with caution noting the importance of the 'corporate veil' and any unintended consequences this may have for those who have complied with the law and obtained insurance.

The corporate veil should only be pierced in the most egregious of cases, for example in respect of those businesses and developers that have purposely and intentionally failed to comply with their insurance obligations, and for the purpose of genuine uninsured work.

It is crucial to note that those who have complied with the law and obtained insurance are not 'punished', by having their premiums increased to cater for such a gap.



### **Builder/responsible business should be given the opportunity**

In the 2022 consultation, a proposal was put forward on whether homeowners be required to diligently pursue the responsible business for a remedy first, if they want to claim for uninsured loss. HIA maintains its position that the builder/responsible business should be given the opportunity to remediate and rectify the defects. This is not only the most cost-effective approach, but allowing other builders to attend to these would lead to issues and create complexity particularly when the statutory warranty period is still on foot.

If this approach was to be adopted and the homeowners are not able to pursue the responsible business for a remedy first, then it is worthy to include an obligation on the homeowners to notify the insurer of the defects as soon as it is identified (as opposed to waiting towards the end of the coverage period) and to develop a process to enforce this requirement on the homeowners

## **2. Review the feasibility and desirability of a multi-insurer market for the HBC Scheme and, if so, recommend additional actions to facilitate this.**

HIA has consistently urged the NSW Government to encourage multiple insurers and providers to operate in the Scheme, subject to the right regulatory settings being in place.

It is important that any opportunity to entice competitive and sustainable insurers to enter the market is explored. To attract private sector's interest, it might also be valuable to undertake further consultation with them to gauge their interest, particularly obtaining feedback on what elements (or defects) they would be willing to insure.

As expressed on numerous occasions, to get private insurers into the market, the NSW Government must first address a number of structural barriers embedded in the current Scheme that not only make the Scheme unattractive but also serves as a disincentive for other private sector insurers to enter the NSW market.

### **Providing certainty for a shorter period of defects cover**

HIA has always argued that the maintenance of a long and uncertain tail product linked with a nebulous claims trigger is an unattractive proposition to the private market.

Without a doubt, the defects insurance cover period must be reduced; without such a change, private insurers are unlikely to ever re-enter the NSW HBCF market.

Further, recent data shows that even after 10 years, only approximately 50 per cent of the warranty claims in NSW have been finalised. Although there is no definite guarantee that all warranty claims can be finalised even within the reduced period of defects cover (regardless of whatever the number of years that may be), shortening the tail in any event will be the first 'attractive step' to entice private insurers. The shortening of the currently uncertain liability period for the insurers would take some of the pressure off them.

Under private market conditions this change would have a range of positive effects.

For the consumer, the builder's obligations and responsibilities under the current 6 years statutory warranties applicable to major defects remains untouched. A consumer's fundamental right to have residential building work completed and free from defects remains the centrepiece of the NSW consumer protection framework.



For a builder, reforms to the HBCF that would practically allow private insurers into the market would take significant pressure off premiums, helping to maintain affordability. Further, a shorter and more certain 'tail' provides an incentive for a homeowner to report defects as soon as they arise, increasing the likelihood of the builder being present to rectify which will reduce the pressure on the fund.

Finally, a confident, buoyant and active building industry is beneficial for builders, taxpayers, and the state Government.

### **Linking the claims trigger to a clearer definition of a defect**

In conjunction with this, the severing of the link between a warranty insurance claim (because of the insolvency, death, disappearance or licence suspension of a builder) and a breach of statutory warranty (by providing a separate and distinct claims trigger) would provide clarity and certainty in relation to what can be claimed. This would reduce the frequency of claims ultimately reducing frustration and litigation around the type of defects that can be the subject of a claim. This creates certainty and bolsters confidence in the industry.

Under these circumstances, risk can be effectively quantified having a positive impact on premiums and ultimately housing affordability. Further, the product becomes truly reflective of its purpose creating clarity in the industry as to the application of warranty insurance.

### **High minimum insurance cover**

While the *Home Building Amendment (Compensation Reform) Bill 2017* provided for split product cover, the regulations require that each of these two separate products must be for a minimum insurance cover of \$340,000. This poses a significant barrier to entry. Private insurer interested in offering split products are to have capital reserves of \$680,000, compared to the combined product at \$340,000 offered by, for example icare.

This approach acts as a significant disincentive to private insurers seeking to provide innovative and alternate solutions. It is clear that no reputable insurer has found a split product option attractive under this scenario, rendering the option commercially unviable.

### **Fidelity Funds permitted**

Fidelity funds operate outside of the established prudential framework for insurers, presenting yet another barrier to entry to private insurers. As further discussed below, HIA supports the removal of legislative provisions that permit 'alternative indemnity products' as part of the review of the building reforms.

### **Government monopoly provider**

Fundamentally, a public sector approach differs in a number of respects from that of the private sector. For instance, one of them being to prioritise the need for profit generating activities. This difference acts a substantial barrier to the entry of private insurers. Compounding this is the information advantage the Government monopoly provider currently has. To encourage the private sector to engage in the NSW warranty insurance market, that information should be shared.

### **The role of private insurers**

A private insurer could typically manage defect risks through specific warranty or defect insurance products (i.e. a split product arrangement) which can cover the cost of rectifying defects within a certain period after construction. This type of coverage is separate from the insolvency protection offered by the HBCF. Private



insurers have the expertise to assess, underwrite, and manage the risks associated with defects, whereas the HBCF's role is limited to insolvency-related claims.

Accordingly, having private insurers in the market who will proactively manage defect risk under a split product arrangement would have a positive impact on premiums.

### **The Role of the broker**

HIA understands that icare is transitioning to a model where businesses will be able to interact directly with icare.

As highlighted in HIA's 2020 Submission, HIA has a number of concerns with this approach.

To fundamentally alter the distribution method for insurance under the HBCF is unsound, overstates the 'cost' of the brokerage system in NSW and will not have any significant effect on the long-term viability of the fund.

Reducing administrative costs by manipulating the distribution model shuts the gateway to the private insurer market and removes a key element of individual risk ratings. The transition proposed will make insurance under the HBCF a permanent fixture on the NSW Government's balance sheet.

The role played by intermediaries goes directly to the ability of a builder to obtain insurance.

The broker network:

- Distributes thousands of warranty insurance certificates per year;
- Plays a vital role as advocate during the initial and ongoing eligibility processes; and
- Manages and assists builders with the thousands of eligibility reviews conducted each year – the cost of which to the brokers, cannot be determined.

To remove or attempt to replace the competitive and efficient private sector network that carries out these functions by arbitrarily removing brokers would ultimately be more costly and less efficient.

Furthermore, if the current system of intermediaries was replaced and brokers were not available for builder advocacy a bottle neck would occur within a government department with thousands of builders seeking advice and assistance from one source rather than multiple sources. This would inevitably impact on the quality of the decisions made.

Agent administrative cost represents underwriting and claims management of individual cases. It is a misapprehension to suggest that significant savings can be achieved against the functions that the agent is currently responsible for.

Further, changes made in 2017 to the brokerage arrangements and fee structures has meant that:

- From April 2017, icare ceased paying commissions to broker distributors effective. This change has brought the HBCF in line with icare Workers Insurance which does not pay commissions.
- Broker distributors have adopted a fee-for-service model where they now charge builders with competitively-set fees.
- Broker distributors' fees will be separate to the premium paid for HBCF insurance.



- Broker distributors decide how much they charge for their services independently and it is a matter between the broker distributor and their builder clients.

Therefore, HIA maintains its position that it is unlikely that any further changes would have any significant impact on the costs associated with the Scheme.

### **Nous Group report**

Nous Group (Nous) was engaged by HIA Insurance Services (HIAIS) to conduct an independent and objective review of the current home warranty distribution model in NSW and provide a recommendation for the future state model, considering as options a broker distribution and a baseline direct distribution model. Nous subsequently released a report 'Relevance of broker distribution model in NSW' (Report) on this review on January 2013.

The overarching objective of this review is to identify the ways in which the broker distribution model is important to stakeholders involved in the issuance of home warranty insurance in NSW. This involved determining the model's positive elements from the perspective of homeowners, building businesses and icare. This was supplemented by a series of supporting lines of enquiry:

- establishing the quantitative and qualitative benefits of a hybrid model relative to an entirely automated 'direct' model
- mapping the current user journey and identifying known delight and pain points and opportunities for improvement.

Nous conducted structured interviews with representatives from the building industry, icare, Victorian Managed Insurance Authority (VMIA) and both NSW and Victorian branches of HIAIS.

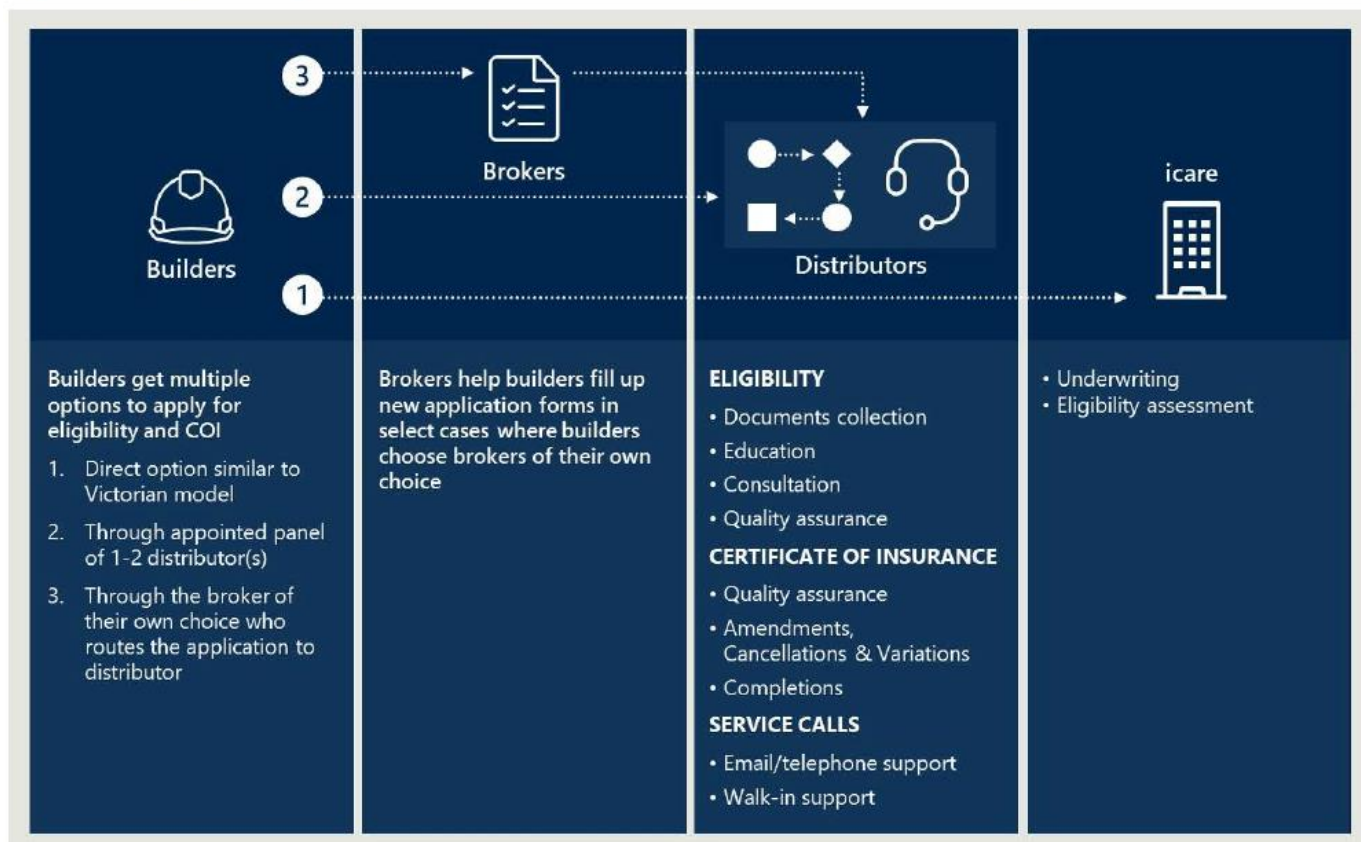
The Report indicated that currently icare focuses on core activities such as pricing the risk by underwriting and managing the HBCF. The non-core activities are managed by the broker distributors and that helps in providing a focus for icare.

The direct distribution model would mean most of the secondary activities such as service support on application queries will have to be performed by icare, and that would not only mean creating an infrastructure, hiring new people but also learning some of these activities from ground zero. The distributor industry is already equipped to handle the service support requirements, education, consultation and marketing and the industry will benefit a great deal if these activities continue to be performed by distributors.

The report concluded that Hybrid model is the way forward as it will provide the best customer experience, higher profitability to icare, and stability in the industry. The hybrid model is customer centric and would be able to reduce the \$25 Million cost for icare significantly by virtue of automation as well redistributing the activities performed by the distributors.

The Hybrid model will provide builders with multiple options to apply for eligibility and Certificate of Insurance as shown below:

Figure 6 | Proposed hybrid distribution model



HIA is open to further discussion on this subject matter.

**3. Given the Government is in the process of consolidating building-related legislation, review the draft legislation relating to the HBC and recommend the changes, if any, that are necessary or desirable at this time to promote cohesiveness with the wider legislative package.**

**Draft Building Insurance Bill**

HIA takes this opportunity to reiterate HIA’s view on the proposals put forward by the Building Commission NSW on the Building Reforms proposal (also known as the HBA Review)

**HBCF - ‘Cost of Insurance’**

HIA understands that the requirement that residential building contracts for work over \$20,000 include the cost of insurance under the HBCF will be removed.

As has been previously outlined on numerous occasions, HIA supports this approach.

HIA has long held concerns regarding this requirement and opposed the requirement from its inception back in 2017. Since its adoption, HIA has continued to raise the practical problems with complying with this requirement, such as, often the cost of insurance under the HBCF is not known at the time of signing the



contract as the insurer requires a copy of a signed contract in order to provide the cost of insurance. To that end, industry has been forced to include an estimated cost which, concerningly may not have complied with the legislative requirement.

To remedy the situation regulatory guidance from SIRA and a statement of regulatory intent from the then NSW Fair Trading was produced to 'fill the gap' between the regulatory requirements and the practical realities of the situation.

### **Alternative Indemnity Products**

HIA supports the removal of legislative provisions that permit 'alternative indemnity products'.

Additionally, HIA's position has always been and remain that fidelity funds are not suitable for the Scheme.

Firstly, fidelity funds do not provide adequate consumer protection. The inability of a fidelity fund to unilaterally increase contributions poses a risk that losses as a result of claims cannot be covered nor recouped.

Secondly, fidelity funds are not subject to the same oversight and regulation as other APRA approved insurance products. APRA has consistently over the years drawn attention to the fact that existing fidelity funds (constituted as a trust) generally do not have adequate risk management systems and internal controls in place, or sufficient capital, to satisfy APRA's Prudential Standards. Liquidity of assets and the forms in which they may be invested, gearing, and the methodology for determining the trust's risks and liabilities are also areas where fidelity funds are not required to comply with the same standards as insurers. There is no doubt that any potential NSW home warranty fidelity fund would also fail to satisfy APRA standards.

Allowing fidelity fund to operate in the NSW scheme and providing them with discretionary power whether and how much to pay will only undermine the need for a competitive and viable market, further serving as a disincentive for private sectors to enter into the market due to the lack of clarity, certainty and even level playing field.

### **Proposed accompanied regulations still unknown**

HIA understands that several provisions are still open to further revisions or amendments via unknown regulations. HIA is hesitant to support proposals that lack certainty and clarity.

It is appropriate for further consultation to occur on the regulations when drafted and HIA looks forward to be involved when the time arrives.

### **Draft Building Bill**

HIA holds reservation with respect to the expansion of the regulatory framework to prefabricated building work has not been fully thought through and will have a raft of unintended consequences, including upsetting current, legitimate and well-known and used arrangement with respect to such work.

### **Consumer protection and prefabricated building work**

HIA notes the consumer protection statements in the Prefab Paper and the intention of the legislation to *'establish a comprehensive framework that integrates prefabricated building work more effectively into the NSW construction landscape.'*



One of HIA's concerns regarding the application of the (largely) existing consumer protection framework to prefabricated building work include the lack of clarity on how the requirements to obtain insurance under the HBCF interact with the inclusion of prefabricated work in a home building contract.

The definition of 'contract price' clearly contemplates the inclusion of other amounts another person is entitled to receive under a separate contract for 'building work' (defined to include prefabricated building work), there is potential for this to mean that the builder cannot take money from the homeowner to commence work on prefabricated components without insurance under the HBCF in place.

While this may be doable in circumstance where only part of the home is prefabricated i.e. a pod (As referenced in section 16 of the Draft Bill), in fact such arrangements may not be captured in light of 2 definitions relating to prefabricated work, where the contract is for prefabricated building work as per section 17, the follow questions arise:

- Must insurance under the HBCF be in place in respect of such work prior to taking/demanding any money from the homeowner?
- If yes, will an insurer issue a policy for such work? Further, this would represent a significant expansion of the insurance scheme and its potential impact on the builder and the scheme does not appear to have been considered.
- How can the builder manage the potential significant upfront capital outlay for such work without being able to recoup either through a higher deposit or more flexible progress payment arrangements?

#### **4. The review is to be informed by past reviews addressing matters within the scope of the terms of reference.**

HIA has highlighted key aspects of past submissions to assist inform this Review below.

##### **HIA's 2021 Submission**

HIA identified that under H01 (previously C09), a secondary dwelling, when constructed in connection with a primary dwelling requires its own certificate of insurance under the HBCF. This means, for example that if a granny flat, is built at the same time as a new dwelling, two certificates of insurance are required.

As HIA had previously submitted, in these circumstances applicants should not be required to apply for two certificates principally on the basis that:

- Pursuant to the *Environmental Planning and Assessment Act 1979*, this dwelling is not a subdivided dwelling (the land cannot be subdivided into two separate titles) and hence should not require an insurance policy of its own.
- Secondary dwellings cannot be sold as a separate property and accordingly, only one HBCF certificate should be required.

Accordingly, a secondary dwelling which is part of a primary dwelling and form part of the same contract, should only be required to apply for one certificate of insurance as opposed to two certificates.

##### **HIA's 2020 Submission**

HIA supports the following draft recommendations outlined in the 2020 IPART Review:



- Recommendation 5 - SIRA report on costs as part of its annual performance monitoring review so that icare's costs can be more easily tracked over time, and compared with costs of the schemes in other states.

As outlined in our previous submission, while he does not oppose this recommendation, comparing costs is somewhat of a moot point unless there is some subsequent action to remedy poor performance.

- Recommendation 11 - That the NSW Government requires icare to make available separate cost-reflective construction period and warranty period products so that a new entrant could provide construction period cover only.

However, HIA notes that while HIA would support moves to require icare to make available separate cost-reflective construction and warranty period products that simply does not go far enough to resolve the fundamental issue regarding the operation of the split product.

The current regulatory framework allows for both split product offerings and combined product offerings. While the minimum coverage remains different between them, no private provider will offer each limb separately. The Draft IPART Report argues that requiring a minimum of \$340,000 to apply to each product would not drive-up costs because claims are rarely made for both periods of cover. Whether a claim is actually made is irrelevant to the minimum capitalisation requirements that must be met. An insurer must ensure they are adequately capitalised in the event that the minimum cap of each limb is exhausted, increasing costs, including premiums and reducing the attractiveness of the market when providers can offer a combined product at (arguably) 50 percent less cost.

This fundamental inconsistency must be first resolved.

While HIA does not oppose the following draft recommendations, further consideration needs to be given on what it would mean for private providers who may recoil at an approach in which the regulator is telling them how to determine their premium requirement, risk appetite, eligibility assessment and claims handling processes, other than what is currently required by law. This also has the potential to undermine the competitive advantage a private provider may be able to build into their processes and approach.

- Recommendation 12 - That the NSW Government amends the *Home Building Act 1989* to require an independent regulator to determine icare's premiums for the HBCF to ensure they reflect efficient costs. SIRA's role, as the scheme regulator, could be expanded to provide it with determination powers. Alternatively, IPART, as the NSW pricing regulator, could be given the on-going role of determining icare's HBCF premiums.

HIA agrees with this draft recommendation. Whether it is the role of SIRA or IPART icare should be required to charge a premium equal to the actuarial forecasts and one which allows true competition from new entrants.

- Recommendation 13 - The NSW Government amends the *Home Building Act 1989* to require SIRA to determine icare's builder eligibility assessment and claims handling processes.
- Recommendation 14 - SIRA establishes appropriate KPIs against which it can measure and publicly report on icare's performance in resolving eligibility issues and finalising claims in a timely manner.



- Recommendation 15 - icare provides greater transparency in how it undertakes its eligibility assessments and how it determines individual builder loading/discounts used in risk-adjusted premiums.

## Continual changes to the HBCF Scheme

Industry experiences ongoing/constant changes (including increase in regulations/red tape) to icare HBCF rules impacting members, and in particular small businesses.

HIA continuously expresses concerns with the regulator's approach with communication (including challenges with transparency) particularly when introducing new rules/guidelines/manual changes, where most times involve no public consultation (and RIS) that would give stakeholders (or HIA/associations) opportunity to highlight the potential impacts to be considered resulting in businesses being adversely impacted.

Understanding of how businesses operate/day-to-day practices is critical when making rule changes to ensure that unintended consequences are avoided and disruptions to business practices are minimised, particularly in what already a challenging climate faced by the industry.

Examples/case studies of recent changes:

- Exclusion of principal residences under the personal asset calculation to be used towards a deed of indemnity, resulting in businesses' HBCF Eligibilities being reduced and not being able to take on more work in the pipeline to support their cash flow/livelihood. It is important to note that for small businesses, their principal place of residence might be the only one/the biggest asset they have.
- Businesses are being significantly impacted by the new underwriting ruling where icare HBCF has changed their scope of accepting 'trust' structures – i.e. businesses with trust structures are no longer accepted. This includes icare HBCF no longer accepting existing 'discretionary family trust' structures as a vehicle for HBCF Eligibility and have directed builders to change their trading structure to become Pty Ltd in their own rights.
- The use of Automated (Builder) Scorecard Review (ASR) process, which is an automatic eligibility assessment based on an eligibility score generated through the consideration of a number of business characteristics. This score will determine a builders open job limit for insurance under the HBCF. While icare's view is that the changes would be better for builders, the feedback we have received from members tend to be different, with the most common impacts being their eligibility limits getting reduced.
- The change of icare processes in relation to the requirement of signed and dated contract as a precondition to apply for HBCF Certificate created challenges for many business practices. Businesses typically provide HBCF certificate when presenting the contract to the homeowners to provide assurance that their projects are insured, but with the change businesses are faced with homeowners who are hesitant to sign contracts without supplying them with the HBCF certificate. Any intended measure should be implemented in a way that does not punish industry participants or disrupts practices that would make it hard for businesses to operate.
- Building Contract Review Program (BCRP) - intended to assist new entrants to the building industry, as well as existing small to medium builders without demonstrated experience for proposed projects. However, in practice all builders are being subjected to a 'one size fits all' approach, including new businesses led by already experienced builders as well as those with capital. A tailored case-by-case assessment should be taken as opposed to a 'broad brush approach' to ensure that such program functions as intended.



## Summary of Recommendations and Proposals to be considered for the HBCF Review

	Key Issues	Recommendations/Proposals
1	The current design of the product must be reformed	<ul style="list-style-type: none"> <li>• Providing certainty for a shorter period of defects cover;</li> <li>• Linking the claims trigger to a clearer definition of a defect.</li> </ul>
2	Competition	The private sector must be encouraged to enter the market.
3	Insurance under the HBCF is a safety net	It should not be used as dispute resolution system.
4	Eligibility	<ul style="list-style-type: none"> <li>• When it comes to assessing HBCF eligibility limits, consider excluding those projects where physical work has not actually commenced (and if needed, put into a different category of alternative eligibility limits) until such time the land is registered and construction can commence.</li> <li>• Tailored approach when assessing eligibility as opposed to a one size fits all approach as businesses are made up of different sizes, models, structures, etc.</li> </ul>
5	Claims Management	<ul style="list-style-type: none"> <li>• Further inquiry should be conducted in relation to claims management, including investigating acceptance of claims not covered under the policy, inadequate tendering, and the situation where a claim can be brought within 10 years of the completion of the property meaning that claims can continue to develop for up to 13 to 14 years.</li> <li>• Consider implementing 'excess' fund to be paid by the homeowners when submitting HBCF claims (similar to when making other insurance claims such as car, building, content, etc).</li> </ul>
6	Premium	<ul style="list-style-type: none"> <li>• Options to opt-outs or premium caps for high value projects</li> <li>• Exclusions for certain works such as those from other jurisdictions.</li> </ul>
7	Transparency	More transparency whether regarding premium formula and calculation, eligibility assessment process and claims management/process.
8	'Cost of Insurance'	Remove the requirement that residential building contracts for work over \$20,000 include the cost of insurance under the HBCF.
9	Alternative Indemnity Products	Remove any legislative provisions which permit these products.
10	HBC Construction types	A secondary dwelling which is part of a primary dwelling and form part of the same contract, should only be required to apply for one certificate of insurance as opposed to two certificates.
11	The role of broker	The 'hybrid' model as recommended by the Nous Group Report should be considered.
12	Small businesses	Any proposed reforms should take into account analysis and impacts specifically for small businesses.