

Inquiry into Western Australia's Home Indemnity Insurance Arrangements – August 2012

Calliden welcomes the opportunity provided by the Western Australian Government to offer feedback on the current arrangements for Home Indemnity Insurance (HII) in Western Australia. As the only private insurer remaining in the Victorian market and as one of only two insurers nationally we believe we can offer useful insight into the practical working of the HII process.

HII is a consumer protection product designed to assist and protect the Western Australian public should their builder die, disappear or become insolvent. It is similar to other consumer protection products e.g. Compulsory Third Party insurance and Workers' Compensation in that its intrinsic value to the public has been deemed worthy of protection from open market pressures. This has led to HII being state managed to varying degrees nationally.

Calliden notes the importance of the building industry and its contribution to the Western Australian economy. We contend that any reform to the consumer protection framework must protect the consumer while ensuring the financial viability of the building industry. HII is a unique resource which currently forms a dual role of pseudo regulation and financial testing of the building industry. As a consequence, HII improves the overall financial viability of the industry through the underwriting process and thereby enhances the reputation of Western Australian builders.

The warranty protection afforded by the current scheme is a very real and valuable safety net for the consumer who is building a home. Despite many enquiries the current scheme has stood the test of time, protecting consumers and supporting the building industry when last resort events occur. The insurance product is providing the safety net it has been designed to do and the present framework while not without flaws is not in Calliden's opinion, fundamentally broken.

Calliden believes that the key to improving the current system is to streamline the process for all stakeholders from the education of consumers at the front end to final settlement of a claim

The Western Australian Home Building Industry

(1) Do you have additional information that could strengthen the authority's understanding of the operation of home indemnity insurance market?

- The Calliden Group is one of the two underwriters offering HII in Western Australia. The current focus of the Calliden Group is on the relatively small turnover segment of builders in Western Australia. This is a considered strategy due to high capital support required, reinsurance availability and the risk appetite of the Calliden Group as a private insurer in HII.
- We believe that other states are adjusting the interpretation of disappearance into be only within in Australian boundaries. We would recommend Section 25D (ii) should be altered, after due search and enquiry , to "within Australia"

(2) Are there elements of interstate home indemnity insurance schemes, that are superior to existing arrangements in Western Australia and if so why?

Insurance Models

The HII model, which has evolved in the 40 years since its initial introduction and most common in Australia, is mandatory last resort. The model has succeeded because it provides consumer protection while ensuring consumers retain a degree of responsibility. The Western Australian HII has performed better than other states because of its strong licensing regime which reinforces the financial testing process imposed by the warranty underwriters.

In Calliden's opinion on other the other insurance models is set out below.

- A First Resort Scheme such as is available in Queensland, is an administratively onerous scheme to operate. This model was in operation pre-2002 in NSW and Victoria and proved very unprofitable for insurers. It absolves homeowners of any real responsibility when entering a contract and may act as a disincentive to settle disputes quickly before they escalate.
- The current NSW Model is in its foundation years and its platform is to encourage the building industry to recognise the need for real profitability and capitalisation. The product is distributed through two agents and their network of authorised representatives. The positives are that the underwriting and premiums are standardised by the government and agents administering the product focus on service standards. .
- The Victorian Government has taken back the scheme from the private insurers except for the Calliden Group which continues to write business to its own account.

This fragmented system adds complexity to the market without offering the benefits of the NSW scheme.

- A Voluntary Scheme as seen in Tasmania has proven itself to be unworkable with insurers finding it uneconomical and withdrawing from the market. The Tasmanian Government are currently looking at alternatives for consumer protection including dispute resolution processes which have their limitations and are generally adversarial in nature
- An alternative scheme has been suggested for a Professional Indemnity scheme to be introduced. Scope of cover under such a product and therefore the potential premium cost would likely be unsustainable for many small builders

(3) What is preventing other insurance companies from providing home warranty insurance?

Constraints may include the following:

- High capital requirements increased by the capital adequacy requirements, new APRA requirements will be introduced in January 2013
- High claims experience – historical claims experience has been extremely high in some underwriting years which have been reflective of the underwriting process at the time. Underwriting processes have evolved since and given the right support are able to manage risk more closely
- In the past competition centred solely on reducing premiums and underwriting suffered as a consequence, this resulted in claims which made the schemes unprofitable because funds had no chance of accumulation
- High reinsurance costs as result of claims experience
- Warranty is a specialised product and is a cross between general insurance underwriting accounting and mortgage lending and experienced resources are at a premium.

(4) Are home warranty insurance premiums set at a reasonable level

The risk attached to this product has a 6 year tail and the existing market premiums are in Calliden opinion challenged to meet administration and claims costs and as a result there has been little opportunity to accumulate reserves sufficient to meet a larger insolvency type claim. This drives the focus on the more financially stable builders in the underwriting process by a private insurer.

The building industry in Western Australian controls the information which it is willing to provide and therefore affecting the accurate assessment of risk. There is also a risk of market distortion because 80% of risk is concentrated in the 10 largest builders and as result may have undue bias when assessing market conditions to strike premiums.

If we look at a premium quoted in the submission of \$1500 on a small project of \$300,000, this equates to 0.50% of the total cost of the project and Calliden do not believe that premiums at these levels add an unreasonable cost to the price of building a home when aligned to the risk protection provided to the consumer.

The Impacts of Government Intervention in the Home Indemnity Insurance Market

(5) What are the risks to the State Government arising from its intervention in the home indemnity market?

- Under the current scheme, the state government is exposed to 10 of its largest which amounts to 80% of the HII market. This constitutes the large builder segment and this segment is all underwritten through the one underwriter QBE.
- The segment could have an enormous influence on the underwriting and subsequent premiums charged and this could affect the ability of the fund to accumulate sufficient reserves. These builders rely on high volume for making profits and are subject to the vagaries of supply. If production is suddenly unavailable their business model is adversely affected. All have high overhead costs and prices are based on low profit margins for each project
- Generally, reporting from the high turnover builders is treated with selective adherence and this restricts the underwriter's ability to monitor performance.
- Calliden underwrite in their own right and spread their risk across a broader builder segment of small to medium builders and limits its exposure to builders within its underwriting appetite.

Is the state government managing these risks appropriately?

- If the state government is managing the large builder segment, with all 10 builders or 80% of the large builder segment, providing regular reporting and meeting risk controls including performance targets and appropriate capitalisation levels, then they are largely managing the risks appropriately.

(6) Is the State Government being adequately compensated for risks being held?

As Calliden has no line of sight on this we are unable to comment.

(7) Should the State Government continue to play a role in the home indemnity insurance market?

Calliden have previously stated that they believe that HII is a very real protection for consumers and that it is important that the state government continue to support the home indemnity market in some form. As Western Australia is in a unique position due to the concentration of building in the large builder segment it has an opportunity to consolidate the scheme with more innovative ways by continuing to support the private insurers. The adoption of an agency framework across the entire builder market, utilising agents would bring more consistency for all builders in the State.

(8) Does Home indemnity insurance met the intended level of protection for consumers?

Yes, refer our preamble

(9) Is there an ongoing need for mandatory provisions of home indemnity insurance? The issue can include but is not limited to:

(a) the impacts on consumers if housing indemnity insurance became voluntary

Calliden believes there would be a very low take-up of HII, if made voluntary and the scheme would have to be replaced with another form of consumer protection.

(b) the impacts on the building industry;

Removal of HII could have the effect of damaging the reputation of the building industry with no backfill consumer protection that the product offers.

(c) the impacts on home indemnity insurance providers;

Private insurers anticipate a low take up of a voluntary scheme and there would be little or no opportunity for accumulation of reserves and it is likely that Calliden would withdraw from this class of business as it would be economically viable.

(d) the impacts on the real estate industry, particularly with respect to any potential liability a real estate agent may incur if a home is sold within its rectification period: and

The Real Estate Industry would see an impact on the free flow of properties from sellers to purchasers and it could have the effect of creating two classes of properties those with HII and those without.

(e) the impacts on government

Those most likely to not take up a voluntary product would have a higher potential for claims and therefore increased trouble. Consumers could be adversely affected by the lack of control and they in turn will look for Governments to provide some form of recourse, we note the Western Australian Government has already experienced something similar to this with the collapse of HIH & FAI in July 2001.

(10) Do current arrangements impose a heavy “red tape” burden on residential builders or consumers?

Calliden has supported financial testing for HII since its inception and has seen the underwriting process go from a one page form with name, address and telephone number, to where it has evolved today. Calliden contends that every class of business in Australia is now subject to increased risk assessment and compliance requirements. We do not believe the assessment requirements for Builder’s Eligibility are onerous or intrusive. Calliden believes that the financial testing and underwriting process, with strict reporting and capitalisation requirements has assisted the building industry in Australia to ride through the current downturn. This in turn has been a direct benefit to consumers.

(11) Is an alternative regulatory model needed to replace the existing regulatory framework for home indemnity insurance?

The warranty protection afforded by the current scheme is a very real and valuable safety net for the consumer who is building a home. Despite many enquiries the current scheme has stood the test of time, protecting consumers and supporting the building industry when last resort events occur. The insurance product is providing the safety net it has been designed to do and the present framework while not without flaws is not in Calliden’s opinion, fundamentally broken.

Calliden believes that the key to improving the current system is to streamline the process for all stakeholders from the education of consumers at the front end to final settlement of a claim

(12) What alternative regulatory models could be applied to replace or improve current arrangements?

Calliden recommendation is that an agency model is adopted across the entire scheme. This gives consistency of product and control of process and standards of financial assessment. Agents of the government with knowledge and systems in the market,

could then provide the administration of the product focusing on competitive service levels.

(13) Are there examples of regulatory frameworks used in other jurisdictions that are superior to the existing Western Australian regulatory framework?

Already discussed

Subsidence Insurance

(14) Why is subsidence insurance not available in Western Australia?

Limited knowledge of product requirements and is considered a new class of business yet to be scoped for consideration. This is likely to be more suitable for domestic home insurance rather than a consumer protection indemnity product.

(15) Are problems due to ground subsidence significant in Western Australia?

Calliden is not able to comment

(16) Are some areas of State more prone than others to damage caused by ground subsidence?

Calliden is not able to comment

(17) Should “no fault” ground subsidence be included in the scope of home warranty insurance arrangements?

Calliden would not support inclusion in HII product

This would be a considered a new risk product and Calliden could not offer an opinion without deep actuarial analysis. We would anticipate an assessment would require detailed seismic data to track historical trends. Once received Calliden would have to make a judgement if a form of cover could be viable and then formulate relevant underwriting criteria before a submission to reinsurers.

(18) Would insurance companies be willing to provide insurance against the damage caused by Subsidence?

Calliden would not consider offering this product at this time

- (19) Can problems caused by ground subsidence be managed in a more effective way than through insurance**
Insufficient data to make a comment