

This is a direct response to draft paper prepared by the Economic Regulation Authority (ERA) on the effectiveness of WA's home indemnity insurance arrangements and options for its future provision.

Willis Australia Limited provides the following commentary with regard to the Builders Warranty Indemnity element.

The ERA was instructed by the Treasurer of WA to report on the effectiveness of WA's home indemnity insurance arrangements in June 2012 and consider options for its future provision. The ERA released on 4/4/2013 its draft report on its Inquiry into WA Home Indemnity Insurance Arrangements.

The ERA has recommended that the existing home indemnity insurance model be replaced by one that separates construction period risk coverage from warranty period risk coverage. The recommendation is that:

- The private sector insurers provide insurance to cover construction period risks and that this portion of the insurance be mandatory such that builders are required to hold the appropriate insurance before commencing work; and
- The building industry (through the building industry associations) becomes a provider of warranty period risk insurance.

The ERA is stating that this model is superior to the other models it assessed (nine in total) and that its implementation would deliver affordable protection to consumers and net benefits to the community.

**The following is a submission commenting on the matters raised in the Draft Report.**

**The premise of the paper put forward by the ERA is that:**

**1. Private sector insurers will provide the insurance to cover construction.**

Assumption appears to be that the private insurer will grant builder coverage for insolvency risk during construction.

No insurer other than the two remaining (although a third is mentioned as being interested) has the resources to run with such an arrangement, i.e. Underwriters, software application platform, Underwriting guidelines and Reserving as required for Capital Adequacy.

It is somewhat sceptical that QBE will remain in the WA market given they have negotiated in every other state to act as an agent for the respective state governments. As a private insurer QBE are answerable to their shareholders to provide an investment return hence why many private insurers exited this market.

Calliden as a private insurer long term in this market is questionable as their market share is small and a greater investment is required by them, which appears unlikely. The overall investment in resources needed here is high while the return is quite low.

It is preferable that the State Government act as the insurer; and the private insurers act as agents and administer this product which they can operate more efficiently.

The obstacle for new entrants underwriting the product is the lack of expertise available for new entrants to deal with this complex financial risk product. It will take considerable time and investment for a new entrant to build this knowledge and expertise.

To ensure current insurers remain in this market and entice new entrants' premiums must be increased to enable higher returns for the private insurers and their investment required in order to make it an attractive proposition.

## **2. The associations will provide the tail of the insurance:**

ERA assumption is that the Associations will deal with both the builder and the consumer and utilise their knowledge and expertise to the benefit of both. Problem with the associations is that there could be a conflict of interest where the primary role for the Associations is to act for the interests of their members i.e. the builders. Also, the Associations must consider taking the appropriate accreditation required for someone to provide advice on a financial risk insurance product and what professional indemnity insurance they may require to cover the provision of financial advice.

As it currently stands the Associations are only obligated to provide assistance to their financial members and are obligated to provide best service to meet the need and interests of their members only.

It is recommend that State Government intervention be undertaken via the Building Commission being responsible for providing mediation and adjudication services to assist with disputes between builders and home-owners instead of possibly proposed Associations. This would alleviate the conflict of interest the associations would pose if involved in the mediation/arbitration process.

In regards to a proposed Fidelity Fund arrangement it is felt that this will not be attractive to the major builders as they will be contributing the bulk of the levy to make up the fund. This will likely not be acceptable to the major builders who will carry the risk of the fund and the entire market.

### **Points of interest that ERA has not considered or overlooked**

The ERA has acknowledged that the Insurance Commission of Western Australia (ICWA) is likely best to oversee this insurance scheme. Although ERA may believe this, the ICWA specialises in workers' compensation insurance and third party motor vehicle insurance on behalf of the State Government.

As Home Indemnity Insurance (HII) is a financial risk product it requires a complete different set of criteria to oversee this product. It is felt that the Building Commission, with its expertise already in this field, would be better placed to oversee HII.

To support this, the NSW and Victorian Governments have taken the approach to administer this product via the private insurers acting as agents. The state government's objective is to work in the interests of both the builder and the consumer to find best practice solutions. With a private insurer this is not always at the forefront.

A Fidelity Fund arrangement is not guaranteed to keep premiums down, even with the suggested reduced indemnity period. The Associations underwriting this risk and administering the scheme will require an investment in resources and a return to consider such an exercise. More than likely, at the end of the day, the investment will be required to be borne by the State Government up front to

establish this. A further investment in personnel, software, underwriting guidelines etc. will be needed.

There still remains the concern of a conflict of interest as to who will the Associations represent. Preventive measures to be considered

It would be better placed to have the State Government own independent department (existing or to be established) look after the warranty period in conjunction with licensing. Licensing is an area that appears to have been overlooked by the ERA.

Those who administer building licenses would be in a much better position to ensuring builders adhere to appropriate building standards and maintain appropriate business practices. Any failure to abide by the Building Code or failure to abide by any arbitration will attract penalties through license restrictions or even cancellations preventing it from reoccurring. Suggestion is that those who control licensing can direct the builder to rectify the work before proceeding to the next project hence ensuring a culture of abiding to best building practice.

This establishes a culture of best building practice from the outset to ensure the builder act in the best interests of the consumer, having the effect of minimising disputes from the outset.

## Conclusion

The role of the building industry Associations should be to provide representation and providing appropriate training for both building and business practices. It is felt that they cannot represent interests of the builder and homeowner at the same time.

Subject to how much funding the State Government wishes to inject to provide a solution it must be acknowledged that there is no quick fix.

Given the lack of investment at present into expertise and software and underwriting, it will take considerable time to get up to any speed and there will be a lot of teething issues along the way.

The ERA response is an end solution dealing with the problems that arise. They have missed an opportunity to deal with the cause of the problem. Establishing the ground work from the outset in preventing such issues and disputes is a better tact than having a band aid solution.

*A change in culture of best building practice is the best move forward. With the WA residential building industry controlled by so few builders than the rest of the states it has the capability of leading the way.*

*To encompass the licensing, policy, underwriting guidelines, administration, mediation and arbitration all under one umbrella as a one stop shop will better control this market and have all parties' interests at the centre of best practice.*

Any questions in regards to this please do not hesitate to contact me directly.

Thanks and regards,

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