

31<sup>st</sup> August 2012

Economic Regulation Authority  
Inquiry into Western Australian Home Indemnity  
Insurance Arrangements  
PO Box 8469  
PERTH BC WA 6849

Dear Sir,

### **Inquiry into Home Indemnity Insurance**

Thank you for the opportunity to comment on the Issues Paper prepared for the Inquiry into Western Australia's Home Indemnity Insurance (HII) Arrangements.

As you may know Master Builders is Western Australia's oldest industry body representing the views of builders in the residential, commercial and civil engineering sectors of the building and construction industry. Established in 1898 we have around 1800 members, of which the largest group are builders in the residential sector. Around 90 per cent of large "project builders" operating in WA are members of our organisation. In addition our membership includes a large number of smaller, "niche builders" in metropolitan and regional areas. Views expressed in this submission can therefore be viewed as representative of builders involved in the residential building sector in Western Australia. We should also state that the Association is a shareholder in the national company MBA Insurance Services Pty Ltd, which provides a range of insurance products including HII in Western Australia.

In preparing this submission our organisation draws on its experience of HII since its introduction in 1996, together with recent input from individual builders who responded to our invitation to make comment on the issue. A broad cross section of views were received. However we note that few industry stakeholders were aware of this Inquiry. We suggest that when the draft report is released that it be distributed widely to obtain a broader representation of views from individual builders.

In addressing specific items referred to in the Issues Paper, Master Builders wishes to make a number of general points. Firstly, there is general dissatisfaction in the industry with the instability and uncertainty caused by fluctuation in the number of insurers who have offered HII in Western Australia. Over the last 16 years builders have on several occasions experienced "crisis" levels of interruption to their business activity and cash flow caused by the sudden exit of an insurer from the market resulting in an inability to obtain this mandatory insurance.

Secondly, there is general resentment among builders over the ability of insurers to act as a “defacto” licensing body and determine the type and volume of work that a builder can take on. Building contractors licensed by the Building Commission are effectively regulated by another private sector agency which can dictate the volume, type, timing and amount of building a registered builder can undertake. This is made worse in the current insurance market where only two providers of HII are available. For builder turnovers over \$10m per annum, a QBE monopoly effectively exists. So, should QBE decide to withdraw from the market, the housing industry would be thrown into chaos. Recent across the board premium increases by QBE, with more to follow, should also be noted in the absence of a competitive market.

Builders have little or no choice but to accept any restrictions imposed by insurers, including large increases in insurance premiums, bank guarantees or changing the structures of their businesses. In many cases, builders are effectively being asked to underwrite the risk of the insurer.

Thirdly, there is a general cynicism that insurers take no risk with this product which delivers little benefit to consumers. With a maximum last resort payout of only \$100k (regardless of contract value) insurers usually also have access to a director’s deed of indemnity against personal assets. Builders argue that they will be personally liable anyway should a last resort claim be made and question whether the premium is pure profit to the insurance company. Given Western Australia’s low claims experience it appears that Western Australian builders are subsidizing insurance losses in other states of Australia.

In addition, consumers are probably largely unaware that the maximum payout under a standard HII product is limited. In the event of a liquidation much of this could be used to cover liquidator or legal costs. Many consumers will be left largely out of pocket and will probably have to contribute additional funds to see their home completed by another builder.

With Master Builders WA having such a large membership it is not surprising that there are a range of views expressed as to what should be the future shape of HII arrangements in Western Australia. These options can be divided into several categories.

1. Move to a voluntary HII scheme as existed in Western Australia prior to 1996. This would require home buyers to do their homework on their builder’s credentials and experience. We note that the Tasmanian government introduced this arrangement recently with no adverse effects to our knowledge.
2. Restrict coverage of HII to all residential contracts covered by the Home Building Contracts Act; that is, up to a maximum value of \$500k. Supporters of this proposal argue that this would provide some minimum level of protection or at least give some security to those homebuyers who are most vulnerable. There is some merit in postulating that clients who enter into housing contracts above \$500k are in a better position to either assess or ascertain the risk of their builder defaulting.

3. Introduce a government scheme similar to the Queensland model where registration and indemnity insurance are linked and provided by the State Government, unlike the hybrid arrangement that currently exists in Western Australia where mandatory insurance is provided by the private sector but is not linked to licensing arrangements. The WA government, however, still provides some underwriting of the risk of larger project builders defaulting.
4. Introduce an industry funded "fidelity fund" arrangement which exists in the Australian Capital Territory, and is about to be adopted in the Northern Territory. Many builders who have in the past supported the establishment of a co-operative industry mutual fund see significant advantages of this type of arrangement; particularly that industry controls its own destiny and that any surplus funds can be directed towards the betterment of the industry through such initiatives as training or safety services.

Whichever model is proposed by the state government it is clear that there are significant problems with the current system, not the least of which is the state government liability should adversity occur. A system of insurance which relies on state government support to attract and retain the presence of private insurers is an undesirable situation, and has led to considerable instability and inequity in the market. While the first and fourth options have significant appeal to this organisation, options 2 and 3 may be more palatable to the state government.

There is also price discrimination in premiums charged by insurers and paid by large and small builders which may be based on financial capacity alone rather than other factors such as industry longevity, building quality etc. This adds a competitive disadvantage to pricing in the building industry for smaller builders whom, it could be argued, pose a lower risk to insurers than the collapse of a large corporate builder.

Builders also question the value of this insurance to consumers. Given Western Australia's favourable claims record in relation to other states, local consumers appear to be receiving little value for this cost. Benefits are limited and have been diluted over time due to rising costs. Benefits are only accessible as "last resort insurance" (which could be eroded by liquidator and legal costs). Costs of this insurance to the consumer are not limited only to premiums paid. Builders are pricing in a margin for the considerable "red tape" that they have to endure in order to apply for insurance and to comply with regular reviews by insurers. To some extent consumers are under a misapprehension that they will be fully covered in the event of a builder's collapse, disappearance or death. However this is clearly not the case.

There are a number of anomalies in the scheme. For example, while an owner builder is not required to obtain HII as a condition of the building permit a professional builder building his own home is required to take out insurance and effectively insure himself!! In the builder's eyes he is paying money for nothing. Similarly there seems to be little or no reason for HII to be required for "off the plan" contracts where the construction risk is taken by the developer.

With respect to WA's housing indemnity scheme being extended to cover ground subsidence, Master Builders does not support this proposition. HII was introduced for a specific purpose and we do not believe it should be tinkered with to deal with isolated issues that may have arisen within the industry. We maintain that there is insufficient good reason for ground subsidence to be included.

Our past experience is that insurers have been reluctant to release statistical information on claims history in Western Australia. If the ERA encounters similar resistance from insurers this would be unacceptable given the state government's potential exposure from its involvement in the arrangements.

Master Builders would be pleased to discuss any aspect of this submission. Kindly contact the undersigned if you wish to do so. We welcome the opportunity to co-operate with the state government to improve the current system of HII in Western Australia.

Yours sincerely,  
MASTER BUILDERS ASSOCIATION OF WA

  
Gavan Forster  
Housing Director