



Submission to The WA Government Inquiry into  
Housing Indemnity Insurance

16<sup>th</sup> August 2012

## Introduction

MBA Insurance Services (**MBAIS**) is the general insurance brokerage owned by six of the Master Builders Associations around Australia. (NSW, ACT, VIC, TAS, WA, NT). We currently service the insurance needs of the 21,000 members of these State Associations.

The purpose of establishing this business was to ensure that the building and construction sector would always be influential within the insurance industry in all matters affecting its industry. This means that the industry aims to have a seat at the table with all those bodies whose decisions can impact them, such as Governments and Insurance Companies.

By being a leading broker in this sphere, MBAIS ultimately helps to keep premiums down and policy coverages up.

MBAIS has major offices in Melbourne, Sydney and Perth, and smaller offices in the other States. All employ specialist staff skilled in the key areas of building and construction insurance – Contract Works, Housing Indemnity and Trades Liability.

However unlike every other general insurance broker, whose profits go to private investors, every dollar that MBAIS earns gets ploughed directly back into the building and construction industry, through local MBA initiatives such as training programs, apprenticeship schemes and the like.

Following are our brief responses to the questions raised in the Governments ERA Issues Paper of July 2012. We would relish the opportunity of speaking further with the ERA about specific issues raised in this paper.

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## Section 2

1. MBAIS supports the WA Govt reviewing other successful housing indemnity markets such as the one that exists in the UK. However whilst this Scheme has been successfully running for over 80 years, the entire building landscape is completely different in relation to key matters such as licensing, progress payments, dispute resolution and the like. Unfortunately in this Scheme it is the builders who get treated the harshest yet it is regarded as working well for consumers and Insurers. (see 'NHBC' for more information about this Scheme)

It would be too simplistic a view for any Government to think that just by changing the Insurance Scheme, this will fix all the problems associated with the current Housing Indemnity Insurance issue. Yes, insurance is integral to the successful functioning of any consumer protection Scheme, however it needs to be supported by a range of other factors in order for all stakeholders to be happy with what they are getting out of the insurance.

2. The indemnity limit of \$100,000 seems to have fallen 'behind the times' in comparison to other States and increased building costs which have risen sharply over the past few years. Also when you compare the relativity of an average house price in WA versus the other States, this limit of indemnity should be lifted

Although only in its infancy stages, we believe that the introduction of a dispute resolution process in support of a 'Last Resort' Scheme, underwritten by the State Government, as is now happening in NSW, is the best way of establishing a housing indemnity insurance Scheme. Any insurance Scheme must be 'last resort' or else it will drown in litigation. Having an effective, fast dispute resolution mechanism complementing the insurance, where a consumer can challenge a builder who is still actively trading, and where the decision of this mechanism is binding gives the consumer a much broader range of remedies if they have a problem with their house. And Government run means that consumers and builders will never be 'left in the cold' by private insurers exiting the market at their will, and it allows those businesses supporting the Scheme like brokers, to spend money on resources and systems to improve the service and efficiency within the insurance Scheme.

3. The private general insurance industry has not been providing acceptable returns to its shareholders for the past 5 years or so, due to the mass number of natural disasters within Australia that have occurred during that time. They are therefore being extremely rigorous at the moment about what type of business they will or will not entertain. In a business like Housing Indemnity insurance, where you could be paying claims for up to 10 years from the date of the build, and where you are operating in an economic environment that is seeing numerous builders become insolvent or close their doors, this is not an appealing class of insurance. Housing indemnity insurance is one of the most capital intensive businesses that an Insurer could have in their portfolio of different insurances, hence they require 'super returns' to make it viable.

In addition to this, housing indemnity insurance has a real 'smell' about it in every State, and many private insurers believe that they would prefer not to risk their business's reputation by being involved in such an emotional and public class of insurance. They would say that being named in just one article in the West Australian (rightly or wrongly) regarding a housing indemnity issue would undo thousands of dollars that they might be spending on advertising their business in other classes of insurance.

Finally, the private insurance industry does not traditionally like being involved in 'hybrid' arrangements where there is either a sharing of underwriting capacity, or resources, or investment etc. It would argue that the alignment between the public and private sector is very hard to achieve when the private sector is purely focused on delivering profit, whilst the public sector has to operate first and foremost in the interests of the public. Whilst this may seem too simplistic, it is the way that the private insurers think.

4. (a) This is a very difficult question to answer unless you had access to the information that an actuary would use to calculate premiums

Insurance premiums are easy to calculate when you are dealing with 'short tail' classes (eg house insurance, motor insurance, business insurance etc – i.e. where 90+% of your final claims are going to be notified in the year that the insurance is taken out) however calculating premiums for 'long tail' classes (eg. workers compensation, housing indemnity, public liability etc - i.e. where often < 50% of your final claims are going to be notified in the year that the insurance is taken out) is a job for qualified actuaries.

We'll leave this up to the actuaries.

- (b) MBAIS doesn't believe that the cost of the insurance (at some 0.5% of the total cost of a home) would be considered as adding unnecessary cost to the price of building a home. Premiums would of course need to be raised if the indemnity limit was increased from the existing \$100K.
- (c) Most of the major private insurer groups have more than enough financial capacity to support the WA housing indemnity Scheme, however if only very few participate, you could run into potential 'accumulation' risks, where their financial capacity is limited by their capital utilisation and their reinsurance treaties etc.

## Section 3

5. MBAIS believes that any risk that the Government might incur in becoming involved in the Housing Indemnity insurance market would be outweighed by the future stability and security that would be achieved within the Scheme if the Government were to intervene in a similar manner to that of the current NSW Scheme (n.b. we are still

recommending further changes to the NSW Scheme, but we believe that they are on the right track with the direction they are moving in)

Whilst we understand that Governments don't want to carry long tail losses on their Balance Sheets, and be potentially caught like they have been in the past with public servant superannuation schemes and the like, the private insurance industry cannot be relied upon in the long term, and this only creates enormous instability and a lack of confidence in the building industry.

Also, if managed properly, this insurance should not become a financial burden on the Government's Balance Sheet.

6. If the Government were to underwrite the Scheme, then it would be incumbent upon them to operate the Scheme with a surplus, in order to avoid any unexpected significant long term losses. This is not going to mean over inflated premiums for consumers, rather, it protects the premiums that the consumers are going to have to pay in the long term because the Scheme should be always running in a surplus position.

MBAIS sees its role as being crucial in supporting a Government underwritten Scheme because of the advocacy that we carry for the building and construction industry. The role of the insurance broker in housing indemnity is crucial, particularly through the underwriting process, because we assist the builder in understanding the need for so much information and the importance of getting the information to the underwriters in a timely fashion, whether that be in the case of a new builder, or in the case of a builder review.

7. For various reasons already outlined, we believe that Government involvement is one of the key pillars of a successful and sustainable Housing Indemnity Scheme.

## Section 4.

8. In terms of whether or not the current housing indemnity insurance meets the intended level of protection for consumers, this would be debatable. In its purest sense, it is providing 'last resort' cover to the consumers who require it, because they've had a builder who's either died, disappeared or become insolvent, and they have defective or uncompleted work that is clearly the responsibility of the builder. The Insurer willingly intervenes in all of these cases and in most circumstances, you end up with a happy claimant who has had their home rectified to an appropriate standard.

Unfortunately, many consumers believe that this insurance is broader in its coverage than what it actually is, hence they look to claim off their policy when their builder is still actively trading, only to be told that they need to get their builder back to rectify the work etc. before any other action is taken. This can be quite a daunting task for many people and hence these consumers would often consider the Scheme not providing them with the level of protection that they require.

9. In a growth State like WA, we believe that there is a definite need to make housing indemnity insurance mandatory. The example of Tasmania is a typical story where, particularly in tough economic times, where this type of insurance is most needed, those that can least afford not to have it, will end up being the ones that forego their cover to their own detriment. You will also find that the whole product will ultimately disappear from the market because the private insurers will not want to provide cover in a voluntary Scheme.
  - (a) If a major builder in Western Australia were to become insolvent, the lack of mandatory insurance would cause an outcry that could ultimately bring a Government to its knees. This situation is very possible in Perth because of the concentration of large home builders (with the Top 20 undertaking approximately 70% of the housing work each year)
  - (b) We don't see any real impact on the building industry other than it could lead to complacency in building and construction creeping into the industry, if the quality of the builders work wasn't being monitored using other mechanisms.
  - (c) If the insurance is not mandatory, as with what happened in Tasmania recently, the private insurers will desert the WA housing indemnity market, thus leading to no-one being protected, unless the Government stepped in and underwrote a voluntary Scheme product.
  - (d) There would be no real impact on the real estate industry as they have very little involvement now, provided it is made very clear to any potential purchaser that a particular home either has or doesn't have housing indemnity protection throughout the first 6 years following its building.
  - (e) We believe that it would be a very brave Government to make this insurance voluntary, particularly in a period of potential or real economic downturn. (also see response to 9)
10. There is currently too much red tape in the underwriting of housing indemnity insurance. This is however only experienced by the builder. MBAIS believes that there are several ways in which the existing underwriting process could be streamlined to make it less onerous and drawn out, and we would happily consult to the Government on this issue if our assistance was required in the future. For the purposes of this paper though, we have not detailed all of our suggested changes.

Consumers do encounter some red tape when it comes to claims , however our experience is limited in this area and hence we prefer not to comment on this aspect of the Scheme's management.

## Section 5.

11. Yes, refer our comments in 2, 7 and 9. These changes are necessary to drive stability and long term confidence with consumers. However remember other changes within

the industry and the Government also need to be made to support the changes to the Insurance Scheme. A holistic overhaul of various aspects of the housing protection Scheme is what's needed.

12. The only possible alternative to the Government underwritten Scheme that we have previously espoused in this paper, given the current environment within the building and construction industry, is the creation of a Fidelity Fund. This option has been successfully used within the ACT and is soon to be used within NT, however there are several issues that would need to be considered before you might opt for such a Fund. These include ;
  - (1) The costs associated with establishing a Fund in WA would be quite significant (possibly > \$10M) and these costs have to be funded by the private sector, unless the Government commits to supporting such a Fund.
  - (2) The concentration of larger builders in WA significantly increases the risk exposure to major losses, hence unless you could buy some supportive Reinsurance at reasonable rates (which is very difficult in the present climate for Australian insurers) you run the risk of the members of the Fidelity Fund being exposed to cover losses that exceed the Funds limits from their own private capital holdings.
  - (3) The current uncertain worldwide economic climate is not the ideal time to be starting a long tail insurance business and it would be a bold group of people that were prepared to start up such a Fund. A significant loss in the first year of the Fund could wipe out the financial viability of the Fund very quickly.
  - (4) You would not want such a Fund to be regulated by APRA because the Fund would drown in compliance costs and other regulations that would do nothing other than significantly increase the premiums that builders and consumers are now paying for housing indemnity insurance.
13. We don't have enough detailed knowledge of the regulatory frameworks of the various other State Governments to be able to comment.

## **Other Issues That Should Be Considered in a Revised Housing Indemnity Scheme**

1. If the Government commits to establishing a revised Scheme, it must commit to a specified timeframe that will allow those businesses working within the Scheme, to assess their level of expenditure in terms of systems and resource development etc.
2. MBAIS believed that owner builders should not be protected by any Scheme and future purchasers of owner builder homes should be advised about this lack of protection before purchasing a home.

3. The Government need to set aside a sum of money to specifically educate the public about what housing indemnity insurance actually covers, and more importantly what it doesn't cover.
4. A professional indemnity extension to a public liability policy (as is done with plumbers in Queensland) is not a viable alternative to a proper Housing Indemnity Scheme, due to issues around the need to buy 'run off cover' etc. which can be difficult.
5. Any current 'high rise' exemption does require clarification and more stringent rules need to be introduced to avoid Body Corporates using this insurance as a maintenance tool
6. At present, developers don't seem to bear any risk in relation to rectifying faulty workmanship or finishing uncompleted work etc. Are we happy that this remains the case. ? Should builders wear all the burden ? Can the responsibility be shared by both parties ?