



National Insurance Brokers Association.



NATIONAL INSURANCE BROKERS ASSOCIATION OF AUSTRALIA (NIBA)

SUBMISSION ON THE INQUIRY INTO WESTERN AUSTRALIA'S

HOME INDEMNITY INSURANCE ARRANGEMENTS

13 May 2013

ABOUT NIBA

NIBA is the voice of the insurance broking industry in Australia. NIBA represents 400 member firms and around 3,000 individual Qualified Practising Insurance Brokers (QPIBS) throughout Australia.

Brokers handle almost 90% of the commercial insurance transacted in Australia, and play a major role in insurance distribution, handling over \$16 billion in premiums annually and placing around half of Australia's total insurance business. Insurance brokers also place substantial insurance business into overseas markets for large and special risks.

Over a number of years NIBA has been a driving force for professionalism in the Australian insurance broking industry. It has encouraged higher educational standards for insurance brokers and introduced a strong independently administered and monitored code of practice for members. The 400 member firms all hold an Australian financial services (AFS) licence under the Corporations Act that enables them to deal in or advise on Risk Insurance products.

NIBA appreciates the opportunity to be able to provide comments on the Economic Regulation Authority's Draft Report following its inquiry into Western Australia's Home Indemnity Insurance Arrangements.

ABOUT INSURANCE BROKERS

The role of insurance brokers

The traditional role of insurance brokers is to:

- assist customers to identify, understand and manage their risks, and provide advice on what insurance is appropriate for the customer's needs;
- assist customers to arrange and acquire insurance; and
- assist the customer in relation to any claim that may be made by them under the insurance.

In doing the above the insurance broker acts on behalf of the customer as their agent.



National Insurance Brokers Association.



Insurance brokers offer many benefits to customers and consumers:

- experience in predicting, managing and reducing risks;
- assistance with selecting and arranging appropriate, tailored insurance policies and packages
- detailed technical expertise including knowledge of prices, terms and conditions, benefits and pitfalls of the wide range of insurance policies on the market;
- assistance in interpreting, arranging and completing insurance documentation; and
- assistance with claims and a higher success rate with settlements (about 10 per cent higher than claims made without a broker).

In limited cases insurance brokers may act as agent of the insurer not the insured but where such a relationship exists the customer is clearly advised up front.

EXECUTIVE SUMMARY

NIBA generally supports the proposal to change the existing arrangements into two forms of protection for building owners:

- insurance protection for non-completion (if necessary with government reinsurance); and
- protection for defects during the warranty period.

These types of risk are very different, as noted in the draft report, and require a very different response from a regulatory perspective.

However, NIBA has major reservations in relation to the draft proposal that protection for defects during the warranty period be provided by some form of “warranty period insurance” provided through the building industry associations.

PROTECTION FOR NON-COMPLETION

As noted in the NIBA submission in response to the Authority’s Issues Paper, non-completion usually arises where the builder disappears, dies or becomes insolvent. The primary risk is one of insolvency of the builder, and where this occurs, there can be significant impacts on the property owner.

Risk assessment and underwriting criteria for insurance relating to financial loss as a result of insolvency are very different from the types of risk being insured for warranty period defects. The insurance industry is very familiar with providing insurance cover in respect of potential financial loss arising from insolvency, and insurance brokers play an important role in advising their clients on ways to manage their risks and obtain cost effective insurance from the market.



Again, as noted in our earlier submission, it will be critical that the wider processes for building regulation in Western Australia operate effectively to ensure that only properly capitalised, well managed builders are allowed to operate in that market. This will minimise the number of builder insolvencies, and thereby keep premium levels affordable for builders and their clients.

WARRANTY PERIOD DEFECTS

NIBA is concerned that the draft Report does not present a clear way forward in relation to risks associated with warranty period defects.

- The Draft Report makes references to “warranty insurance”, but also refers to alternative financing mechanisms such as a fidelity fund.
- The Draft Report refers to protection for warranty period defects being arranged via the building industry associations, but the Draft Report also cites an apparent reluctance from those associations to undertake this activity.
- The Draft Report appears to suggest that warranty period protection become optional, but it is not clear whether this is a clear recommendation or not, or whether optional cover would be in the broader community interest.

At paragraph 9.7.2 of the Draft Report, the Authority indicates that “warranty period insurance” would be characterised by a “more regular claims profile” with lower claims costs, more regular claims frequencies and lower claims variability. In addition, paragraph 8.1.9.1 indicates that defect risk insurance on its own could be provided under a capital base that is an order of magnitude lower than that needed for the provision of construction period insurance.

NIBA respectfully submits that the key characteristics of warranty period protection represent the key elements of an insurable risk, highly consistent with many other types of insurance cover provided to commercial and private clients by the Australian insurance industry. These characteristics give greater confidence to insurers when pricing the risk, and they are better able to manage their exposures and liabilities (including their required capital backing) in these circumstances.

NIBA therefore respectfully submits further inquiries should be undertaken with the insurance industry in relation to the extent to which cover of this nature would be likely to be provided by insurers – separate to the cover relating to construction period risks.

The Draft Report also makes a number of references to the capital required to support “warranty period insurance”. If this cover is in the form of insurance provided by APRA authorised insurers, necessary capital would be provided by insurers participating in the market, and the conduct of those insurers would be constantly monitored and regulated by APRA from a prudential perspective.



If the so called “warranty period insurance” is to be provided in some way by the building industry associations, it is not clear what capital would be available to support the liabilities, nor is it clear how that process would be monitored and regulated in the interests of clients. It is not at all clear that the associations would be prepared to operate such a scheme in any event. (This is not surprising, as the role of an industry association is to represent the interests of its members, not to operate as an industry regulatory body.)

There is a suggestion that warranty period defects be covered by a form of a fidelity fund. An industry fidelity fund gives rise to serious moral hazard issues, as the better, more professional builders would be required to fund (most likely subsidise) the losses of the less professional, more careless builders. This would add to the costs of competent builders, when in fact they should receive the benefit of their competence and professionalism by carrying cheaper warranty period insurance cover.

Hence, NIBA respectfully recommends the retention of the insurance model in the provision of warranty period protection. Under the insurance model, builders who are at a higher risk of incurring warranty period claims will pay more for the protection they give to their clients, and more professional and competent builders will pay less. Insurance brokers will assist their clients in the management of these risks, and in obtaining the most cost effective cover from the insurance market, bearing in mind the claims history and management approach of the client.

Finally, the Draft Report appears to suggest that protection for warranty period defects should be optional. NIBA notes the Tasmanian experience, where optional cover resulted in no cover at all. That would appear to be an unfortunate, and most likely unintended, outcome.

CONCLUSION

For the reasons stated, NIBA is generally supportive of splitting the current home indemnity arrangements into construction period risks and warranty period risks. The nature of these risks is very different, and there are different underwriting and operational considerations for these two types of risks.

However, NIBA has reservations regarding the Authority’s draft recommendations in relation to the so called “warranty period insurance”. NIBA representatives would be pleased to meet with the Authority and elaborate on these concerns if needed.

If you would like to discuss any aspect of this matter further do not hesitate to contact us.

Dallas Booth, Chief Executive Officer, NIBA

Direct: +61 (0)2 9459 4305 Email: dbooth@niba.com.au