

Chapter 2

Description and history of home warranty insurance schemes

Description of home warranty insurance schemes

2.1 Home warranty insurance¹ covers the homeowner for non-completion and defects in building work.

2.2 Last resort insurance provides cover only if the builder is dead, disappeared or insolvent. These events act as a 'trigger' for a claim to be processed under the last resort system.

2.3 Last resort insurance, if triggered, provides for an insurer to cover the homeowner for loss arising from completing the house or remedying any defects in the previous building work. The value of insurance is capped at \$200,000 in Victoria and \$300,000 in NSW.²

2.4 Claims for non-completion are capped at 20 per cent of the contract value in NSW and Victoria. The cap for non-completion reflects the expectation that home owners will have made progress payments to the builder according to normal practice in the building industry. If the builder does not complete the work, it is assumed that the cost of completion will not be the full value of the house.

2.5 A 'first resort' scheme provides similar cover, but without the limitation that the builder must be dead, disappeared or insolvent.³ In this case, if a claim is proved the insurer arranges or pays for rectification then seeks recovery from the builder.

2.6 In either case the builder buys the insurance, with the homeowner named as beneficiary. This differentiates home warranty insurance from most insurance products wherein consumers take out a particular amount of insurance to protect their own assets. Home warranty insurance is a third party insurance, similar to compulsory wholesale insurance taken out by employers on behalf of employees for injury at work, or to compulsory insurance taken out by motorists on behalf of others who may

1 Often called builder's warranty insurance or home builders' warranty insurance; home indemnity insurance in Western Australia.

2 Other statutory limits are in Queensland \$400,000; SA \$80,000; WA \$100,000, Tas \$200,000; ACT \$85,000; NT \$80,000. Insurance Council of Australia, submission 44, attachment A.

3 The current government operated first resort scheme in Queensland provides more cover than the last resort schemes in other states, viz: no-fault subsidence (providing the builder has tested the ground according to the Australian Standard); cover for consumers who are not insured because of the builder's fraud; and no 20 per cent cap for non-completion claims.

be injured in an accident. Thus it is not typical of 'insurance' as understood by many consumers.

2.7 All states and territories have home warranty insurance. In all except Queensland it is last resort. In all except Tasmania it is mandatory (the insurance was made voluntary in Tasmania from 1 July 2008). In all except Queensland it is privately underwritten. The first resort scheme in Queensland is operated by a government monopoly, the Queensland Building Services Authority, which also carries out builders licensing and enforcement functions.

2.8 NSW and Victoria had first resort schemes similar to Queensland's. They switched to private insurance after abandoning their monopoly government models in 1996-97. They narrowed the coverage to last resort from 1 July 2002, as a response to the crisis in availability of insurance following the collapse of HIH in March 2001. In other states and territories the insurance has always been privately underwritten last resort. More details of the NSW, Victorian and Queensland schemes are at paragraph 2.19 and following.

2.9 Five general insurers offer home warranty insurance. All insurance is mediated by brokers. Further details of the states' schemes are in appendix 3. In the ACT insurance is also offered by the Master Builders Fidelity Fund. Being a discretionary mutual fund the MBFF is not prudentially regulated by APRA, but is regulated under the ACT *Building Act 2004*, which reflects APRA standards.⁴

Recent history⁵

2.10 The collapse of HIH Insurance in March 2001 created severe capacity constraint in the market as the company at the time had between 30% and 40% market share and in many cases offered the lowest premium. Immediately following the HIH collapse a number of other insurers pulled out of the market in part due to the withdrawal of reinsurance. As a result many (particularly small to medium) builders found it difficult to obtain HBWI, and were not able to retain their building licences.

2.11 On 13 March 2002, after consultation with the insurance industry, the New South Wales and Victorian Governments jointly announced a '10 point plan' intended to stabilise the market for home warranty insurance (comments in square brackets are from the 2002 Allen report mentioned further below):

New Model for Builders' Warranty insurance in NSW/Victoria

1. The threshold for compulsory home warranty insurance will be raised to \$12,000. [the same as for Western Australia and South Australia]

4 Mr J. Howard (Master Builders Fidelity Fund), *Committee Hansard* 13 June 2008, p.45

5 This section is based on Insurance Council of Australia, submission 44, and Productivity Commission, *Review of Australia's Consumer Policy Framework*, April 2008, p119

2. The minimum period of cover for structural defects will be 6 years. [from 7 years in NSW and 6½ years in Victoria previously]
3. The minimum period of cover for non-structural defects will be 2 years. [no distinction between structural and non-structural defects existed previously]
4. The mandatory requirement for builders of high-rise residential buildings to provide builders warranty insurance will be removed. Owners of high-rise dwellings will have access to a last resort catastrophe fund which is to be funded by builders and insurers. [2002 note: NSW did not proceed with this exemption, but instead agreed to underwrite private insurance for this purpose]
5. The maximum cover (i.e. excluding legal costs) for non-completion claims will be 20 per cent of the original building contract amount. [bringing NSW in line with Victoria]
- 6A. A homeowner will be able to claim under a home warranty insurance policy when their builder is dead, has disappeared, or is insolvent. [making insurance a 'last resort' as exists in WA, SA and the ACT]
- 6B. Insurers and NSW and Victorian agencies will agree procedures which will provide insurers with an opportunity to meet consumer needs for settlement of a claim prior to the 6A trigger point being reached.
7. The minimum amount of cover will be \$200,000 (inclusive of legal and other costs). [putting Victoria on a par with NSW]
8. New South Wales and Victoria will use their best endeavours to harmonise their builders' warranty insurance products and the specified processes to be followed by all parties (insurers, builders and homeowners). [2002 note: this resulted in both states adopting early intervention mechanisms along the line of Qld and WA, although NSW stopped short of giving builder licensing investigators powers to arbitrate disputes on site]
9. Insurers' liability in respect of claims above \$10 million arising from the death, disappearance or insolvency of any single builder will be capped. The catastrophe fund referred to at 4 above will also be available to meet claims liabilities in excess of \$10 million.
10. New South Wales and Victoria will use their best endeavours to harmonise the reporting requirements for insurers between the two states.⁶

2.12 NSW and Victoria changed their schemes accordingly from 1 July 2002.⁷

6 Apart from the points in square brackets, this is the complete text of a document provided by the Builders Collective of Australia, which appears to be contemporary but has no author or date. It is presumably the '10 point plan' referred to in the governments' announcement of 13 March 2002, however the Committee has not been able to find it in its original context to confirm this. Builders Collective of Australia, submission 20, p.14. P. Allen, *National Review of Home Builders Warranty Insurance and Consumer Protection*, report to Ministerial Council on Consumer Affairs, June 2002, p.20

2.13 The Ministerial Council on Consumer Affairs in 2002 commissioned a national review of home warranty insurance and consumer protection (the Allen Inquiry). The review considered insurance as well as licensing, contracts, dispute resolution and compliance. Its core recommendation was to 'put less emphasis on insurance and give more attention to strengthening the regulatory framework'.⁸

2.14 A 2005 inquiry into housing regulation in Victoria by the Victorian Competition and Efficiency Commission (VCEC) considered home warranty insurance among other things. Its main conclusions on HWI were:

- the crisis in availability of insurance which occurred in 2001-02 had ended;
- the market for insurance was competitive and there was no sign of insurers making excessive profits;
- insurers had responded to concerns that insurance eligibility demands were preventing discouraging people from entering the industry;
- the number of registered builders showed little change in the period 2000-2005;
- owner-builder trend data did not support claims of a major shift to unregistered builders to avoid the insurance;

2.15 VCEC supported continuing privatised last resort insurance, arguing that 'this [first resort/last resort] debate is almost academic, because private insurers are unwilling to offer such "first resort" cover'.⁹ It recommended some improvements: better information to consumers; a code of conduct for insurers; and better dispute resolution services.¹⁰

2.16 An inquiry by a NSW Legislative Council Committee in 2006-07 was concerned by evidence of poor consumer protection. It supported additional measures

7 To take the NSW scheme as an example: the regulation provides that the insurance *must* provide certain cover (eg 'loss or damage resulting from non-completion of the work because of the insolvency, death or disappearance of the contractor'), and *may* contain certain limitations on the cover (eg 'the contract may limit liability resulting from non-completion of the building work to an amount that is 20 per cent of the contract price....'). Nothing stops insurers from offering wider cover, but in practice this does not happen. The reference to 'maximum' cover in point 5 of the 10 point plan is misleading. Home Building Regulation 2004 [NSW], cl.56,58. Similarly Victorian Government Gazette 23 May 2002, *Domestic Building Insurance Ministerial Order*.

8 P. Allen, *National Review of Home Builders Warranty Insurance and Consumer Protection*, report to Ministerial Council on Consumer Affairs, June 2002, p.vii

9 VCEC, *Home Building Regulation in Victoria - Building Better Outcomes*, October 2005, p.218

10 VCEC, *Home Building Regulation in Victoria - Building Better Outcomes*, October 2005, p.225ff

to improve consumer information, promote early and fair dispute resolution, and promote the accountability and transparency of the scheme.¹¹

2.17 The Productivity Commission considered home warranty insurance in its 2008 report *Review of Australia's Consumer Policy Framework*. The Commission seemed to accept the argument of insurers that 'private capital would never be used to make a first resort HWI market'. However it noted the large number of complaints made to the inquiry, and agreed that consumer protection in home building could be better. It recommended enhancing the effectiveness of early stage consumer protection measures such as better linking of licensing to builder performance and better dispute resolution procedures. The Productivity Commission recommended:

In examining how to improve 'last resort' home builders' warranty insurance, the Senate Economics Committee should also consider how to enhance the effectiveness of earlier stage consumer protection measures in the home building sector, including through:

- providing for guaranteed access to effective alternative dispute resolution across Australia; and
- better linking licensing schemes to actual builder performance.¹²

2.18 In response to ongoing concerns Tasmania made its last resort scheme voluntary from 1 July 2008. This is intended as part of a suite of changes aimed at improving consumer protection in the home building sector. Other elements of the new policy package include:

- a mandatory dispute resolution process, administered by Consumer Affairs and Fair Trading (CAFT), open to both consumers and builders to initiate;
- some mandated standard contract terms, in order to reduce the likelihood of contractual disputes; and
- mandatory provision of information to consumers on the protections available to them.¹³

11 Legislative Council General Purpose Standing Committee No. 2, *Inquiry into the Operations of the Home Building Service*, December 2007, p.73ff

12 Productivity Commission, *Review of Australia's Consumer Policy Framework*, April 2008, p126-7

13 Department of Justice (Tasmania), *A New Consumer Building Framework - consultation paper*, February 2008. Productivity Commission, *Review of Australia's Consumer Policy Framework*, April 2008, p125

Home warranty insurance in New South Wales¹⁴

2.19 Before 1997 NSW operated a government-sponsored first resort scheme. The provision of insurance was privatised from 1 May 1997 following a recommendation of the 1993 Dodd inquiry into the then Building Services Corporation. The Dodd report found that 'there was no reason for the Government to continue in its monopoly of the insurance market and moreover its political ownership leaves it vulnerable to pressures not faced by private insurance.'

2.20 On 1 April 2002 the threshold for insurance was increased to \$12,000 (previously \$5,000). From 1 July 2002, in response to problems of availability of insurance following the collapse of HIH in March 2001, the scheme was changed to provide for claims to be made only where the builder has died, disappeared or become insolvent.

2.21 The 'Grellman' inquiry into the NSW scheme in 2003 did not recommend any fundamental change to the privatised last resort model, but made various suggestions for improvement.¹⁵ Some changes were made to the scheme from 1 September 2005 in response to Grellman's recommendations. For example the changes -

- established the home Warranty Insurance Scheme Board to monitor the scheme and advise the minister;
- recognising that a builder may seek insurance from more than one provider, authorised and required insurers to seek and provide relevant information among themselves regarding builders;
- authorised the Commissioner for Fair Trading to exchange information about builders with insurers;
- introduced claims handling guidelines which insurers must comply with;
- introduced a rule of 'deemed acceptance' of a claim after 90 days (previously the rule had been 'deemed refusal' after 45 days).¹⁶

2.22 On 30 December 2005 the Minister for Commerce signed an industry deed with insurers setting out the manner in which the government has agreed to exercise its powers under the *Home Building Act 1989*. The insurers agreed to provide certain information, which is the basis of the Office of Fair Trading's quarterly reports on the scheme since March 2007.

14 This section is sourced generally from NSW Legislative Council General Purpose Standing Committee No. 2, *Inquiry into the Operations of the Home Building Service*, December 2007, p.73ff; and from the NSW Office of Fair Trading's submission 16 to that inquiry

15 *NSW Home Warranty Insurance Inquiry - Final Report*, 30 September 2003 [Grellman inquiry]

16 Office of Fair Trading, submission 16 to NSW Legislative Council General Purpose Committee No. 2 Inquiry into the Operations of the Home Building Service, 2006, p.19

2.23 In a dispute situation where the builder is still in business complainants can use the dispute resolution service of the Office of Fair Trading, or take cases to the Consumer, Trader and Tenancy Tribunal (CTTT), which was established in 2002. A building inspector may issue a rectification order. Failure to comply with a rectification order is grounds for disciplinary action against the builder. The consumer is advised to take the matter to the CTTT using the rectification order as evidence. In 2005-06 the Home Building Division of the CTTT received 4,003 applications, of which 76 per cent were matters under \$25,000.¹⁷

Home warranty insurance in Victoria

2.24 The privately underwritten Domestic Building Insurance Scheme was introduced in May 1996, replacing the previous government scheme administered by the Housing Guarantee Fund. On 1 July 2002 it moved to being a last resort scheme, as agreed with NSW according to the 10 point plan (see paragraph 2.11).

2.25 Building Advice and Conciliation Victoria (BACV) was established by the Victorian Government in 2002 as a one-stop shop for building disputes. It provides free advice and conciliation services and is jointly delivered by Consumer Affairs Victoria and the Building Commission. Eighty per cent of disputes conciliated by BACV are successfully resolved. Disputes which cannot be resolved by BACV can be taken to the Victorian Civil and Administrative Tribunal (VCAT). The number of building matters initiated in VCAT has declined from over 1000 in 200-01 to 824 in 2006-7.¹⁸

2.26 The Building Practitioners Board, a statutory authority, is responsible for registering builders. It checks that applicants have the appropriate qualifications and insurance. As in NSW, financial assessment of builders is effectively delegated to insurers. The Board has disciplinary powers to suspend or cancel a licence or impose penalties.¹⁹

2.27 The Victorian Government advised that it is currently reviewing its builder registration and disciplinary framework with a view to better protecting consumers against problem builders.²⁰

17 Office of Fair Trading, submission 16 to NSW Legislative Council General Purpose Committee No. 2 Inquiry into the Operations of the Home Building Service, 2006, p.43,46

18 Victorian Building Commission annual report 2006-07, p.36. Victorian Government , submission 38, p.3-4

19 Consumer Affairs Victoria, submission 91 to VCEC Housing Regulation inquiry 2005, p.11. Department of Sustainability and Environment, submission 84, to VCEC Housing Regulation inquiry 2005, p22.

20 Victorian government, submission 38, p.4

2.28 Victoria has no reporting comparable to NSW's home warranty insurance reports, but advised that it is currently working with the insurance industry on ways to improve data collection about home warranty insurance.²¹

*Home warranty insurance in Queensland*²²

2.29 Queensland has mandatory 'first resort' home warranty insurance - a claim for non-completion or defects can be made even when the builder has not died, disappeared, or become insolvent. The scheme was introduced in 1977. It is administered by the Building Services Authority, which was established in 1991 to replace the Builders' Registration Board of Queensland, which dated from 1972.

2.30 The BSA is not regulated by APRA, but voluntarily follows the conditions APRA imposes on general insurers. Insurance cover (aside from the 'first resort' aspect) is similar to that in other states, but with some differences:

- cover of \$200,000 for non-completion, defects and subsidence that occur before practical completion;
- \$200,000 for defects and subsidence that occur after practical completion;
- the maximum total cover is \$400,000;
- these amounts include up to \$5,000 for alternative accommodation, removal and storage costs.

2.31 The cover against subsidence is 'no-fault' providing the builder has tested the ground according to the Australian Standard. As well, the scheme covers consumers who are uninsured because of the builder's fraud.

2.32 The BSA is also responsible for builders' licensing and disciplinary matters. Applicants must satisfy financial requirements, and are monitored more or less closely according to their turnover level to assure their financial stability. There is a system of demerits points leading to possible loss of licence for infringements.²³

2.33 The BSA has no specific legislative charter for dispute resolution, but it argues that its power to require rectification of defective work acts as an effective dispute resolution mechanism. Early intervention is designed to prevent disputes from escalating. Consumers and builders may appeal BSA decisions in the Commercial and Consumer Tribunal.²⁴

21 Victorian government, submission 38, p.5

22 This section relies generally on submission 8, Queensland Building Services Authority.

23 Mr I. Jennings (Queensland Building Services Authority), *Committee Hansard* 10 April 2008, p.19

24 Queensland Building Services Authority, submission 8, attachment, p.3

Suggested changes

2.34 Opponents of present last resort schemes mostly suggested either that the insurance should be made voluntary, or that the other states should adopt a government-operated first resort scheme, as exists in Queensland and used to exist in NSW and Victoria before the mid-1990s.

2.35 Insurers and regulators made various suggestions for improvement:

- better disclosure to the consumer about the nature of the product;
- an additional trigger to allow an insurance claim, viz cancellation of the builder's licence;
- a statutory contract condition that allows the consumer to terminate the contract in the event of the builder's insolvency (in this case the contract would not become an asset in the hands of the receiver);
- a 'guarantee of completion' - in a non-completion claim the insurer would be obliged to arrange completion of the house, not merely to pay out the beneficiary.

2.36 Other suggestions were made which relate more to minimising disputes or improving the dispute resolution arrangements which may precede an insurance claim or are the consumer's only recourse if the last resort conditions are not met. They included:

- more diligent vetting of builders by the licensing authorities, and more diligent action to de-license offending builders;
- better public information about builders' licensing record (record of infringements etc);
- better certification of building works;
- clearer, perhaps mandatory, standards and tolerances, so that there can be less dispute over whether work is a defect;
- cheaper and quicker dispute resolution in state fair trading departments and tribunals.