

# Chapter 1

## Introduction

### Conduct of the inquiry

1.1 On 19 March 2008 the Senate referred to the Standing Committee on Economics for inquiry and report:

Australia's mandatory Last Resort Home Warranty Insurance scheme, including:

- (a) the appropriateness and effectiveness of the current mandatory privatised Last Resort Builders Warranty Insurance scheme in providing appropriate consumer protection and industry management;
- (b) the reasons for and consequences of the ministerial decisions relating to the removal of consumer protection provisions in respect of Corporations Regulation 7.1.12(2);
- (c) the ramifications for the future supply of this insurance product following the draft recommendations from the Productivity Commission report released in December 2007;
- (d) any potential reforms and their costs and benefits which may lead to appropriate consumer and builder protection and improved housing affordability; and
- (e) any related matters.

1.2 The committee advertised the inquiry on its website and in *The Australian* and wrote to many peak bodies inviting submissions. The committee received 125 submissions (see Appendix 1) and held seven hearings (see Appendix 2). The committee thanks submitters and witnesses for their contribution. At two of the hearings the witnesses asked, and the committee agreed, to take evidence confidentially on grounds of commercial confidentiality.<sup>1</sup> Where the report refers to evidence taken confidentially this is done with the witnesses' agreement. The Committee received a private briefing from the Productivity Commission on its recent review of Australia's consumer protection framework.<sup>2</sup>

---

1 Hearing of Vero Insurance Ltd on 20 June 2008 and of HIA Insurance Services Pty Ltd on 11 August 2008.

2 Productivity Commission, *Review of Australia's Consumer Protection Framework*, report 45, 30 April 2008

## Background

1.3 The inquiry arose as a result of questions being raised about the adequacy of consumer protection in the current arrangements.

1.4 The insurance is taken by the builder, and covers the homeowner/consumer against loss from defects or non-completion of building work in certain conditions. In most states/territories the insurance is mandatory - the builder must take the insurance before either signing a contract or starting work. It is also 'last resort'- i.e. a claim can be made only if the builder is dead, disappeared or insolvent. Queensland has a 'first resort' scheme in which that limitation does not apply.<sup>3</sup> Tasmania's mandatory last resort scheme was made voluntary from 1 July 2008.

1.5 The insurance is obtained from private insurers, except in Queensland where the scheme is a government monopoly. In theory nothing stops builders or consumer from buying extra cover, such as first resort cover, voluntarily, but in fact insurers do not offer it.

1.6 The current last resort arrangements in New South Wales and Victoria started on 1 July 2002, and there have been several inquiries and a number of complaints about the scheme, mostly from New South Wales and Victoria. Concerns about the insurance arrangements, compared to concerns about regulation of builders and dispute resolution in domestic building, should be distinguished conceptually but in practice they are closely related.

1.7 Most submissions were from either consumers or builders who are unhappy with the existing system. Almost all submissions were from New South Wales and Victoria. There were few submissions from South Australia or Western Australia, although these states' schemes have always been last resort schemes.<sup>4</sup>

## Treatment of adverse reflections and submissions

1.8 The committee prefers to make submissions public as a resource for further public debate on the topic of inquiry. However the committee may keep a submission confidential at the submitter's request or by the committee's resolution.

---

3 The cover is also broader in Queensland: it includes 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. In the ACT the Master Builders Fidelity Fund may at its discretion, and sometimes has, paid claims where the builder was not dead, disappeared or insolvent. Queensland Building Services Authority, submission 8, attachment, p5. Mr J. Howard (Master Builders Fidelity Fund), *Committee Hansard* 13 June 2008, p.43

4 In South Australia the scheme under the *Building Work Contractors Act 1995* carries over that established by the *Builders Licensing Act 1986*. An industry-based voluntary scheme operated before then. In Western Australia the scheme was voluntary before 1997.

1.9 This inquiry received confidential submissions at the request of individual complainants; parties with reasonable requests for commercial confidentiality; and by committee resolution due to extensive adverse reflection.

1.10 The Senate's rules provide that if a submission makes relevant 'adverse reflections' on another party, the other party should be given reasonable opportunity to reply. Adverse reflections are generally regarded as comments which, if it were not for parliamentary privilege, might sustain a defamation action. Mere disagreement with another party's views is not an adverse reflection.

1.11 Many submissions to this inquiry contained adverse reflections. Mostly they were consumers naming individual builders or insurers, and builders complaining about insurers or the Housing Industry Association. The committee invited and received a number of replies.

1.12 Furthermore, the committee received some submissions regarding disputes that originated prior to the introduction of the change to 'last resort' in NSW and Victoria on 1 July 2002. The committee accepted these as public submissions, however must note that these cases fall outside the terms of reference of the inquiry, as they do not relate directly to the mandatory last resort home warranty insurance scheme and its mechanisms post 2002.

1.13 The Committee's focus was the policy aspects of home warranty insurance. The committee was not in a position take a view on individual disputes.

## **Summary of evidence received**

### ***Issues in submissions from consumers***

1.14 The main issues or claims in submissions from consumers were:

- the lack of information and misunderstanding about the coverage of the insurance;
- that claimants may need to force a builder into insolvency, which is a slow and costly process (and legal costs are not recoverable in the insurance claim);
- alleged oppressive behaviour by insurers refusing claims or undervaluing the cost of claims;
- state licensing authorities not being diligent enough in vetting builders and getting rid of bad builders;
- resolving disputes in the various state consumer tribunals is slow and expensive; builders or insurers may prolong proceedings to wear the claimant down.

1.15 There was no suggestion that the insurance is a significant issue for the affordability of housing (for new house construction the insurance is usually under 1 per cent of the project value).

1.16 The stories of the individual complainants were often harrowing. However from a policy perspective the committee must consider whether they are representative of a wider problem, or whether they are unusual cases in a generally satisfactory system. The committee notes that many of the very complex and difficult cases presented as evidence originated prior to the introduction of the 'last resort' changes in NSW and Victoria on 1 July 2002, and therefore relate to a system that has already been superseded.

### ***Issues in submissions from builders***

1.17 The main issues or claims in submissions from builders were:

- difficulty getting insurance; with a general argument that it is not right that unaccountable private insurers effectively act as the financial assessors on behalf of state licensing authorities and may decide who is allowed to work as a builder;
- alleged oppressive behaviour by insurers such as unreasonable caps on turnover or unreasonable demands for security;
- difficulty getting insurance is encouraging builders to withdraw from the industry, or not enter it, adding to a skills shortage;
- the need for insurance encourages working outside compliance, such as with sham owner-builder arrangements.

1.18 Again, the committee must consider whether the submissions indicate a general problem, or whether the submitters' difficulties are unusual cases in a generally satisfactory system.

### ***Response from insurers and regulators***

1.19 The main supporters of last resort insurance in this inquiry were the Housing Industry Association, the Insurance Council of Australia, the NSW and Victorian governments, and Vero Insurance Ltd. Their main responses were:

- mandatory last resort insurance has delivered consumer protection at an economical, and still declining, cost;
- complaints that the market is not competitive, and insurance is too hard to get, may have had substance in 2001-2002, after the collapse of HIH, but this is no longer the case;
- financial assessment by insurers imposes a worthwhile discipline on builders and has improved builders' capital adequacy, to the benefit of consumers.

1.20 Both supporters and detractors of last resort schemes referred to the cost of insurance, in opposite senses. They compared premiums in NSW and Victoria with those in Queensland: supporters argued that competition has brought cheaper premiums in NSW and Victoria; detractors disputed this. This is considered further from paragraph 5.5. The primary concern of consumers was the quality of the consumer protection.

## **Structure of the report**

- 1.21 Chapter 2 gives history and description of current arrangements.
- 1.22 Chapter 3 discusses the issues raised by builders.
- 1.23 Chapter 4 discusses the issues raised by consumers.
- 1.24 Chapter 5 discusses responses by insurers and regulators.
- 1.25 Chapter 6 discusses other consumer protection issues.
- 1.26 Chapter 7 discusses various other matters.
- 1.27 Chapter 8 makes recommendations.