



MASTER BUILDERS
A U S T R A L I A

30 June 2008

Committee Secretary
Senate Economics Committee
Department of the Senate
Parliament House
CANBERRA ACT 2600

By email: economics.sen@aph.gov.au

Dear Sir

Please find enclosed a copy of Master Builders submission entitled *Australia's Mandatory Last Resort – Home Warranty Insurance Scheme*.

Please note that Master Builders Association of Queensland does not endorse the submission.

Yours sincerely

Richard Calver
Acting CEO

Enc: *Australia's Mandatory Last Resort – Home Warranty Insurance Scheme*.



Submission to
Senate Economics Committee
Inquiry into Australia's Mandatory Last Resort
Home Warranty Insurance Scheme

June 2008
Master Builders Australia Inc ABN 701 134 221 001

building australia



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1.0 INTRODUCTION

- 1.1 This submission has been prepared from an initial draft circulated to member associations of Master Builders Australia Inc (Master Builders) by the Master Builders Association of Victoria (MBAV).
- 1.2 Master Builders represents the interest of all sectors of the building and construction industry. Master Builders consists of nine State and Territory builders' associations with over 31,000 members.
- 1.3 The Master Builders Association of Queensland (MBAQ) does not endorse this submission and will be making its own submission to the Committee.

2.0 PURPOSE OF SUBMISSION

- 2.1 Master Builders now responds to allegations made against some or all of the State Master Builder associations during the course of the Senate Committee's Inquiry.
- 2.2 The Inquiry has examined the history of the privatised home warranty insurance scheme, the perceived value of this form of consumer protection, the way it is being marketed/distributed and its impact upon both clients and the building industry.
- 2.3 Many of the submissions have been vitriolic, claiming the private warranty insurance regime as now operates in New South Wales, Victoria, South Australia, Western Australia and the ACT poorly serves the interests of consumers. (Noting that home warranty insurance will no longer be mandatory in Tasmania after 1 July 2008). Allegations have been made that the regime has seriously jeopardised the interests of builders forced to comply with a statutory requirement as a pre-requisite to trading.
- 2.4 Master Builders is also aware that some submissions recognise that home warranty insurance has flaws, particularly under the last resort regime that is currently in operation in the majority of jurisdictions. Nevertheless, home warranty insurance provides a level of customer protection where the policy terms apply, ie the death and/or the insolvency of a builder.
- 2.5 Master Builders chooses not to make any further submissions on the efficacy of the insurance product (noting that Mr Jerry Howard Deputy Executive Director of

MBACT gave extensive verbal evidence to the inquiry¹) but wishes to respond to a number of the allegations made in order to protect the good name of State and Territory associations. These accusations include questioning Master Builders' integrity, ethics and commitment to the pursuit of the best interests of its members and the industry it serves. Indeed Master Builders is sometimes mentioned by name in a derogatory manner or in a context that suggests that the schemes in place are for the benefit of the association, not the members or the broader industry.² This submission will broadly address those accusations and provide what we believe is a more balanced picture of the manner in which the insurance product is administered and marketed. We emphasise that the schemes are not of Master Builders design but are the legislative creations of State and Territory Governments.

3.0 STATE BY STATE RESPONSE

- 3.1 Master Builders is formed under a federated structure, with nine autonomous association members operating under the generic name of "Master Builders". Most of these organisations were formed at least 100 years ago and have no formal relations with each other, other than a collective, formal interest in Master Builders.
- 3.2 Federated structures do not lend themselves easily to a consistent view or policy on a given topic. The regional focus of Master Builder associations means that on some issues there is consensus and at other times diverging views exist. As indicated in paragraph 1.3 of this submission, on this occasion MBAQ does not endorse the submission.
- 3.3 Home warranty insurance is a subject which has elicited a different response by associations across Australia, given that each association has established structures that relate to State and Territory specific legislation and local consumer protection issues.

4.0 PERSPECTIVE ON THE ESTABLISHMENT OF THE STATUTORY SCHEMES

- 4.1 Following the collapse of the HIH insurance group³, approx 20,000 builders and contractors across Australia were compelled to find a new source of home

¹ Pages E42-E57 Committee transcript Sydney 13 June 2008

² Eg Transcript 10 April 2008 evidence of Mr Dwyer p E11

³ On 15 March 2001, HIH received approval from the NSW Supreme Court to place HIH into provisional liquidation.

warranty insurance. In all States except Queensland, a certificate of currency for home warranty insurance establishing proof of insurance in favour of the client was required as a precondition of obtaining a building permit. Shortly after the collapse of HIH, builders were unable to commence new works and were at risk of litigation from their clients about the failure of the insurance procured under HIH. This was a period of great disruption for affected clients as well as causing financial and other distress for affected builders.

- 4.2 The transition in finding a new insurer to meet their needs was both time-consuming and financially debilitating, as during this time builders were prevented from legally carrying out their trade, resulting in almost total loss of income. The stress upon domestic builders who were waiting to satisfy the requirements of insurance companies was profound. The associations across Australia worked feverishly to try and find a way to relieve the strain upon their members and to assist them to meet their statutory requirements.
- 4.3 The majority of builders took greater than three months to meet the requirements of insurers, with at one stage the number of companies offering the cover being reduced to two companies. Many builders were unable to obtain insurance for five months. This was a factor of the need to satisfy the pedantic requirements of insurance companies, access to documents and titles, the very slow assessment period, the repeated loss of documents due to the sheer volume being handled by insurance companies and the execution of guarantees and indemnities, the latter which seem of little utility.
- 4.4 Difficulties for builders continued beyond this initial point. This was because even though some builders were granted access to insurance, turnover limits imposed and/or the financial requirements needed to bring those limits to a workable level caused a fresh round of frustration and anger. Whilst this was happening, each association dealt with specific State level issues in trying to alleviate the burden upon their membership.
- 4.5 The Victorian and New South Wales Governments elected jointly to devise what is now known as the “last resort” insurance package (the principal subject of the Committee’s Inquiry) in an effort to stabilize the market and, with the passage of time, increase the number of competitors prepared to offer this “long tail” insurance.

- 4.6 In Victoria, in or around 2002, the State Government for a short time acted as reinsurer to the Dexta Corporation to minimise the trauma being experienced in the building industry by the lack of effective competition. Compliance with registration requirements was also eased, given the inability of builders to provide proof of insurance when they were unable to procure same, averting the deregistration of thousands of builders.
- 4.7 In New South Wales, lobby groups emerged such as Builders for Active Insurance Reform (BFAIR), highlighting the trauma visited upon the industry by a State Government that was largely indifferent to these circumstances apart from the establishment of an Inquiry to investigate the matter.⁴ This Inquiry argued on balance that despite the evident problems to all parties, the status quo was the preferred course of action, albeit that consumers failed to understand the “last resort” characteristics of the scheme. MBANSW sought to explain every angle of the issue to its members, including circulating views held by consumer groups.⁵
- 4.8 In the ACT, and also in Tasmania, the respective Governments recognised the limited capacity of the insurance industry to meet this peculiar insurance product and facilitated by legislation the opportunity for a less regulated scheme (outside the purview of APRA), known as fidelity insurance. In the ACT this option continues today – obviously to the satisfaction of the ACT Government. The Tasmanian Government has discontinued the scheme.
- 4.9 The Western Australian Government, after much debate, created a facility for a scheme based upon the idea of a Mutual Discretionary Fund. This was passed by their Parliament but no private insurance was ever made available given the lack of support by underwriters and reinsurers. We note that MBAWA has provided a written submission to the Committee.
- 4.10 In every instance, the building industry and consumer groups dealt with their respective State Government to define or redefine the issues surrounding the warranty insurance crisis by either the passage of legislation to attempt to deal with the problem and/or the amelioration of registration or licensing requirements to ease the burden to some extent upon builders and contractors.

⁴ NSW Home Warranty Insurance Inquiry, September 2003, NSW Parliament Senate Committee

⁵ Including circulating to its members in full, with permission, an article extracted from Choice entitled *Insurance in Name Only* Executive Newsbrief Oct 2004 MBA NSW

- 4.11 In each of these jurisdictions, the local association was active and pressing for reform or assistance, including the option for abolition of private home warranty insurance in favour of the creation of a statutory scheme operated in each State or Territory. State Governments declined the opportunity to create these funds, as less than a decade earlier they had moved from statutory schemes operated by Government to ones operated by the private sector.
- 4.12 State Governments were well aware of the volatile nature of the insurance market particularly with long tail risks as being risks they did not wish to underwrite. Most State Governments rationalised that if they stood in the shoes of reinsurers or insurers for the building industry, they would have been obliged to offer cover and policies to other industries and groups also severely affected following the collapse of HIH. These included insurance for community groups involved in high risk activities or, indeed, less than high risk activities that involved events or carnivals, making many industry groups face up to the prospect of shutting down or continuing to operate without any professional indemnity insurance.
- 4.13 As an example of both the impact upon the industry and a review of the efforts undertaken in this instance by MBAV, a *Housing News* item dated 27 March 2003 is attached. Notable comment from members following survey work undertaken with them showed that 80 percent believed the criteria to obtain home warranty insurance was unreasonable, 40 percent of members lost between 1-4 projects and a further 31 percent lost 5-8 lost projects awaiting insurance approval since the crisis had begun and 50 percent who had obtained warranty insurance believed the turnover limits were insufficient to meet their business needs.

5.0 REBUTTAL OF COMMENTS

5.1 Against this broad outline of the Master Builders perspective, we now turn to individual submissions where the MBA has been unfavourably mentioned.

5.2 Shaun Thomlinson (undated)

5.2.1 In the eighth paragraph of Mr Thomlinson's submission, he asserts that "the MBA needs to be held accountable for their involvement in this sham warranty that has seen their own members take their lives in some instances, and then have the ordacity (*sic*) to say how wonderful this product is".

- 5.2.2 Master Builders has never held that the insurance product was without faults and strongly advocates that claims history be publicly available on the basis that statutory insurance should be accompanied by a requirement upon insurers to publish their claims experience.
- 5.2.3 Secondly, and importantly, Master Builders did not and does not control the consumer protection regime in any State or Territory and it was in the interests of consumers and for the protection of those consumers that builders were forced to meet these requirements. State and Territory Governments devised the schemes, not Master Builders. The accusation about the content of the insurance policy and the decision to keep it in force rested solely with the State Government. Mr Thomlinson's accusations are therefore incorrect and misdirected.
- 5.2.4 In the second last paragraph of his submission, Mr Thomlinson asserts that the MBA "has no conscience".
- 5.2.5 The assertion by Mr Thomlinson that Master Builders would consciously be involved in any activity that induced members to take their own lives is scandalously inaccurate. Master Builders has sought to work within the system that created the relevant product in order that member interests are advanced.
- 5.3 Kim Booth MP, Member for Bass (19 March 2008)
- 5.3.1 In his correspondence to the Productivity Commission, Mr Booth has made a fundamental error in suggesting that Master Builders Northern Tasmania Inc ("MBNT") was, or is, part of Master Builders. He reported that MBNT were charging a 60 percent commission on warranty insurance and that these margins were typical of the commissions being earned by the MBA. Neither assertion is true.
- 5.3.2 MBNT is a group that offered insurance under terms and conditions which other MBAs are not familiar with and is accountable for its own conduct. However, it should be brought into perspective that MBNT represents a group of approx 100 builders in Northern Tasmania and has chosen never to be affiliated with the Master Builders movement and is unlikely ever to be made part of the Master Builders federation.

5.3.3 The assertions about the high margins made through sales of warranty insurance certainly do not apply to the Master Builders movement.

5.4 Lionel Buckett, Australian Hardwood Homes (18 April 2008)

5.4.1 On page 3 of his correspondence, Mr Buckett asserts that MBANSW was somehow inhibited in speaking its mind in fear of retribution from the NSW Government.

5.4.2 MBANSW was never under any direct or indirect threat from the NSW Government to tow the line on any policy, including silence or compliance where warranty insurance was concerned. Such an assertion is deeply inaccurate.

5.4.3 On page 4 of his correspondence, Mr Bucket misrepresents the assistance rendered by MBAV to MBANSW in respect of insurance.

5.4.4 At the time, MBAV was the only MBA in Australia which had held a broking licence and had done so for approx 20 years. MBANSW had up until that time been involved with broking houses on a referral basis. As the need to help members directly in their business increased, it was agreed that MBAV would offer its assistance and expertise to assist MBANSW and its members.

5.4.5 At that time, MBAV and MBANSW were losing money in the operation of their warranty insurance operations, the opposite of what Mr Buckett asserts.

5.4.6 On page 5 of his correspondence, Mr Buckett further asserts that Mr Dan Nardo (*sic*) advised that insurance commissions for the MBA from warranty insurance premiums were over 40 percent. Mr Naidoo was also alleged to have asserted that Victoria's turnover was \$12 million and MBANSW's turnover on insurance was \$3 million.

5.4.7 These figures are a gross overstatement and in no way reflect the business volumes of warranty insurance transactions. The commission offered by insurance companies at the time was 10 percent, not 40 percent.

5.4.8 Master Builders' earnings from warranty insurance in the State of Victoria recently (2006-07) were \$150,000 and in 2003 it made a loss of \$150,000.

To suggest that the writing of the relevant insurance was a profitable activity is patently wrong and the efforts of MBAV to assist its members was based upon its commitment to help members in the operations of their business.

5.4.10 On page 6 of his correspondence, Mr Buckettt asserts that the “blood of builders” is on the hands of the executives of Master Builders and they failed to act.

5.4.11 It is understood that tragically a number of trades people and builders took their lives given the traumatic circumstances they were confronted with, not least of which was their inability to procure warranty insurance following the collapse of HIH. Master Builders did all it could to assist members in representation to Government and denies that it was in any way negligent in assisting its members to meet their statutory requirements.

5.5 Russell Pickens, Port Phillip Constructions P/L (undated)

5.5.1 Mr Pickens’ correspondence opposes warranty insurance and provides examples of the cost of warranty insurance but does not explain how it has failed the owners of the two properties mentioned. It does go on to say that Master Builders has “duped” its members by lobbying the government to keep this insurance scheme in place and, furthermore, that it is selling the insurance products on a commission of up to 60 percent. He further asserts that this is a conflict of interest and the board members of the association should be investigated for defrauding their own members and consumers.

5.5.2 Mr Pickens is wildly incorrect in his assertions. Master Builders in all jurisdictions called for either effective competition in the provision of private warranty insurance for the building industry or the abandonment of it in favour of a statutory scheme run by the State.

5.5.3 As explained previously, commissions of 60 percent are not made. According to our best information, the allegations relate to an isolated instance that occurred with an organisation in northern Tasmania but certainly not the Master Builders movement.

5.6 Keith Atkins, Keith Atkins Bathrooms (undated)

5.6.1 Mr Atkins is clearly holding a strong and divergent view from a number of organisations, including MBANSW, in respect of tiling procedures/

methodologies. He is highly critical of not only Master Builders but TAFE, the Tile Merchants Association and other industry groups who disagree with him.

- 5.6.2 Mr Atkins makes negative comment about the Executive Director of MBANSW, asserting that only Mr Atkins' views are correct. This is unrelated to the issue of warranty insurance but shows Mr Atkins' displeasure with a number of groups who hold different views to his own.
- 5.6.3 In respect to his submission to the Senate Inquiry, in the fourth dot point of his submission, he asserts that Master Builders had made an agreement to lessen (reduce) the insurance availability for builders.
- 5.6.4 Nothing could be further from the truth. Master Builders and the Housing Industry Association (HIA) compete for membership and there has never been nor will be an agreement between two associations charged with the responsibility of servicing their members to collude to the commercial detriment of their membership base.
- 5.6.5 We reject Mr Atkins' assertion as being completely erroneous and would ask that he provide information to support his outrageous assertions.
- 5.6.6 On page 2 of his submission, Mr Atkins accuses Master Builders of corruption, organised by the association for developers who did not have to supply home warranty insurance.
- 5.6.7 This is another fanciful distortion and we have no knowledge of the basis for this accusation and regard it as repugnant, spurious and unfounded.
- 5.6.8 The continuing theme in Mr Atkins' submission is that Master Builders and HIA were restricting the trade of builders in order to supply "slave labour for corrupt developers". Such an accusation beggars belief and is untrue and slanderous.
- 5.6.9 On page 7 of Mr Atkins' submission, he asserts that Master Builders and the HIA are receiving millions of dollars from insurance transactions, providing a slush fund to the federal and/or State Labor parties to silence any action.

5.6.10 Speaking only for Master Builders, we declare that individually or collectively, we have not made millions of dollars from warranty insurance. Secondly, there has never been an attempt to “bribe” State or federal Governments to continue the current home warranty insurance schemes.

5.6.11 Mr Atkins makes these accusations without any evidence and we know them to be baseless.

5.6.12 Further on page 7 of his submission, Mr Atkins asserts that Master Builders collaborated with Rodney Adler of FAI Insurance to “destroy the building industry”.

5.6.13 Master Builders used FAI to supply warranty insurance, as well as HIH. Very few people foresaw the collapse of Australia’s second largest insurance company, Master Builders included.

5.6.14 Master Builders would not undertake a transaction that would have a detrimental effect on its membership base and we reject the assertion as being, once again, completely erroneous.

5.7 Ian Piddington, Craftsman Homes (14 April 2008)

5.7.1 Mr Piddington has written to express his “utter disgust” at Master Builders and HIA as being responsible for the handling of the home warranty insurance scheme. Mr Piddington supports the Member for Bass, Kim Booth, that Master Builders was backing the scheme to the detriment of its members.

5.7.2 Mr Booth and Mr Piddington are both poorly informed and are making incorrect accusations without offering any basis for their assertions.

6.0 SUMMARY

6.1 The Master Builders association in each State and Territory (other than Queensland) was faced with the dilemma of what it should do to best service its members in respect of assistance to them following the collapse of HIH and the consequent turmoil with access to warranty insurance. In each instance, each association chose a course which they believed was the best way to help their members meet their statutory obligations and trade lawfully in their State or Territory.

- 6.2 These decisions were guided by the elected representatives of the association, who are builders and contractors in their own right. These contractors and builders derive no profit or remuneration from their role as a director of these not for profit organisations. Their guiding light is the Constitution of each association, which calls upon the organisation to provide timely assistance to members either at a technical level or through lobbying to meet their best interests and that of the industry broadly. In each case, the State or Territory association decided to actively work to meet obligations created by State and Territory legislatures and help members meet their obligations by providing direct or indirect access to home warranty insurance policies.
- 6.3 This assistance was seen as the best way to deliver on the associations' relevance to their members. This course was chosen rather than to wash their hands of these obligations. Unavoidably this leaves it open for those who wish to accuse Master Builders of performing this service purely based upon a profit motive.
- 6.4 If significant sums of money were involved then greater motive can be ascribed to support these allegations. The reality is that State or Territory Master Builder associations derive little money from the sale of warranty insurance policies. Certainly for both Victoria and New South Wales it is only marginal income considering the high levels of staffing required to properly service members' needs, set off against modest commissions. In fact, for the two years following the collapse of HIH, both associations lost money assisting members. We assert that profit from the sale of warranty insurance has not and will never be a significant factor in choosing the proper course of action for members.
- 6.5 Many of the other assertions and accusations covered in the relevant submissions deals with the paranoia and/or conspiracy theories that the associations acted in cahoots with State Governments against their members' best interests. From Master Builders' perspective, this is repugnant and factually incorrect.
- 6.6 Traumatic events bring about a variety of responses and interpretations concerning the cause of the catastrophe. Unavoidably, some people including builders in Australia have made accusations against Master Builder associations when perhaps their enmity should be more appropriately turned towards State Governments. It was these State Governments who envisioned transferring a public sector consumer protection regime to the private sector, without anticipating what would happen in the event of collapse or withdrawal of a major insurer such

as HIH nor ensuring transparency on claims/loss ratios to determine that the relevant product was meeting the stated need at a fair price.

7.0 CONCLUSION

7.1 Master Builders has acted in the best interests of its members having regard to the manner in which last resort home warranty insurance has been established in the States and Territories. Master Builder associations have acted only to facilitate the statutory schemes that were created by State and Territory Governments.

7.2 In this submission, Master Builders has responded to some of the allegations made against the associations and believes them to be groundless, as set out in this submission.

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HOME WARRANTY INSURANCE – THE REAL STORY

MBAV has conducted a survey to determine members' attitudes, perceptions and losses in dealing with home warranty insurance. From this research, MBAV can say conclusively that the impact of warranty insurance is having a profound effect upon the residential building industry and most of it for the negative. Key elements of the survey are as follows:

- 74% of members say they are dissatisfied with the current warranty insurance system. 85% regard it as a matter of importance that an equitable warranty insurance system be put in place.
- In attempting to establish eligibility with a new warranty insurance provider (either Reward or RSA) 20% obtained insurance after 1 month, 35% in 3-4 months, 17% 5-6 months, 23% 6 months or longer.
- 80% of builders surveyed believe the criteria to obtain warranty insurance are unreasonable.
- 58% of builders surveyed had to restructure their business to accommodate the requirements of insurers. This took the form of capital injections, deeds of indemnity or bank guarantees.
- Builders lost work through problems associated with warranty insurance - 40% lost 1-4 projects while 31% lost 5-8 projects.
- Builders who responded are not new to the industry. 88% have been in business for 6+ years - the majority of respondents for more than 15 years.
- Currently 70% of builders surveyed have warranty insurance in place, 14% have not and 16% are in the process.
- 50% of those who have obtained insurance believe the limits imposed by insurers are insufficient to meet their business needs.

Some members are of the view that MBAV has not done enough about warranty insurance. We wish to set the record straight -

- MBAV opposed the introduction of privatised home warranty insurance at the time Premier Kennett introduced the Bill into Parliament.
- MBAV obtained the State Government's agreement to support Dexta for an additional six months, preventing additional hardship to the industry.
- MBAV believes warranty insurance, as it is currently configured, is dysfunctional. Good builders are suffering business interruption in obtaining their "insurance" yet are personally liable for 10 years; consumers have less protection now than they did when the scheme was first introduced and too few insurers see it as a desirable business to support.
- MBAV believes either a third major player must enter the market to provide effective competition or the State Government should reintroduce HGFL.
- MBAV does not charge members for assistance (applications) to insurers.
- MBAV provides a choice between Reward or RSA – no-one else does.
- MBAV has engaged additional staff (now totalling 17) to more quickly assist builders with their interaction with insurers.
- MBAV is working closely with the Victorian Government to find a workable solution.

MBAV needs your ongoing support and that of your industry colleagues. We are committed to finding a solution and will keep you informed of any progress.