

SENATE ECONOMICS COMMITTEE

**Inquiry into Australia's Mandatory Last Resort
Home Warranty Insurance Scheme**

NSW GOVERNMENT SUBMISSION

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Home warranty insurance

The home warranty insurance scheme is an integral component of the NSW Government's consumer protection package for homeowners having building work undertaken in this State. Most insurers withdrew from the home warranty insurance market after the collapse of HIH insurance in 2001 and the 11 September 2001 attacks on the United States.

The current home warranty insurance scheme was put in place in 2002 and is designed as a last-resort rescue mechanism where a builder has become insolvent, died or disappeared and is unable to honour a responsibility for ensuring that residential building work is properly and adequately performed or to commence or complete a building contract or return and rectify defective work.

The Government has introduced a range of measures to protect homeowners' interests including mandatory critical-stage inspections for all classes of buildings; early intervention dispute resolution by the Office of Fair Trading, enhanced mandatory contract provisions requiring compliance with the Building Code of Australia, the provision of a consumer guide to homeowners, and the inclusion of a check list and cooling-off period.

A public register of builders and trade contractors has been set up providing on-line information about builders and other licensees so homeowners can assess the background of those with whom they intend dealing.

Where dispute resolution cannot take place because of the death, disappearance or insolvency of the builder, the home warranty insurance scheme provides additional protection such as a minimum cover of \$300,000 for a period of six years for structural defects and two years for non-structural defects. Cover is also provided for loss of deposit and completion costs.

As of 30 September 2007 some 1,100 claims had been lodged under the scheme with over \$12 million having been paid to claimants and a further \$7 million set aside for open claims.

In 2002, policies were offered by only two insurers. There are now five insurers providing home warranty insurance and another providing specialist cover for owner-builders, thereby addressing difficulties previously faced by builders in obtaining insurance and reducing waiting times. The increased competition has also resulted in reduced premiums.

The New South Wales Government through the establishment of the Home Warranty Insurance Scheme Board has also implemented an effective governance regime for home warranty insurers. The Scheme Board has overseen the development of an industry deed and amended conditions of approval for insurers requiring compliance with market practice and claims handling guidelines as well as a complaint management and dispute resolution system and procedures for the collection of data and the publication of information on the scheme.

The Market Practice Guidelines require insurers to have in place agreements with all intermediaries (including industry associations, such as the Master Builders Association and the Housing Industry Association, where they act as intermediaries for insurers) requiring the intermediaries to comply with the Guidelines.

In addition the Guidelines require intermediaries to disclose to the builder all remuneration received by the intermediary, including:

- the dollar amount of commission the insurer pays the intermediary including all fees and allowances. Where the dollar amount level of commission is not calculable a description of the nature of the commission and how it is calculated is to be provided; and
- any additional fees or brokerage the intermediary charges the builder in addition to the insurer's premium.

Industry associations are not treated any differently to other brokers/agents of insurers.

During 2007 enhancements were made to the scheme with the minimum level of cover raised from \$200,000 to \$300,000 and the introduction of new rules more clearly defining when a builder has disappeared as well as the commencement of the regular publication on the website of the Office of Fair Trading of information on the operation of the scheme.

The Government is currently considering further changes that have the potential to significantly improve consumer access to making a claim under the scheme that will further ensure that it delivers on the Government's consumer protection objectives.

The 2003 *NSW Home Warranty Insurance Inquiry* undertaken by Richard Grellman examined the merits of a voluntary home warranty insurance scheme in NSW. The inquiry considered a voluntary scheme fraught with risk and does not satisfy the interests of builders or consumers. In short, it found the scheme's compulsory nature reflects the importance of providing consumers with a minimum level of protection.

The inquiry concluded that if the scheme was optional, it was likely that price sensitive consumers, perhaps the most vulnerable group, would elect to run the risk and not insure. In the interests of consumer protection, the inquiry reaffirmed the need to maintain a minimum level of compulsory cover. A mandatory scheme not only protects the initial home owner, but also successors in title.

While the primary responsibility for ensuring that residential building work is properly and adequately performed lies with the builder engaged to undertake the work, the home warranty insurance scheme is there as a last-resort rescue mechanism for homeowners where a builder does not honour this responsibility in the most fundamental of ways. That is, they are unable to commence or complete a building contract or return and rectify defective work because they are insolvent, have died or disappeared.

Alternative dispute resolution

An early intervention dispute resolution service has been provided by the Office of Fair Trading since February 2003 following the establishment of the Home Building Service.

The operation of the dispute resolution service initially involves an attempt to resolve the dispute by Fair Trading Centre staff. In 2006/07 of the 6,112 complaints received by Fair Trading around 2,251 or 36% of disputes were resolved at this stage. Of the 2,517 complaints referred to the Home Building Service, 1,784 were subject to site inspections, of which 1,533 or 86% were resolved. The remaining complaints were referred to the Consumer, Trader and Tenancy Tribunal or other agencies, or were dealt with as disciplinary matters against licence holders.

The early intervention dispute resolution service has reduced the volume of building complaints going to the Consumer, Trader and Tenancy Tribunal by approximately 30%.

Disciplining builders

The NSW *Home Building Act 1989* provides ample scope for the de-registration of builders who do not meet appropriate performance standards. The Act provides that where the Commissioner for Fair Trading is satisfied that any ground on which disciplinary action may be taken against a builder has been established the Commissioner may suspend a licence or cancel a licence and disqualify the builder, either temporarily or permanently, from being the holder of a licence or a member of a partnership, or an officer of a corporation that is the holder of a licence.

The grounds for taking disciplinary action against a builder include that the builder is not entitled to hold a licence or is not a fit and proper person to hold a licence and is guilty of improper conduct. Improper conduct by a builder includes a breach of a statutory warranty. The statutory warranties contained in the Act are implied in every contract to do residential building work and include that the work will be performed in a proper and workmanlike manner and in accordance with the plans and specifications set out in the contract; and that all materials supplied by the builder will be good and suitable for the purpose for which they are used and that, unless otherwise stated in the contract, those materials will be new; and that the work will be done in accordance with, and will comply with, the Home Building Act or any other law; and that the work will be done with due diligence and within the time stipulated in the contract, or if no time is stipulated, within a reasonable time.

In addition, the legislation requires that before renewing a licence the Commissioner must be satisfied (among other matters) that the builder is not subject to any order of the Consumer, Trader and Tenancy Tribunal that has not been satisfied within the period required by the Tribunal; and is not the subject of what the Commissioner considers to be an unreasonable number of complaints or formal cautions or penalty notices or insurance claims.

The following statistics indicate the extent to which the NSW regulator has exercised the disciplinary powers provided by the Home Building Act. During the financial years 2004/05, 2005/06 and 2006/07, the Office of Fair Trading undertook the following:

- 158 disciplinary hearings which resulted in:
 - 32 licence disqualifications
 - 2 licence suspensions
 - 62 monetary fines totalling \$363,000;
- the cancellation of 814 licences due to Licensing Branch compliance actions, such as licensees becoming insolvent, failing to comply with a Consumer Trader, and Tenancy Tribunal Order, or lodging a fraudulent application;
- 105 licences were cancelled following 'Operation Ambrosia', the Independent Commission Against Corruption's investigation into the use of fraudulent documentation to obtain building licences; and

In addition to the above, licence holders are also subject to compliance action as part of Fair Trading's yearly compliance operations. As a result of field visits and site inspections by HBS building investigators during the period 1 July 2004 to 31 December 2007, 767 penalty infringement notices were issued for breaches of the Home Building Act 1989, resulting in fines totalling \$495,500.