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Mr John Hawkins
Committee Secretary
Senate Economics Committee
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18 APR 2008

Dear Mr Hawkins

**ECONOMICS COMMITTEE INQUIRY INTO AUSTRALIA'S MANDATORY
LAST RESORT HOME WARRANTY INSURANCE SCHEME**

I am writing on behalf of the Victorian Government to provide a submission to the Economics Committee Inquiry into home warranty insurance. This submission is being made in response to an approach by the Committee Secretariat and focuses on issues that fall within state government jurisdiction.

The contents of this submission are consistent with two recent submissions made by the Victorian Minister for Consumer Affairs on behalf of the Victorian Government to the current Productivity Commission Review of Australia's Consumer Protection Framework. I would encourage the Economics Committee to consider those submissions in detail (available on the Productivity Commission's website), as any view on last resort builders' warranty insurance cannot be developed without a clear understanding of how arrangements fit within the broader consumer protection framework.

Yours sincerely

TIM HOLDING MP
Minister for Finance, WorkCover
and the Transport Accident Commission

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**VICTORIAN GOVERNMENT SUBMISSION TO THE ECONOMICS
COMMITTEE INQUIRY INTO AUSTRALIA'S MANDATORY LAST
RESORT HOME WARRANTY INSURANCE SCHEME**

**Summary of Current Arrangements in Victoria and Inter-jurisdictional
Comparisons**

The Victorian Government is committed to effective protection of domestic building consumers to appropriately allocate risk between builders and consumers. To this end, the Victorian Government's approach is based on:

- guaranteed access for consumers to alternative dispute resolution;
- appropriate performance standards among building professionals; and
- mandatory home builders' warranty insurance (BWI) that delivers genuine value to consumers.

In making comparisons between the various home building regulatory models in each state and the differences between them, it is important to note the underpinning policy approaches. Victoria has sought to maintain high levels of consumer protection while avoiding unnecessary regulatory burden. The Victorian model therefore features a somewhat leaner regulatory framework than may exist in other jurisdictions, complemented by various non-legislative means of maintaining high standards of practice among builders.

The current framework for BWI and consumer protection arrangements in Victoria, which has been in place since 2002, can be viewed as a balance between distinct components. The first component relates to the regulatory processes contained within the *Building Act 1993* and *Domestic Building Contracts Act 1995* and how those processes are used to resolve disputes between builders and consumers. The 'first resort' is focussed on dispute resolution as embodied through the Building Advice and Conciliation Victoria (BACV) service and is underpinned by building regulation. The second 'last resort' insurance component of the scheme is provided by private insurance firms. Under this framework, the obligation is on the builder to complete the work for which they have been contracted. The last resort insurance component ensures coverage in the event that the terms of the contract cannot be fulfilled due to death, disappearance or insolvency of a builder.

The October 2005 final report of the Victorian Competition and Efficiency Commission (VCEC) *Inquiry into regulation of the housing construction sector and related issues* supported the revised Victorian insurance arrangements. Prior to 2002, owners could also claim against their insurance policy where a builder was still available to rectify defective or incomplete works – a so called 'first resort' cover.

The VCEC considered the revised arrangements in light of criticism that the change to last resort insurance reduced protection for consumers and calls for the re-instatement of the former arrangements. The VCEC concluded that the evidence suggested that the change in the cover on BWI, along with the introduction of BACV,

had not resulted in a loss of consumer protection and was, in fact, an effective substitute for the former arrangements.

VCEC also found that there was a lack of evidence to support the view 'that a shift from the private competitive provision of insurance to a Queensland-type government monopoly would deliver, in aggregate, superior outcomes for Victoria's housing construction industry and consumers'.

The Victorian framework, like the New South Wales (NSW) model, ensures the risk from entering a contractual arrangement for domestic building work is carried by the consumer and the liability for incomplete or defective work falls to the builder. In turn, the last resort nature of BWI ensures that in the event that the terms of the contract cannot be fulfilled due to death, disappearance or insolvency, the home owner has a mechanism for managing the risk of contractual failure where the builder cannot complete the work in those circumstances.

In Victoria and NSW, when a dispute arises between a builder and a consumer the dispute should, in the vast majority of cases, be resolved through the dispute resolution mechanism administered by the Government. Since this dispute resolution mechanism aims to ensure builders undertake the work for which they have been contracted, the outcome of such disputation in the majority of cases should be the builder returning to fix the problem or the consumer coming to the realisation that the matter at hand is not covered by the contract or has been constructed to the appropriate standard.

In the Queensland system the two components last resort insurance and dispute resolution between consumers and builders are both administered by the Government. It is understood that Victorian premiums are on average less than those in Queensland.

Guaranteed access for consumers to alternative dispute resolution

The Victorian Government is committed to guaranteed access to alternative dispute resolution so as to minimise unnecessary litigation and the associated imposts on both consumers and builders. BACV was established as a service jointly operated by Consumer Affairs Victoria and the Building Commission. BACV services are provided to consumers and builders free of charge so as to maximise accessibility. BACV services may include a free, independent expert assessment and written report to assist in the resolution of disputes of a technical nature. Around 80 per cent of disputes conciliated by BACV are successfully resolved.

Consumers and builders have the further option of dispute resolution through the Victorian Civil and Administrative Tribunal (VCAT), which provides an informal, accessible and effective quasi-judicial dispute resolution option which is faster and less expensive than litigation via the court system. Once a building complaint has been lodged with the VCAT or a court of law, alternative dispute resolution is no longer provided through BACV. There is no evidence that the number of domestic building matters lodged at VCAT has increased since the changes to the BWI scheme

from first to last resort in 2002. The number of matters initiated has declined from over 1000 in 2000-01 to 825 in 2006-07.

As outlined in the Victorian Government's first submission to the Productivity Commission Review into Australia's Consumer Protection Framework, Victoria has reviewed its Alternative Dispute Resolution services and identified a diversity of mechanisms. The Victorian Government's first submission discussed the work being undertaken in Victoria to review alternative dispute resolution schemes, partly to address this diversity.

The Victorian Government is closely monitoring its domestic building alternative dispute resolution services to identify opportunities for improvement and conducting a broader review of alternative dispute resolution services to identify opportunities for improvement.

Enhanced scope to de-register builders

The Victorian Government is committed to the maintenance of appropriate performance standards among building professionals. To this end, the Victorian regulatory system employs a variety of measures to deter poor practices and reward excellence. These include a robust registration scheme accompanied by the capacity to discipline and/or de-register problem builders. These measures are supported by incentives to participate in voluntary Continuing Professional Development programs and appropriate recognition and reward for builders who exceed the minimum standards of quality and workmanship.

The vast majority of Victorian consumers experience no problem with their builder during their building projects. In 2006-07, 84,000 domestic building permits were issued. Only four per cent of consumers report a dispute with their builder which represents about 3,400 building project owners.

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

Revamping compulsory builders' warranty insurance

The Victorian Government acknowledges there has been some criticism of the current mandatory 'last resort' insurance product and supports the principle of ensuring consumers are receiving value for money.

The Victorian Government believes that there appears to be some lack of awareness among consumers generally about the nature of the BWI product. On this basis, the Government is currently working towards improving consumer awareness of the existing arrangements.

The question of whether BWI should be mandatory or voluntary was considered by the VCEC which found that, on balance, mandatory BWI appeared to be justified in

view of the intractable information asymmetries facing consumers. The justification for Government involvement in the dispute resolution procedures for domestic building and for mandating last resort insurance is that, unlike other consumer matters which may be heard by small claims tribunals or similar, the stakes are significantly higher. The sums of money involved are significant, it is generally a one-off purchase and often relates to the most significant contractual matter that a member of the general public will ever enter.

Caution should be exercised in seeking to revamp an insurance product which has apparent benefits to consumers. Home builders warranty insurance constitutes an important part of the consumer protection framework by guarding against the risk of significant detriment arising from the death, disappearance or insolvency of a builder. Such risks may have been low during the recent high levels of building activity but can be more pronounced during times of economic downturn.

A more comprehensive assessment of current Victorian BWI arrangements, which have only been in place since 2002 (BWI is a 'long tail' insurance product), may only be possible when the product matures in the next 3-5 years.

The Victorian Government is currently working with the insurance industry on ways to improve data collection on the BWI product to assess its efficacy and to expand the grounds on which home builders warranty insurance claims can be made.