



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

April 2008

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Introduction

On 19 March 2008 the Senate referred the matter of Australia's Mandatory Last Resort Home Warranty Insurance Scheme to the Senate Economics Committee for inquiry.

The Inquiry will investigate the appropriateness and effectiveness of the current mandatory privatised Last Resort Builders Warranty Insurance scheme in providing appropriate consumer protection and industry management. It will review the future of the industry in light of draft recommendations from the Productivity Commission.

Overview

Home warranty insurance (also known as builders' warranty, building, housing or home indemnity insurance) was originally intended as a consumer safeguard to protect consumers from financial loss when a builder failed to complete the work or meet certain standards. Home warranty insurance is a product that consumers of building services pay for via their builder. In August 2004 *CHOICE Magazine* investigated home warranty insurance. That investigation found that in most states mandatory insurance was unreasonably limited to circumstances where a builder dies, disappears or becomes insolvent. CHOICE also found that the privatisation of home warranty insurance coupled with changes to the insurance market had whittled away many consumer protection measures. We believe nothing has substantially changed since publishing this report.

Current Schemes

The legislative requirements for home warranty insurance vary from state to state, but are broadly similar in the states where it's privately underwritten (everywhere except in Queensland and the NT). The requirements mentioned below¹ are those that apply in NSW and Victoria, which together account for about 75% of the nation's home warranty insurance market.

- Home warranty insurance is compulsory — the builder has to have it and will charge consumers, perhaps indirectly, for the premium they pay. Builders have to take it out for residential building projects worth \$12,000 or more.
- Before they commence work, builders must let home owners know the insurance company that'll underwrite home warranty risk — in NSW they must provide the original insurance certificate and in Victoria they have to provide the details in the contract.
- The insurance is valid for the construction period and six years afterwards, for structural defects.
- It's a privately underwritten 'last resort' scheme, which means consumers can only make a claim if the builder has died, disappeared or become insolvent.
- The maximum amount consumers can claim for incomplete work is 20% of the contract value, with a \$200,000 limit.
- Owner-builder work worth more than \$12,000 is exempt from the insurance requirement, unless the home is sold within six years of completion.
- Buildings above three storeys are also exempt.

Impacts of scheme privatisation

In NSW and Victoria the government-run schemes were privatised in the mid 1990s. At the time, FAI, which was later bought by HIH insurance, was the major insurer of home warranty risk in Australia. Its collapse in March 2001, together with the attacks of September 11, 2001 and a downturn in international share markets, plunged the

¹ This information is drawn from CHOICE work published in August 2004, we understand that there may have been changes in these requirements since that time. For current information, please contact your local Fair Trading office.

international insurance market into upheaval and in Australia left a large number of builders looking for insurance cover from a decreasing number of insurers. To placate insurers and ensure builders could still obtain insurance, the state governments in Victoria and NSW agreed in 2002 to introduce some changes to the home warranty legislation, including making it ‘last resort’, raising the threshold for compulsory insurance, reducing the period of cover, excluding buildings above three storeys, and limiting maximum insurance payouts and cover.

Some of the exemptions in the mandatory insurance scheme can also spell problems for consumers. For example, consumers buying into high-rise residential buildings (with more than three storeys) do not enjoy the protections afforded to consumers in low-rise residential buildings.

A government inquiry into home warranty insurance reported in 2003 that home owners in NSW were dissatisfied with the ‘last resort’ aspect of the insurance scheme and didn’t understand its purpose.² While consumers (through the builder) have to pay for this compulsory insurance, in most states consumers can’t just make a claim when something goes wrong. The insurance only kicks in when the builder has died, disappeared or become insolvent.

This requirement isn’t just unexpected and confusing for consumers, it makes a mockery of consumer protection, leaving consumers without insurance cover when the builder is still around but has failed to work to standard or complete the project. In such a case consumers are expected to use other avenues to recover their loss — directly from the builder, through the dispute resolution procedures of the NSW Home Building Service or Building Advice and Conciliation Victoria, or through consumer tribunals and the courts. So, many consumers are essentially uninsured against what they think they’re insured against — incomplete or poor work — because of the ‘last resort’ clause.

Consumer interest in schemes

CHOICE believes only the Queensland scheme currently operates in the best interests of consumers. In Queensland, the government underwrites home warranty risk. The Building Services Authority (BSA) regulates the industry and has overall responsibility for licensing, dispute management and home warranty insurance. The BSA provides consumers with a single low-cost body to resolve dispute rather than relying on often costly courts and tribunals.

In recent years, Queensland’s home warranty insurance premiums have been well below those in most other states. And for the lower premiums they have to pay, Queensland consumers get much more comprehensive insurance than consumers in other states. It’s the only scheme in Australia that compensates for subsidence and settlement, and it’s ‘first resort’ — consumers have access to the insurance if the builder fails to complete or rectify defective work, even if they’re still trading.

² NSW Home Warranty Insurance Inquiry, September 2003, NSW Parliament

The current privatised home warranty scheme as it operates in most Australian states appears to primarily benefit insurers and larger building companies at the expense of consumers and smaller builders. A Queensland-style system offers much higher levels of protection for consumers as well as being easy to access for builders.

Productivity Commission

CHOICE supports the approach recommended by the Productivity Commission in its *Review of the Consumer Policy Framework*. Draft recommendation 5.5 seeks that:

Australian Governments should take early action to provide better and uniform protection for those have a home built or renovated. Specifically, this should entail:

- Guaranteed access for consumers to alternative dispute resolution mechanisms
- Provision of greater scope to de-register builders who do not meet appropriate performance standards; and
- A revamping of compulsory builders' warranty insurance to ensure that it is of genuine value to consumers and that consumers understand the product.

We believe this recommendation addresses the issues as they exist in the industry. We further note that this issue has been the subject of numerous state and federal government reviews, including the comprehensive review undertaken by the Ministerial Council for Consumer Affairs in 2002. The issues in the industry are well understood and will be usefully progressed by the Commission's recommendation.

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