30 November 2009

Mr Richard Willis
Council Committees Office
Department of the Legislative Council
Parliament House
EAST MELBOURNE VIC 3002

Dear Secretary,

Re: Inquiry into Builders Warranty Insurance

I write to thank you for the opportunity to provide feedback concerning Victoria’s Builders Warranty Insurance Scheme.

The Master Builders Association of Victoria (“Master Builders”) represents approximately 4,400 domestic builders and subcontractors within the Victorian residential building sector.

As Victoria’s leading residential industry association, we regularly consult our members on their views regarding the structure, operation and performance of Victoria’s Builders Warranty Insurance market.

Master Builders currently supports the existing system of Mandatory Last Resort Home Warranty Insurance (“HWI”) in Victoria. While our Association recognises that the current system is not without flaws, our industry is primarily concerned with the existence of a stable, reliable and competitive insurance product market which serves the best interests of builders and consumers alike.

Outlined below is a summary of our position in regards to the key factors relevant to this Inquiry. As you will note, our support for pragmatic and responsible reforms is tempered by the scars of historical upheavals within the warranty insurance arena.

History (2000-2009)

Between 2000 and 2009, the residential building sector twice experienced massive bouts of instability through either the collapse or withdrawal of insurance companies from the provision of home warranty insurance.

The first collapse with HIH (March 2000), caused massive dislocation for 4,000 builders in Victoria. These builders were not able to procure new insurance for a period of up to five months, severely damaging their businesses as they were effectively locked out of legally commencing new building work.
The second major threat came less than one year later, when Dexta Corporation was forced to announce its imminent withdrawal from the provision of warranty insurance caused by their reinsurer refusing to continue their relationship. At the time, action by the Bracks’ Government to act as an alternate reinsurer mitigated a recurrence of the trauma associated with the demise of HIH for a period of time.

In the years following up until July 2009, the home warranty insurance system in Victoria enjoyed a period of relatively stabillity, with builders being able to access warranty insurance from a variety of insurers in a moderately competitive market.

**Recent History (2009-Present)**

On July 1 2009, HWI insurance company Lumley General announced its plans to withdraw from the home warranty insurance market, taking effect on 31 December 2009. Two weeks later, a second industry insurer, CGU Insurance, announced its plans to withdraw as well, taking effect on 30 November 2009.

The unexpected withdrawal of these two insurers triggered a massive upheaval in the industry. Within a few days, the remaining three insurers in the market were assessing the value of their commitment to the industry, including the features of their existing products, premium rates and overall risk exposure to the industry.

In the days following the Lumley and subsequent CGU announcements, Master Builders proactively contacted its membership to ensure that all builders utilising Lumley and CGU products were provided assistance to successfully switch providers.

It should be acknowledged that the five-six month lead time provided by the two insurers regarding their intended withdrawal has made the task of helping builders switch providers much easier. This has helped ease industry fears about another HWI disaster – in stark contrast to their experience endured earlier in the decade.

Despite these positive factors, it should be noted that HWI transition arrangements for many builders has still been difficult, especially for those with unconventional accounting and asset management. Notwithstanding the similarity in HWI products provided, the financial documentation requirements for Victoria’s five HWI insurers do vary. Consequently, now that two insurers have announced their intention to withdraw, many builders are experiencing difficulty acquiring a new HWI provider due to their inability to meet the slightly different requirements.

For the record, Master Builders does not believe the above problem will easily resolve itself in a market which contains only three insurers. Consequently, some builders, especially at the lower end of the market, will face difficulty securing HWI into the future. We speculate that such an outcome could lead to an increase in unregistered, uninsured and illegal building activity occurring as a result of existing Owner Builder loopholes. Moreover, the safety and industry implications of this occurring should also not be underestimated. Naturally, any decline in builders obtaining HWI will have a negative impact on overall building activity levels as well.

As we fast approach the deadlines for the two exiting providers, Master Builders has noted that the length of time to secure HWI product approval for applicants, even those with completed documentation, has increased. In recent weeks, the expected insurer response time has lengthened from two weeks to over four weeks. This has begun to cause angst among builders and is likely to add to industry pressure as the summer permit season begins.
Government Response (New South Wales)

The New South Wales Government’s response to the withdrawal of Lumley General and CGU Insurance from the HWI has been very disappointing. Whilst we recognise key structural differences exist with the NSW residential building industry, we believe their decision to move to a Government scheme is flawed and has unduly placed Victoria’s functioning HWI scheme in jeopardy.

Government Response (Victoria)

The Victorian Government’s response to 2009’s HWI industry developments has been sound. Extensive consultation with industry has occurred, and input has been actively sought on how best to respond to each new development. Outlined below is a summary of our advice to the State Government in regard to their future management of this complex issue.

Support for Last Resort Insurance

Master Builders continues to support Victoria’s current system of Mandatory Last Resort Insurance. We believe that a mandatory system encourages market choice in regard to insurance services and ensures that premiums are more competitive than would otherwise be the case.

Victoria’s current insurance regime strikes the right balance between good consumer protection in the event of death, disappearance or insolvency (of a building practitioner), and suitably tough regulation which contains dispute resolution services. It is also worth noting that the deregistration powers held by Victorian government regulators (Building Commission) in regard to policing building activity is a key element of our State’s successful system.

Master Builders believes any reform of the current HWI model must be commercially viable, affordable, efficient, stable, competitive, have a smooth transition period and be accessible to all currently eligible residential builders. Moreover, the State Government would need to demonstrate that any such changes being proposed would be beneficial to builders, consumers, insurers and regulators.

Master Builders will not support a system which results in builders who formerly were assessed as acceptable to now be denied the ability to trade (by not being able to secure HWI products). We are also opposed to any systemic reforms which result in a private or public monopoly. It is our view that healthy competition is essential to ensuring HWI products, premiums and customer service standards remain affordable.

Opposition to First Resort Insurance

Master Builders does not support a return to First Resort Insurance as is the case in Queensland. First resort insurance in Victoria was a catastrophe for builders, consumers and insurers alike due to the ease in which unscrupulous builders and/or consumers could commit fraud.

Under the old system, fewer insurance providers were available to builders, and consequently, premiums were higher and services were poorer.

Another negative consequence of the first resort system was that there was a greater likelihood of insurers settling claims with the client, and then pursuing the builder for full reparations. When this occurs, the builders’ position in the event of a dispute is
substantially weakened as his/her chances of resolving the matter before lawyers become involved is diminished. Consequently, this type of system results in a lower likelihood of successful conciliation and a higher level of building costs.

**Opposition to Voluntary Insurance**

Master Builders opposes the introduction of a Voluntary Warranty Insurance regime as is the case in Tasmania. We oppose such a system because it does not serve the interests of consumers or builders. Under this system, consumers can be worse off if a builder does not have insurance and something goes wrong with a project and/or with the builders’ capacity to fix it. Equally, builders can be worse off when the industry is held collectively responsible for the actions of a few, less scrupulous builders.

Master Builders is extremely concerned about the community confidence ramifications of such an event taking place in a voluntary insurance environment. We also have major concerns about how government would respond in the event of a major bailout being required (introduction/increase of levies).

Builders would also suffer financial consequences as a result of insurance company departures (a likely outcome in a voluntary environment). In the event of a voluntary system being introduced, higher premiums and more restrictive underwriting would result in higher business costs for builders.

It is worth noting that voluntary schemes also have mixed success in regards to service uptake, and consequently, different levels of protection and service. Neither builder or consumer are advantaged by pricing in a voluntary scheme as a reduced pool of providers inevitably leads to higher prices for those who choose to avail themselves of this option.

**Consumer Confidence in the Industry**

Maintaining consumer confidence in Victoria’s building industry is a top priority for Master Builders. At present, a key element of Victoria’s licensing and registration process is based upon a builder being eligible for warranty insurance services. These services are only provided by insurance companies after they have conducted a rigorous assessment of the financial stability and strength of the building business in question. If the compulsion to purchase insurance was removed, government would need to step in on behalf of consumers to ensure that all builders were capable of undertaking housing projects responsibly. Master Builders would not support the introduction of onerous government administered assessments to handle this task and thus, is keen to see a continuation of our current system.

**Disclosure of Premiums, Claims and Claim Payments by Insurance Companies**

Master Builders supports the introduction of government regulation which compel insurance companies to disclose their premiums, claims and claim payment histories for all forms of mandatory insurance (as is currently the case in NSW). We believe that such a move will ensure that consumers, builders and policy regulators are each provided with the information they need to determine whether a fair insurance service is being provided to the public.

Master Builders disputes the claim made by some insurance companies that mandatory service data disclosure breaches important confidentially protections expected by their customers. Nor do we support the assertion that mandatory disclosure will result in insurers leaving the market. Master Builders believes that
proper service data disclosure will improve market competition and overall customer service.

Master Builders would like to thank the Parliamentary Standing Committee on Finance and Administration for the opportunity to provide feedback on Victoria’s Builders Warranty Insurance Scheme.

Should you have any queries regarding our submission, please do not hesitate to contact myself on (03) 9411 4501.

Yours faithfully

[Signature]

Brian Welch
Executive Director