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NSW HOME BUILDING COMPENSATION FUND

Submission to the Reform of the HBCF Discussion Paper

ABOUT US

Set up by consumers for consumers, CHOICE is the consumer advocate that provides Australians with information and advice, free from commercial bias. By mobilising Australia's largest and loudest consumer movement, CHOICE fights to hold industry and government accountable and achieve real change on the issues that matter most.

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INTRODUCTION

CHOICE appreciates the opportunity to provide feedback regarding NSW Fair Trading's Reform of the Home Building Compensation Fund (HBCF) Discussion Paper, and the various proposed models for amending the fund's operations.

CHOICE understands that there are difficulties in the provision of domestic building insurance, also known as home warranty insurance, due to the 'long tail' nature of the product. However, it remains vital that consumers are protected for significant work completed on what is often their most valuable asset, their home.

CHOICE is concerned that valuable consumer protections will be lost if any of the discussion paper's suggested models are implemented in NSW. CHOICE has outlined its concerns with each model in the following submission.

Summary of recommendations

1. NSW considers the adoption of a 'first resort' model similar to that of the Queensland Building and Construction Commission.
2. NSW investigates best practice domestic building insurance models in other jurisdictions, including internationally, before implementing any reforms, and presents the findings in a second discussion paper.
3. NSW investigates additional structural reforms in a second discussion paper which would assist in improving the efficiency and accessibility of the HBCF.

1. Consumer protection and domestic building insurance

In the 2014-15 financial year, \$63.1 billion worth of residential construction work was commenced across Australia. However, many who undertook construction were not adequately protected under current schemes. In Tasmania, homeowners were not covered by any scheme at all.

Protection is provided with a protection period of up to 5-6.5 years, determined by each state's separate legislation/regulation. Each state and territory, except Tasmania, has mandatory domestic building insurance, with premiums covered by builders who pass the cost on to the consumer.

These insurance schemes are typically only able to be accessed as 'last resort'. Homeowners must first go through a process of reporting the builder to the appropriate state authority and exhaust their options, including potentially costly legal battles, before accessing funds through the relevant domestic building insurance scheme. This process is costly and cumbersome for homeowners and inherently prohibitive.

Domestic building insurance is a valuable safety net protecting consumers' greatest asset. Any change to the system should not erode homeowners' protections, and at minimum should increase the protections available to them.

2. Proposed models and consumer outcomes

The Reform of the HBCF Discussion Paper sets out a number of suggested approaches for changing the current model with the objective of making it more effective and sustainable into the future.

CHOICE does not believe any of the proposed models are adequate and has responded in regards to specific consumer concerns to each individual model with commentary below. Some suggestions of best practice models and other reforms are presented in section 3.

Model 1: Retain current scheme, reduce administration costs and raise premiums

This model proposes that raising premiums and lowering administration costs will alleviate the unsustainable nature of HBCF. While CHOICE would not automatically oppose a raise in premiums, we would expect that higher premiums would lead to better outcomes for consumers (such as in Queensland where consumers pay the highest premiums, but are also able to access better protections through a ‘first resort’ scheme).

Reducing administration costs may create more barriers for homeowners seeking to access their insurance product, while retaining the current scheme, which is already understood to be ineffective for homeowners, is also undesirable.

Model 2: Reduce scheme coverage

This model suggests a number of options for reducing coverage of the scheme such as raising the claim threshold, excluding certain types of work and/or removing certain types of buildings.

Given the prevalence of problems with domestic building work, reducing the scheme’s coverage would remove vital protection for some homeowners, including on smaller renovations or home additions such as renovation of a single room like a bathroom, where a botched renovation can have significant impact on the rest of the house.

Regulators should also be wary of reducing claim times on premiums as defects may not become apparent for some years, especially with structural work. With shorter claim times, homeowners would be at a significant disadvantage.

Model 3: Combination of reduced scheme coverage and raised premiums

This model combines model one and two and would raise costs for homeowners while providing them with less protection. Homeowners will be paying more for less.

Model 4: A voluntary insurance scheme

Under this approach, builders would be required to disclose to homeowners whether they were purchasing cover or not and homeowners would need to better understand the concept of the HBCF before undertaking any work on their property, or building a new property. Many

homeowners would know little of HBCF, or indeed its very existence, and would be surprised to find that they were not provided with protections for faulty or uncompleted work.

The failed experiment of a privatised voluntary scheme in Tasmania shows that a commercialised domestic building insurance industry will likely never be competitive. The involvement of State Government in these types of schemes is as a direct result of the lack of viability in the market for private insurance providers, almost all of whom pulled out of the market.

Model 5: Combination of voluntary and mandatory scheme

A mix of voluntary and mandatory schemes may result in lower costs to industry and consumers. However it will leave consumers with a more confusing system to navigate – a system that is already unclear.

The commercial viability of voluntary schemes, as noted, would need to be considered. Reflecting on the lack of success of commercial schemes in Tasmania, NSW should carefully consider whether voluntary schemes would prove viable in a NSW context.

3. Other successful models

CHOICE is aware of several models of domestic building insurance which both protect homeowners financially as well as providing a more adequate level of accessibility. We would encourage NSW Fair Trading to investigate these approaches.

Queensland Building and Construction Commission

In most states homeowners do not have access to insurance to fix defects if the builder is still in business, however Queensland homeowners have access to ‘first resort’ insurance.

In Queensland’s ‘first resort’ model, homeowners face fewer barriers in accessing their insurance. A homeowner complains to the QBCC (the responsible regulator in this instance) and the builder is issued with an order to comply. Should the builder fail to comply with the order, the homeowner is able to access their insurance policy and the QBCC pursues the builder for the cost of the claim.

While premiums are marginally higher for consumers in Queensland, the protection they receive through their scheme is markedly better than any other state in Australia. A first resort model would reduce hassle for homeowners, albeit with a slightly increased cost.

United Kingdom

Structural defects insurance in the United Kingdom (the equivalent of domestic building insurance) is not mandatory, however mortgage brokers require the insurance for new houses. This means that insurance is essentially taken up by all homeowners.

The warranty period for works carried out extends for 10 years, a much greater level of coverage than any product offered in Australia, and insurers also offer “first resort” policies.

Structural reform

Other options for structural reform would benefit homeowners by making schemes more accessible. All such options should be explored as a part of the review process.

Such options could include replacing broker commissions with a fee-for-service model or the selling of government policies directly.

Recommendations

- NSW investigates the merits of adopting a ‘first resort’ model similar to that of the Queensland Building and Construction Commission.
- NSW investigates best practice domestic building insurance models in other countries before implementing any reforms, presenting the findings in a second discussion paper.
- NSW investigates additional structural reforms in a second discussion paper which would assist in the efficiency and accessibility of the HBCF.