



Economic Regulation Authority  
Inquiry into Western Australian Home Indemnity  
Insurance Arrangements  
PO Box 8469  
Perth WA 6849

Dear Sir;

**RE: Inquiry into Home Indemnity Insurance**

As a Practising Registered Builder and Company Director within the Western Australian building industry, I hereby submit comment on the Issues Paper for the Inquiry into Western Australia's Indemnity Insurance Arrangements.

The current arrangements with private insurers is inequitable to the operations of WA Builders and has been since introduction, and the premiums, which based on purely commercial risk determination by the insurers, is uncompetitive between large project builders and smaller builders and/or those wishing to enter the industry with little or no personal equity, which is required to qualify for Indemnity cover with private insurers.

In preparing this submission, I utilise my experience within the industry as a Housing Builder prior to/and since the scheme was introduced under WA Legislation, and my involvement during the crisis of the collapse of HIH, as a member of the Housing Indemnity Action Group (HIAG), who represented the 'Coal Face' of WA Builders within our industry.

This was at a time when the Housing Industry Association (HIA) were, in association with their insurers, raising premiums beyond reasonable levels and restricting builder's turnover in some cases to less than 30% of their current turnover at that time.

This therefore inadvertently made it difficult for smaller builders to operate within their market sector, whilst HIA were concentrating on looking after the larger high turnover project builders who were members of their organisation and indeed had significant political influence.

Master builders of Western Australia (MBA) however, at that time, were rightly directing the WA Government that there was indeed a problem with the sudden insolvency of HIH, and that action by the WA Government was indeed urgently required to reinstate reasonable coverage, rates and terms to all builders, by either instigating a scheme legislated and run by/or under the auspice of Government, by facilitating the introduction of an Industry 'Mutual' or 'Fidelity' fund and/or seeking additional insurers to the WA Indemnity market.

The outcome of this venture by a dedicated group of 'Coal Face' WA Builders under the organisation formed being the HIAG, was that Government requested a sole audience with its members and were able to clearly define the issues at hand and set about working to resolve the issues presented by the Builders, which was adverse to the directives being presented by the HIA.

This resulted in Government facilitating additional insurers entering the Indemnity market, albeit that new insurance rates at that time were uncompetitively high for smaller builders (which remains the case today), and turnover restrictions were imposed to smaller builders, whereby they were considered a higher risk than larger mass turnover project builders, when in fact history dictates the opposite, whereby many highly geared large project builders throughout history have suddenly become insolvent and caused undue cost and disruption economically and socially to the building industry in Australia, far in excess of those small builders claims.

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Since the advent of HIH exiting the insurance market and other providers entering the industry to provide Indemnity cover, the number of providers/private insurers has again shrunk to only two participants, being one small operator whom is not capable of acquiring large portions of the Indemnity insurance pie, and a larger provider whom is capable of acquiring a larger portion of the market, however still imposing restrictions in turnover, therefore restricting entrepreneurship and growth by builders, and secondly providing inequitable and uncompetitive levels of premiums between the larger high volume/high turnover builders and the smaller builders, whereby rates per contract can vary from as little as approx. \$120 per home with the larger project builders, to as much as \$2-2500 for a smaller operator for the same value home, based on an insurers analysis of builder risk. This evaluation is quite often inequitable, as it only considers the builders personal/companies equity and not the general operations and history of involvement of the builder, and the risk of the larger builders diversifying their funds into other businesses/ventures, that inadvertently puts their building business at risk. There is also a lot of political pressure for reduced insurance rates by the larger higher turnover project builders, which again reflects the uncompetitive nature of the current scheme with private insurers.

This also inadvertently has developed a second tier of governance by insurers, acting in a 'defacto' role as a licensing body for builders, whereby with onerous restrictions in many cases, the builder is unable to operate, and/or with refusal of Indemnity cover, based solely on their assets for recoverable costs upon insolvency, the builder cannot operate in the WA Building Industry.

Larger mass turnover project builders would argue that to have an even playing field on insurance rates, whereby their rates may increase from current unsustainable low values, that they would lose their competitive edge, however this is untrue as all builders would indeed be on the same rates and in fact rates for smaller builders may be reduced to all and provide an environment of 'Fair-trading'.

As an industry, Builders in WA are currently licensed and controlled by registration with the WA Building Commission, whom assume the role of ensuring builders compliance with regulations and financial ability to operate, therefore as an industry it is both not 'Fair' nor considered 'legal' that an independent insurer should have the rights, based on their own assessment of risk, as to whether a builder should be allowed to operate or not, and at what level of turnover within the industry, as this is unconscionably restrictive to 'Fair Trade'.

The alternative solution of establishing a Government based Indemnity Scheme under the auspice of a 'Mutual' or 'Fidelity' fund, administered by Government in WA, is also not the preferred solution that was discussed at the time of the exiting of HIH from WA, as again this can also be considered too restrictive on builders operations, growth and competitiveness in the WA market, and puts direct financial risk on the WA Government, should a catastrophic insolvency event occur, especially with a major project builder.

This is precisely why the previous Government and Ministers did not enact this avenue of resolution to the Indemnity crisis at that time, and have not provided any positive directives at many discussions since the collapse of HIH, that they are willing to consider this avenue of resolution to the Indemnity Scheme, and neither is this a preferred option by WA Builders.

Currently, the scheme that exists, is a monopoly, governed by Insurance Company risk managers both in other states of Australia and overseas, with little or no direct understanding of both the WA Housing Market, its operations and the level of 'Unfair Trading', that it is/has developed within the industry, with great variance of restrictive trade conditions between differing levels of company structures, and providing policies that are not Insurance' policies, but are Guaranteed policies back to the insurers, that require Bank Guarantees, Directors Guarantees, Asset Guarantees, etc. , which have a knock on restrictive effect for builders when applying for finance to banks, etc., when requiring project interim funding and/or funding for expansion of their business – a no win situation.



With the insurers also insisting on equitable assets from the builders, to ensure that any losses are recuperated from them, this cannot be considered Insurance, under the definition of Insurance, as to charge a premium to provide risk cover, and then to seize builders assets to recoup their full loss costs is surely not 'fair' to the industry and its builders, as no other form of Insurance has such onerous conditions – this is not Insurance at all.

As a scheme, history also indicates that the current Indemnity model has not sufficed to provide the intended protection to homebuyers, in the form which was originally intended and has proven to be of little or no benefit to those homebuyers of a high contract value whatsoever.

Claims history indicates that in many cases, although the protection is capped at \$100,000 Indemnity cover, actual payout of claims has been significantly less, (of an average of approx... \$28,000), with the onus on the homebuyer having to not only in many cases contribute both time and expense in engaging another equivalent level of builder to complete their home upon insolvency, but also bear legal costs associated with the situation, and extended rental/accommodation costs for the delayed period, clearly demonstrating that the fine print associated with private insurance policies for indemnity cover, is both limited and biased in favour of the insurers, and falls well short of full protection for consumers.

The original 'scope' for the scheme was to protect the lower income homebuyers/the mortgage belt, from insolvencies of builders, to the limit of the then 'Contracts Act' being a maximum of \$200,000 at that time, which now is limited to a maximum of \$500,000 through amendment to legislation to the Contracts Act in WA.

This scheme however, over time has inadvertently encapsulated the whole of the housing industry with unlimited contract value, which is somewhat irrelevant to higher contract values, as opposed to lower contract values, where financial protection is more likely required due to the financial position of lower income families and more beneficial.

The higher contract values still have the same maximum \$100,000 cap on any claim, however seemingly there is always a mechanism by private insurers to restrict any claim to a lower value, which therefore becomes insignificant to a consumer building a multimillion dollar home, whom not only are likely to have sufficient financial resources to adequately sustain any catastrophic insolvency event, but more than likely as proven in prior circumstances, have also had the legal and administrative resources to assist them adequately to resolve the circumstance to the satisfaction of being able to select a suitable equivalent level of builder that can deliver the quality of finish originally contracted/intended to continue the works, rather than a nominated builder by insurances that cannot adequately complete their home to the original intended level of quality.

The options therefore going forward with the Indemnity Scheme can be categorised as follows:

1. Abolish the Indemnity Scheme altogether, as industry history indicates that it has not provided adequate protection by private insurers to consumers, and has only encumbered home builders with restrictions and uncertainty of operations to the point whereby on several occasions it has both completely stalled the housing industry, and either restricted builders operations, or forced them to cease building operations altogether in WA.
2. Continue with private Insurance providers with the current Indemnity Insurance Scheme, which would be a deluded decision by Government, as clearly it is not working to accommodate the best interests of the consumer and the builders (with implications as outlined above), with an adage potential circumstance of the current Insurers whom have on occasions indicated that the Insurance provided at current and/or somewhat increased rates to the builders, is not profitable, and due consideration of continuance by Private Insurance may mean them exiting the market, and subsequently once again causing both undue stress to Consumers, Builders and general instability to the housing sector, with no alternate solution for continuance for the scheme by Government in WA.

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I should also note that this current scheme is in fact underwritten by the WA Government, which limits considerably undue risk to private insurers, and could be construed as being 'Unfair trade' on many levels.

The current insurers actually have their 'Cake' and are Eating" it also, with little or no risk which in the commercial world is an absolute joke.

3. Amend legislation for a 'Voluntary' indemnity scheme, to be determined by the consumer, as currently it is another added, and somewhat flawed cost to building, which recently has been introduced by the Tasmanian Government successfully, without any negative effects.

4. Continue the scheme, whether through Private Insurers, (subject to consequences previously outlined), and/or through an alternative scheme/provider, but restrict the legislated requirement to the current 'Contracts Act' value of a maximum \$500,000, to provide protection to those in the lower income bracket as consumers whom are therefore more vulnerable to market insolvencies, and for whom the scheme was originally intended and for those in reality it may to some degree provide some benefit.

5. Develop and introduce a Government scheme as instigated in other states, whereby the Indemnity scheme is enveloped within the auspice of the WA Building Commission, and therefore directly linked to Builders licensing requirements, with premiums set as a percentage of the 'Contract Value' (say 0.10%), as currently exist for Building licence fees, Planning application fees, Construction Training Levy fees and the like.

This would provide and even playing field for all builders at differing socio economic levels within the industry.

This would then allow for even and fair competition, and levelling of the risk of all builders to the Indemnity Cover evenly throughout the industry, rather than a false evaluation of each builder by private insurers.

This would also provide builders with stability in Western Australia, however it would also impose the risk of claims to the Government, which would be considered by the general public as not being the Governments responsibility, and clearly this has been vocalised by many WA Builders in the past as not being a preferred option, as again this would place sole empowerment on one governance body being the Building Commission.

6. Develop with Industry, an 'Industry Based' scheme, either restricted to encapsulate those with the value of the Contracts Act set at \$500,000 (as preferred by industry and consumers), or unlimited in value as currently exists, similar to that recently launched by MBA Northern Territory.

This would be Industry funded as a 'Mutual' or 'Fidelity' fund, which may require initial seeding funds by the WA Government, (up until the fund realises sufficient reserve equity), which would not take long at all, based upon the fact that private insurers would then exit the market.

If premiums for this scheme were based at say 0.10% evenly to all builders, and encapsulating the entire WA Housing sector, funds would be capitalised in a short period of time of approx. 5 years based on an industry income of approx. \$15M per annum (CTF currently collects 0.2% realising approx. \$31M per annum as a comparison), therefore releasing Government seeding funds.

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This scheme may also require underwriting by Government initially for catastrophe, (as current private insurers are for claims in excess of \$10M), which would burden the Government with no greater risk than currently exists.

I understand, however upon the fund realising capitalisation of static reserve funds of say \$50M after 5-6 years, the risk to Government would become negligible.

The scheme could be set up and run under a similar independent structure as currently exists with the CTF (Construction Training Fund), reporting back to the relevant Minister, but administering the day to day organisation and legislation.

Upon attaining equitable static funds in reserve of say \$50M, which would more than cover any major catastrophic event in WA, and after modest administration costs/overheads encountered to run the scheme are deducted, then capitalised excess earnings could then be directed to industry training of both apprentices and existing participants to up skill and maintain compliance.

These excess funds could then be directed to another entity, i.e. CTF to distribute for industry training, which is currently languishing for funds due to the industry downturn, at a time that training is required more than ever within the Building Industry. These funds could be distributed in a similar nature to disbursements currently provided by the Lotteries Commission of WA to various charities etc.

This therefore would over time relinquish Government risk for underwriting any claims, provide certainty to the WA Building Industry that stability would be maintained, provide a clear pathway for those wishing to enter the WA Building Industry, provide equality in Indemnity rates and therefore equality in competitiveness to WA Builders by being on a level playing field with indemnity rates and removing the current discrimination that exists from insurers to differing levels of builders.

It would also provide a level of self-governance within the WA Building Sector similar to that which currently exists with RIEWA (Real Estate Institute of WA) whom have a similar scheme that works well, and provide clarity of conditions of cover via policies to the consumers, whom are currently bewildered by miss-information and fine print from insurers.

In surmising, it is seemingly unlikely that option 1 would be respectfully considered by Government, as there is a clear direction mandated from the Ministry of Fair Trading for 'Consumer Protection'; however it would relinquish Government of any claims liability, which would not be the case in option 2, 3 and 4 above.

Similarly option 5 would not provide liability to be negated by Government, and Industry as a whole does not see this aspect of Insurance to be the role of Government, with further concerns of over policing of builders by one Government Department, that are not, and may have never themselves operated with the private sector of the WA Building Industry and therefore as with the current Insurers, not being able to fully understand and/or comprehend the multitude of organisational structures of Building Companies, and their financial structures.

The development of option 6 above however being an 'Industry Based' 'Mutual' or 'Fidelity' fund, one preferred by industry for the last 10 or more years, is one that will provide industry, both over the short and long term a clear and decisive direction with Indemnity Insurance, stability to what has become a very disruptive and restrictive legislation. This will also reward building industry training, from industry itself, by directing longer term profits/capitalisation back into the WA Building Industry, through self-regulation, by persons whom understand the matrix of individual builders as well as the financial structure of each company and the building industry as a whole.

This also provides surety to the consumer whereby the current scheme is not clear to consumers whom are under vast misapprehension of what is provided and that the contributed funds will not be gobbled up by 'red tape' by authorities, liquidators and the like, therefore the consumers benefit being inadequately reduced, which is currently the case.

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Consumers would be fully covered for any such indemnity claim without the undue mischievous dealings of Private Insurers.

Although option 6 may not be a preferred option for the larger Project Builders with mass turnover as they are currently enjoying un-competitively and unsustainable low Indemnity insurance rates, whilst giving equal or some may argue a much greater risk to our industry as compared to smaller builders.

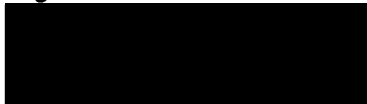
Option 6 is currently and has been a reflection of the mood of our industry and the majority of Builders in WA for quite some time as the preferred long term solution to producing both consumer protection and builders stability in WA.

It should also be noted the WA housing industry, via historical reference, has had a relatively stable market for builders with the lowest insolvencies Australia wide, and although Registered Builders require Indemnity Insurance, owner builders do not, therefore the introduction of Option 6 may also accommodate this anomaly and encapsulate owner builders.

It is also noted that this review was not circulated to all registered builders within Western Australia for comment, which should have been the case, as they are the persons who are directly affected by this legislation, and should be heard. In saying this however, I believe the comments provided above, as a 'Coal Face' Builder in WA, reflect the opinion of the masses of the majority of Builders in WA, and these comments should be seriously considered during this review.

I am more than happy to contribute to any further queries and or comments, should you require my furtherinput.

Regards



Malcolm Goode  
Director / Registered Builder  
Artique building Pty Ltd, T/A Artique Homes

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## Foreword

The Treasurer of the State of Western Australia has requested that the Economic Regulation Authority (**Authority**) undertake an inquiry into the effectiveness of Western Australia's home indemnity insurance arrangements.

In accordance with the inquiry's Terms of Reference, the Authority will determine if there is an ongoing need for the mandatory provisions of home indemnity insurance, and whether alternative regulatory models could be applied in Western Australia to replace or improve current arrangements (which, as indicated in the Terms of Reference may include the establishment of a fidelity fund).

In addition, the Authority is to determine if ground subsidence due to underlying geological causes should be included in the scope of home indemnity insurance arrangements.

The purpose of this Issues Paper is to provide background information and outline the issues to be considered. It is intended to assist stakeholders to understand the nature of the issues under review and to facilitate public comment and debate. Throughout this Issues Paper, questions that may be of particular interest to stakeholders are raised and highlighted in boxes.

Submissions on any matter, including those raised in this Issues Paper, should be submitted by 4:00 pm (WST) on Thursday, 16 August 2012, preferably in electronic form, and addressed to:

Economic Regulation Authority

Inquiry into Western Australia's Home Indemnity Insurance Arrangements

Email address: [publicsubmissions@erawa.com.au](mailto:publicsubmissions@erawa.com.au)

Postal address: PO Box 8469, PERTH BC WA 6849

Facsimile: (08) 6557 7999

Section 1.3 of this Issues Paper provides further information regarding the process for making a submission. Interested parties and stakeholders will have a further opportunity to make submissions following the release of the Authority's Draft Report.

The Final Report for this inquiry is scheduled to be delivered to Government on 30 April 2013, following which the Government will have 28 days to table the report in Parliament.

I encourage interested parties to consider the Terms of Reference and matters raised in the Issues Paper and prepare a submission for the inquiry.

**STEVE EDWELL**  
**MEMBER**