REGULATORY IMPACT STATEMENT

Changes to residential building work insurance settings

Building (General) Regulation 2008

SL2024-25

Prepared in accordance with *Legislation Act 2001*, section 35

Rebecca Vassarotti MLA
Minister for Sustainable Building and Construction

1 Overview

This regulatory impact statement (RIS) relates to the proposed changes to the residential building work insurance settings, which will be achieved by amending the *Building (General) Regulation 2008* (the Regulation).

2 Background

The Environment, Planning and Sustainable Development Directorate (the Directorate) has completed a review of the Fidelity Fund Scheme, an insurance-like product established under the *Building Act 2004* (the Act). The scope of the review focussed on the governance arrangements relating to approved fidelity fund schemes, and the residential building work insurance settings.

The review made 12 final recommendations covering the full scope of the review. The recommendations include updating legislative instruments, appointing a consumer representative, clarifying complaints management procedures, updating the prudential standards, and continuing policy work and consultation on the residential building work insurance settings.

The final report has been provided to the Minister, with the Directorate prioritising the recommendations for implementation.

The final report has been agreed by the Government, including agreement to update the residential building work insurance settings relating to the minimum prescribed insurance amount and time limit to lodge a claim.

This RIS explores the options, benefits and costs of this proposed regulatory change.

Current residential building work insurance settings

The Act establishes the regulatory settings for residential building insurance in the ACT. Insurance is provided either by an authorised insurer (currently QBE Insurance (QBE)), or by an approved fidelity fund scheme (currently the Master Builders Fidelity Fund (MBFF)). This is in addition to statutory warranties set out in the Act.

A fidelity fund scheme provides limited insurance-like coverage for certain issues relating to residential building work. It was established in response to difficulties in obtaining residential building work insurance through the traditional insurance market, and following the collapse of HIH Insurance in 2001 which left the ACT without a residential building insurance provider.

The Act sets out the process for approving a fidelity fund scheme, the approval criteria, determination of prudential standards and auditing approved schemes. It also sets out the conditions for a complying residential building work insurance policy.

The Regulation sets the minimum prescribed insurance amount at $85,000, however in practice this amount is treated as a maximum amount. It also sets the period of time to lodge a claim at 90 days. These settings have not been reviewed or updated since 2002, with building costs increasing significantly during this period.

There are also a range of legislative instruments covering the application process and approval criteria to become an approved fidelity fund, prudential standards and MBFF assets determination. In addition, a trust deed sets out sets out matters such as the establishment of the fund, administration of the funds, payments out, trustees' duties, meeting procedures, voting, proxies and winding up.

3 Problem identification

The final report of the Fidelity Fund Scheme made detailed findings about the governance arrangements and the residential building work insurance settings. It found that the approved fidelity fund scheme has operated well over many years and has performed an important consumer protection function.

The report recommended that some of the residential building work insurance settings be updated to contemporary amounts which considers current building costs and contracting practices, and alignment with other jurisdictions. It is also important to make sure that the settings provide an appropriate level of consumer protection and that consumers are not left at risk and under-insured if a claim is made.

Analysis of residential building work insurance settings across States and Territories was undertaken, with a particular focus on NSW. Different insurance coverage and policy settings apply in the ACT and NSW, which adds complexity for developers and builders working across both jurisdictions.

Consumer complaints were raised as part of the review, to identify issues and options to streamline insurance processes and improve consumer protection. In particular, the timeline to identify building defects, seek rectification from the builder, obtain inspection reports and lodge paperwork to support a claim was considered.

These settings have been identified as priority recommendations in the review, as updating these settings will benefit all consumers engaging with the building industry.

Other jurisdictions

A jurisdictional analysis has found that all States and Territories except Tasmania have a form of residential insurance arrangements which cover consumers for defects and incomplete work, as shown in the table below. It should be noted that there are some differences in the scope of coverage across the jurisdictions.

The contract value that triggers insurance requirements ranges from $3,300 in Queensland to $20,000 in New South Wales and Western Australia. The $12,000 contract value set in the ACT also applies in the Northern Territory and South Australia.

The minimum insurance amount ranges from $80,000 in South Australia to $340,000 in New South Wales, with Victoria and New South Wales setting a threshold of up to 20 per cent of the contract price for incomplete building work, as shown in the table below.

Jurisdiction	Contract value requiring insurance	Defects	Incomplete
ACT	$12,000	$85,000 minimum	$85,000 minimum
NT	$12,000	$200,000 minimum in certificate for both defective and incomplete	

Victoria	$16,000	$300,000	Up to 20% of contract price
NSW	$20,000	$300,000, if issued before 1 February 2012 $340,000 for all other policies (minimum)	Up to 20% of contract price
Queensland	$3,300	$200,000	$200,000
SA	$12,000	$80,000 if issued before 30 June 2017 $150,000 if issued after 1 July 2017	$80,000
WA	$20,000	$100,000	$100,000
Tasmania	-	-	-

Note: Tasmania does not have a legal requirement for building indemnity insurance, but in progressing implementation of a new home warranty scheme.

4 Need for Government action

There is a need for government action, as the residential building work insurance settings outlined in the Regulation have not been reviewed or updated since they were put in place in 2002. As the residential building work insurance industry is regulated by the ACT Government, the government needs to take action to amend the settings in the Regulation to make sure that consumers have the appropriate level of protection and are not under-insured. It is unlikely the insurance providers will make these changes without government intervention.

5 Policy objectives of Government intervention

The policy objectives of the updating the residential building work insurance settings are:

1. Consumer protection: It is important to make sure that the regulatory settings provide an appropriate level of insurance coverage, and that consumers are not left at risk and under insured if a claim is made. Adjusting the time limits to lodge a claim will also give consumers more time to seek advice and gather evidence to support their claims. This must also be considered in the context of cost of living and housing affordability pressures.

2. Align with other jurisdictions, in particular NSW: A jurisdictional analysis has shown a range of residential building work insurance settings, with differences in scope of coverage. For example, the minimum insurance amount ranges from $80,000 in South Australia to $340,000 in NSW. It is proposed that the ACT minimum insurance amount be increased to bring it closer to the NSW level.

3. Reflect contemporary building costs: The minimum prescribed insurance amount set in the Regulation is intended to cover an individual stage of a building project, usually around 20 per cent of the build cost. Industry advice has indicated that increasing the insurance amount to $200,000 will provide sufficient coverage for most types of small to medium scale residential building projects.

6 Information required by section 35 of the *Legislation Act 2001*

The authorising law

The authorising law referred to in the RIS is the *Building Act 2004.* This Act provides a regulatory framework for residential building insurance, approved fidelity fund schemes and other matters, and enables the making of regulations for building issues.

The Act is intended to promote building safety, consumer protection and dispute resolution. It is administered by the Building Reform team in the Directorate. The consumer interface and protection role is provided by the Construction Occupations Registrar in Access Canberra.

The proposal to update the residential building work insurance settings will be achieved by amending the Regulation.

Achieving the policy objectives

To achieve the policy objectives, the proposed regulatory change will update the residential building work insurance settings. Following this, QBE and the MBFF will need to update the premiums and internal processes to action the changes. Consultation has occurred with the insurance providers throughout the review process and they are ready to make the changes if agreed.

Consistency of the proposed regulation with the authorising law

The proposed regulatory change to update the residential building work insurance settings is consistent with the Act.

The Act provides the legislative framework for regulating buildings and building work. The proposed regulatory change falls within the scope of the Act.

The proposed change also aligns with the policy objectives of the government's Building Reform program, that aims to protect homeowners and the community and addresses building safety and quality, drive a building and construction industry that is accountable and transparent, deliver policy and regulatory settings that are current, adequate, and effective and deliver sustainable and climate resilient buildings.

Inconsistency with the policy objectives of another territory law

The proposed law is not inconsistent with the policy objectives of any other Territory law.

The proposed regulatory change will not engage any rights in the *Human Rights Act 2004*, as all consumers who meet the requirements will be entitled to take out an insurance policy to cover their building project.

7 Reasonable alternatives to the proposed regulatory change

There are two alternative options the proposed regulatory change. These are detailed below.

Option 2: Maintain existing arrangements

This option would not require any changes to be made to the current residential building work insurance settings. It will not address the policy objectives of the proposal, which are detailed above. Furthermore, over time the ACT's scheme will fall further behind other jurisdictions in the level of insurance coverage provided. This could leave consumers under-insured against foreseeable losses.

Community stakeholders have been advocating for changes to the scheme, and will be strongly opposed to this option. The option of maintaining existing arrangements is not supported.

Option 3: Defer the proposed regulatory change

This option would defer the proposed changes to the current residential building work insurance settings, for future government and Directorate consideration and implementation.

This option is not supported as it does not deliver the changes advocated for by the community stakeholders. It is also uncertain where this proposal will be prioritised amongst future government and Directorate priorities. This could leave consumers under-insured against foreseeable losses.

8 Benefits and costs of the proposed regulatory change

Benefits

Updating the current residential building work insurance settings offers economic benefits to builders, developers, home owners and home buyers. These include:

a. <u>Improved insurance coverage:</u> Under the proposed changes, consumers will be able to claim up to $200,000 for defective or non-completion of building work, an increase from $85,000. This will help ensure consumers are not left at risk and under insured if a claim is made. Consumers will also have 180 days instead of 90 days to lodge a claim under their policy or certificate. This extra time will allow for the identification of issues and information-gathering, meaning that more claims will be processed, and less claims will be rejected for being out of time.

b. <u>Accountability and transparency:</u> The new insurance settings will be notified in the Regulation and communicated to stakeholders. This will ensure that all insurers and consumers know what claims can be lodged.

c. <u>Reduction in disputes:</u> It is anticipated that the proposed regulatory changes will result in a reduction in insurance claims disputes, as a wider range of claims will be accepted under the new settings, both higher value claims and claims taking longer to lodge. This will save consumers time and stress if an issue arises with their building project.

Costs / drawbacks

Updating the current residential building work insurance settings will likely result in increased insurance premiums, which are paid by developers and builders, and passed on to homeowners.

A full actuarial assessment will need to be conducted, to consider the appropriate change to the risk premium, and there is a balance that needs to be found between any increased premium and the flow on effect to the cost of building, against the increased consumer protection. Premiums are likely to increase, however the consumer will receive a more comprehensive insurance policy.

The cost impact has been carefully considered here in the context of cost of living and housing affordability pressures, which have been balanced against the need to make sure that consumers are not under-insured against losses they may incur if building work is not completed or is defective.

The proposal will result in cost implications and a range of potential drawbacks, these include:

a. Cost: It is estimated that the proposed regulatory change will result in an estimated impact on the risk premium is $897 to increase the insurance amount to $200,000, and $181 to increase the time to lodge a claim to 180 days, a total impact of $1,078. These costs are further explained below.

b. More claims: If the proposed regulatory changes are agreed, it is possible that more claims will be lodged with the insurance providers, as a wider range of claims will now be eligible. The Directorate has been engaging with the insurers throughout the review process so they are aware of the possible changes.

c. Administration burden: If the proposed regulatory changes are agreed, the insurers will need to seek independent actuarial advice, update internal systems and process, train staff, update forms and websites and determine a transition plan to the new settings. The Directorate has been engaging with the insurers throughout the review process so they are aware of the possible changes.

Below is an estimate of the cost impact for consumers for the proposed changes to the insurance settings. It should be noted that the risk premium modelled is only one component of the final premium. Some costs may not move proportionately to the risk premium. The cost of managing a claim or the costs of administering the fund may not increase with changes to the minimum prescribed amount.

Other pricing considerations that may impact the final premium include claims management expenses, profit margin, reinsurance needs and cost of capital, as well as the impact of recent and significant builder insolvencies, that may materially impact on the other pricing considerations. The final costings will be subject to further actuarial modelling by the insurance providers.

Insurance amount

The table below shows the indicative potential risk premium impact for various increases to the minimum prescribed amount for the current approved fidelity fund scheme. The results are shown in percentage terms based on the increase from the average premium in 2022, and dollar terms.

Minimum prescribed amount	**Potential risk premium impact for the MBFF**	**Indicative premium cost**
	2022 average premium	*$1,859*
$100,000	+13%	$2,092
$150,000	+41%	$2,630
$200,000	+59%	$2,951
$250,000	+71%	$3,171
$300,000	+79%	$3,330

Time limit to lodge claims

The table below shows the potential risk premium impact for various increases to the time limits to lodge a claim. The results are shown in percentage terms based on the increase from the average premium in 2022, and dollar terms.

Reporting period	**Scenarios**	**Potential risk premium impact for the MBFF**	**Indicative premium cost**
		2022 average premium	*$1,859*
Increase to 120 days	Notional 5% increase in defect claim number for MBFF	+3.5%	$1,925
	Notional 5% increase in defect and non-completion claim number for MBFF	+5%	$1,952
Increase to 180 days	Notional 10% increase in defect claim number for MBFF	+7%	$1,990
	Notional 10% increase in defect and non-completion claim number for MBFF	+10%	$2,045

9 Benefit / Drawback comparison table

Option	Option 1 (Preferred): Update residential building work insurance settings	Option 2: Maintain existing arrangements	Option 3: Defer the proposed regulatory change
Benefits	• Improved insurance coverage in both the coverage amount and time to lodge a claim • Accountability and transparency • Reduction in disputes • Supported by community stakeholders	• No immediate cost impact • No major changes to volume of claims • No change to existing systems and processes • Existing system is already well-understood by industry	• No immediate cost impact • No major changes to volume of claims • No change to existing systems and processes • Existing system is already well-understood by industry
Drawbacks	• Cost (through increased premiums for consumers) • More claims – increased liability for insurers to meet • Administration burden – more claims to process and work required to meet new requirements	• Does not address the policy issues raised in the review • Insurance cover continues to be limited • Consumers out of pocket • Not supported by community stakeholders	• Does not address the policy issues raised in the review • Insurance cover continues to be limited • Consumers out of pocket • Not supported by community stakeholders

10 Consistency of the proposed law with Scrutiny of Bills Committee Principles

The Standing Committee on Justice and Community Safety's (Legislative Scrutiny Role) Terms of Reference require the Committee to consider whether (among other things) any instrument of a legislative nature made under an Act which is subject to disallowance and/or disapproval by the Assembly:

i. is in accord with the general objects of the Act under which it is made;
ii. unduly trespasses on rights previously established by law;
iii. makes rights, liberties and/or obligations unduly dependent upon non reviewable decisions; or
iv. contains matters which in the opinion of the Committee should properly be dealt with in an Act of the Legislative Assembly.

An analysis of the proposed regulatory change against each of these items follows.

Does the proposed regulatory change accord with the general objects of the Act under which it will be made?

The objects of this Act are to regulate buildings and building work, and for other purposes.

The proposed changes to the residential building work insurance settings align with the objects of the Act.

Does the proposed change trespass on rights previously established by law?

The proposed regulatory change does not unduly trespass on rights previously established by law and does not engage any rights in the *Human Rights Act 2004.*, All consumers who meet the requirements will be entitled to take out an insurance policy to cover their building project.

Will the proposed regulatory change include non-reviewable decisions?

No.

Will the proposed regulatory change include matters more properly dealt with in an Act of the Legislative Assembly?

This policy proposal supports the protection of home owners and the community, and addresses building safety and quality. These are policy objectives of the ACT Government, and consistent with the objectives of the Act and the Inquiry into Building Quality in the ACT.

The Act provides for the regulation of buildings and building work, and provides for regulations to be made by the responsible Minister.