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PERFORMANCE OF VICTORIA'S
DOMESTIC BUILDING INSURANCE
SCHEME 2008-2010

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EXECUTIVE SUMMARY

The Commission's task and approach

In Victoria, the domestic building insurance (DBI) scheme compensates home-owners for loss resulting from non-completion or defects in domestic building work. It is a compulsory, last resort scheme, which means that claims can only be made where the builder has died, disappeared or become insolvent.

The Commission released its first DBI performance report in 2009. That report provided information on the performance of the scheme since its commencement in 2002 until 30 June 2008.

In July 2010, the Minister for Finance asked the Commission to continue to monitor and report annually on the performance of the DBI scheme. This report covers the performance of the scheme between 1 July 2008 and 30 September 2010 based on data reported by the DBI industry.

Recent changes to the DBI market

There have been substantial changes to the structure of the DBI market over the last 18 months.

At the start of 2009, there were five private insurers actively participating in the Victorian DBI market. By January 2010, three of those insurers (CGU, Lumley and Vero) had announced their intention to withdraw from the market.

In response, the then Minister for Finance announced that the Victorian Government would take over the scheme. The Victorian Managed Insurance Authority (VMIA) was given responsibility for operating the scheme. As part of the transition to a state underwritten scheme, the VMIA entered into arrangements with QBE to issue cover to builders. The VMIA is the underwriter for these policies and will be responsible for managing any claims that arise. During the transition, the VMIA has adopted QBE's rate structure and commercial criteria, but is in the process of reviewing premium rates and risk assessment.

Currently, Calliden is the only private insurer still issuing DBI cover to builders. However, the other private insurers continue to manage claims as they arise and will continue to do so during the run-off period.¹

¹ During the run-off period insurers continue to manage and pay-out on the claims related to the cover that they previously issued.

It is important to note that no other changes have been made to the scheme. It continues to be funded by builder premiums and it remains a last resort scheme.

The transitional arrangements for moving to the new scheme have only been in effect since May 2010, therefore the data included in this report provides little insight into the impact of those arrangements, the performance of the VMIA or the management of claims by insurers that have left the market.

However, the data included in this report provides a basis for assessing the impact of the changes to the DBI market and the performance of the VMIA and other insurers over time.

Scheme performance

The Commission collected a range of eligibility, project certificate, premium and claims data from the insurers in the DBI market on a quarterly basis. Data on builder eligibility (a form of pre-approval for cover) and the use by insurers of financial securities to guarantee eligibility provides insights into the ability of builders to access DBI. Data on project certificates provides an indication of the size and composition of the market. The review of premiums and average premium rates over time provides insight into the affordability of insurance and the examination of historical claims data provides an indication of the scheme's financial viability.

In summary:

- There were just over 16 000 builders with eligibility as at 30 September 2010, compared to around 14 000 at the end of the December 2009. This suggests that access to DBI has not been affected by the recent changes in the insurance market. The number of builders with multiple eligibilities has fallen during this period, consistent with the withdrawal of private insurers from the market and does not suggest difficulties in accessing insurance.²
- The use of financial securities and indemnities has decreased. In the September 2010 quarter, 6 per cent of eligible builders required some form of security compared to 45 per cent in the June 2008 quarter. This can be explained by the withdrawal of Vero and Lumley which previously accounted for the majority of the required securities and indemnities.
- There was a reduction in the number of certificates issued to registered builders in the March 2010 quarter around the time private insurers were exiting the market. The steady increase in the June 2010 and September 2010 quarters suggests that the fall in certificates issued was a temporary outcome as builders transitioned from private insurers to the VMIA.
- Average premiums for registered builders increased 33 per cent from \$688 in the December 2008 quarter to \$833 in September 2010. Victoria's increase in

² Builders can have eligibility for DBI with more than one insurer.

premiums follows a similar trend to NSW where average premiums increased by around 47 per cent to \$1 269 in June 2010.³

- Claims have continued to develop. Overall, there have been 3 337 claims since the scheme commenced in 2002. Of these, 765 were notification only claims, 757 claims had liability denied and 180 claims were finalised for no cost.⁴ Of the remaining claims, 977 have been finalised and 658 remain open. The average claim size is around \$38 000 (\$38 500 for registered builders and \$23 500 for owner builders).⁵
- The majority of claims for registered builders relate to insolvency with few claims made for death or disappearance. The most common reasons for insurers denying liability were that the builder was not insolvent or that the problem was not deemed a defect.

The significant changes in the DBI market over the last 18 months have resulted in some volatility in the performance of the scheme. However, there is little evidence to suggest that the scheme is not performing. Builders continue to be able to access DBI and although average premiums have increased it is too early to form a view about the impact on premiums of insurers leaving the market. Future performance reports will continue to monitor the access, affordability and financial viability of the scheme.

Expanding the set of performance indicators

The Legislative Council Standing Committee into Builders Warranty Insurance observed in 2010 that the individual agencies involved in the DBI industry⁶ provide information about their own operations but do not seem to provide information on how many consumers move through different parts of the system or what happened to them.⁷

In the Commission's view, there is merit in broadening the scope of this report to include other aspects of the scheme from the customer's perspective including their experience of alternative dispute resolution.

³ Average premiums may not be directly comparable between states because the rates charged will reflect the mix of builders, different cover types and differences in the level of cover provided.

⁴ The number of claims has increased significantly from the Commission's previous report in part because of adjustments made by one insurer to claims data for the September 2007, December 2007 and March 2008 quarters.

⁵ A notification of a claim includes advice in writing where the information provided is less than required for assessment.

⁶ Including Victorian Civil and Administrative Tribunal, Building Commission and Building Advice and Conciliation Victoria.

⁷ Legislative Council Standing Committee on Finance and Public Administration 2010, Inquiry into Builders Warranty Insurance Final Report, October, p.65.

1.1 Background

The Essential Services Commission (the Commission) has been asked to report annually on the performance of the Victorian domestic building insurance (DBI) scheme.⁸ This report extends the Commission's previous analysis released in 2009, by including data for the period from 1 July 2008 to 30 September 2010.

1.2 Victoria's domestic building insurance scheme

The DBI scheme in Victoria is a compulsory 'last resort' insurance scheme that applies to domestic building work.⁹ The scheme provides compensation to home-owners for loss resulting from non-completion or defects in building work where they are unable to obtain redress from their builder because the builder is dead, has disappeared or is insolvent. It operates as a form of third party insurance as builders take out the insurance policy to protect home-owners.

The DBI scheme is underpinned by the *Domestic Building Contracts Act 1995* (DBCAs) and the *Building Act 1993* (Building Act). The DBCA precludes a builder from entering into a domestic building contract (valued at greater than \$12 000) without being registered under the Building Act. Under the Building Act, builders cannot be registered without being covered by insurance and owner builders cannot sell a building (within six years of completion) without DBI. The Domestic Building Ministerial Order sets out the detailed insurance requirements that registered builders and owner builders require.¹⁰

Key features of the DBI scheme include:

- Cover is capped at \$200 000 per contract, subject to a limit on non-completion claims of 20 per cent of the contract value.
- The period of coverage is two years for non-structural defects and six years for structural defects and non-completion.
- Multi-storey residential developments of more than three storeys and major claims in excess of \$10 million are excluded.

⁸ The terms of reference were received from the Minister for Finance, WorkCover and the Transport Accident Commission in July 2010 under section 10(g) of the *Essential Services Commission Act 2001* (see appendix A).

⁹ Victoria's DBI scheme is considered to be 'last resort' as owners can only make a claim if the builder is dead, has disappeared or is insolvent.

¹⁰ Published as Special Gazette No. S 98, Friday 23 May 2003.

- Owner builders need only take out insurance if the house is sold within six years of completion.

The scheme is one part of a broader consumer protection framework for the domestic building industry. The broader framework includes a builder registration system, regulation of domestic building contracts and assistance for consumers involved in disputes through Building Advice and Conciliation Victoria (BACV) and the Victorian Civil and Administrative Tribunal (VCAT).

1.2.1 Recent changes to the DBI market in Victoria

During the reporting period there have been major changes to the structure and operation of the DBI market in Victoria. These changes affected the Commission's ability to collect and follow up data with insurers and need to be considered when interpreting the data and assessing scheme performance.

At the start of 2009, there were five insurers in the market offering DBI policies. These insurers were CGU, Lumley, Vero, Calliden and QBE. On 1 December 2009, CGU withdrew from the DBI market, followed by Lumley in January 2010 and Vero in June 2010.

Following the withdrawal of these insurers on 29 March 2010, the Victorian Government announced that it would takeover DBI to remove uncertainty and ensure consumers and builders had access to affordable DBI.¹¹ Under the new arrangements the scheme continues to be funded by builder premiums. Other aspects of the scheme, including its 'last resort' nature, remain unchanged.

Responsibility for administering the new scheme was given to the Victorian Managed Insurance Authority (VMIA), the statutory agency that provides risk management and insurance services to the Victorian Government.¹²

As part of the transition to a state-underwritten DBI scheme, VMIA has entered into an agreement with QBE Insurance (Australia) Limited, under which QBE issues cover to builders but the VMIA underwrites the policies and accepts liability. Consistent with the Government's decision, the VMIA will manage any claims arising from these policies. The arrangement between the VMIA and QBE applies to cover issued from 31 May 2010 and will run until June 2011. Currently the VMIA is using QBE's rate structure and commercial criteria, but is in the process of reviewing premiums and other arrangements.

As the private insurers exited the market, there was a transition period where builders covered by exiting insurers had to transfer to the VMIA through QBE or to other private insurers remaining in the market.

¹¹ Minister for Finance, 'Government to takeover domestic building insurance', *Media Release*, 29 March 2010.

¹² To facilitate this, the then Minister for Finance, WorkCover and the Transport Accident Commission issued a Direction under the *Victorian Managed Insurance Authority Act 1996* to allow it to undertake this new function, and the *Building Act 1993* was amended to specify the VMIA as a designated insurer for the purposes of that Act.

There will also be a run-off period during which policies issued by insurers prior to their exit from the market will continue to be valid during the coverage period. During this run-off period, these insurers will be responsible for managing any claims made on these policies.

There are currently two active insurers in the market, the VMIA and Calliden. Following the announcement of the new government underwritten scheme, Calliden advised its intention to withdraw from the Victorian DBI market on 31 March 2011. However, on 14 December 2010, Calliden announced it would continue to remain active in the Victorian DBI market, given that the market had now stabilised.¹³

The withdrawal of private insurers has not been unique to Victoria. In NSW, the Government responded to insurer departures by announcing it would start underwriting the state's mandatory last resort scheme. The NSW Self Insurance Corporation (trading as NSW Home Warranty Insurance Fund) took over as the sole provider of home warranty insurance from 1 July 2010. QBE and Calliden were appointed as insurance agents of the NSW Self Insurance Corporation, through a contractual arrangement. A new premium structure was implemented for certificates of insurance issued from 1 October 2010.

1.3 The Commission's approach

This report extends the Commission's previous analysis released in 2009 by including data from 1 July 2008 to 30 September 2010. The approach adopted by the Commission to prepare this report is similar to the approach used in its 2009 DBI review, which reported data for the period 1 July 2002 to 30 June 2008.¹⁴

The terms of reference require the Commission to look at:

- pricing and claims management of the VMIA¹⁵
- pricing of private insurers that offered DBI during the reporting period and
- private insurers' DBI claims management.

The data reported reflects the changes that have taken place in the market including the exit of four private insurers and the entry of the VMIA.¹⁶ The purpose of this report is to provide information about the performance of the DBI scheme as it transitions to a new market structure, enable comparisons over time with other jurisdictions and to help inform the Government's consideration of DBI policy.

¹³ 14 December 2010, Media Release, Calliden to continue to support Victorian Domestic Builders Insurance Market.

¹⁴ The data collection for the Commission's 2009 review was based on the templates and database developed by the NSW Office of Fair Trading (OFT), with minor amendments made to reflect the Victorian context.

¹⁵ VMIA only started writing policies in June 2010, it is too early to perform meaningful analysis on the data provided so far. This will be the focus of future reports.

¹⁶ Due to this arrangement with the VMIA, QBE effectively withdrew from the market as all policies it issues are underwritten by the VMIA.

This report builds upon the previous analysis, collecting quarterly data on a range of indicators including the number of eligible builders, project certificates issued, premium levels, and the number and value of claims received and processed. The data collected has enabled the Commission to comment on a number of aspects of the DBI scheme's performance including:

- the accessibility of the scheme to builders
- the size, composition and growth of the DBI market
- the affordability and financial performance (profitability) of the DBI market and
- the degree to which any distortions, due to recent transitional arrangements, may be occurring in the market.

In preparing this report, the Commission has collected data from CGU, Lumley, Vero, Calliden, QBE and the VMIA and has also liaised with those insurers to verify the accuracy of the data provided.¹⁷

In summary, insurers were asked to provide the following data on a quarterly basis including:

- Eligibility data — builder registration numbers, turnover and type of cover, security type and value, date of application and date of approval.
- Policy data — type of cover, number and value of project certificates, written premiums.
- Claims data — date of notification and loss, date of finalisation, claims status, liability status, claims payments and case estimates.

Most of the insurers were able to meet the Commission's data requests up to the September 2010 quarter as illustrated by table 1.1. Insurers who left the market were still required to provide quarterly data regarding run-off claims and project certificates in force. In addition to the data indicated in table 1.1, this report uses data previously collected by the Commission for its 2009 review of DBI.

For the 2009 performance report, QBE and Australian Unity were unable to provide quarterly project certificate data for periods prior to 2008, instead providing cumulative annual data. Where quarterly analysis was necessary, data has been averaged or interpolated to approximate quarterly numbers. Data from Australian Unity was collected for the 2009 report and has been included in the historical tables where relevant. Australian Unity wrote only owner builder business and was acquired by Calliden in late 2007. Calliden has only provided summaries of Australian Unity claims, due to the fact that the majority of the files are archived and would need to be retrieved and manually checked, to submit in the required template format. Due to the small number of owner builder policies and claims we have incorporated this summary data, although we note that it has limited the analysis of owner builder claims for the purposes of this report.

VMIA was only required to provide data for the June 2010 and September 2010 quarters, given it only entered the market in May 2010. Project certificate data was

¹⁷ Calliden also provided data on eligibilities and claims for Australian Unity.

collected and provided through QBE and VMIA had not recorded any claims up to September 2010.

Table 1.1 **Overview of data provided by insurers**

	2008	2009	2010
Eligibilities as at			
Vero	✓	✓	✓
Australian Unity	na	na	na
Lumley	✓ ^a	✓ ^b	na
CGU	✓	✓	na
QBE	✓	✓	✓
Calliden	✓ ^a	✓	✓
VMIA	na	na	✓ ^c
Projects certificates issued			
Vero	✓	✓	✓
Australian Unity	na	na	na
Lumley	✓	✓	na
CGU	✓	✓	✓
QBE	✓	✓	✓
Calliden	✓	✓	✓
VMIA	na	na	✓ ^c
Claims as at			
Vero	✓	✓	✓
Australian Unity	✓	✓	✓
Lumley	✓ ^a	✓ ^b	✓
CGU	✓	✓	✓
QBE	✓	✓	✓
Calliden	✓	✓	✓
VMIA	na	na	✓ ^c

Note: Insurers were required to provide data on a quarterly basis. ^a Cumulative data provided for the June quarter. ^b Cumulative data provided for the December quarter. ^c Data provided for the June and September quarters was provided and is included in the QBE data. **na** Not applicable. **np** Not provided.

1.3.1 Limitations of the data

Caution needs to be taken in interpreting and drawing conclusions from the data reported. The last resort DBI scheme has only been in place since 2002 and given the 'long-tail' nature of DBI it is difficult to draw definitive conclusions about the

performance of the scheme based on the data that is currently available. The long-tail nature of DBI creates uncertainty because:

- there may be a significant delay between the date a project certificate is issued and the commencement of the project
- the duration of building projects will vary
- coverage remains in place for six years after completion of the project and
- it may take time for owners to identify a loss, lodge a claim with an insurer and for the insurer to assess and otherwise accept or reject the claim.

It is also important to note that the information provided relates only to claims that have been notified to insurers. It does not include claims that have yet to be reported to insurers or reflect any provisions that individual insurers might have in their financial accounts.

The financial performance of the DBI scheme can only be assessed by comparing the premiums collected by insurers with all the relevant costs incurred over the life of DBI cover. The ultimate liability associated with any claim is subject to the outcomes of events that could occur at any time over the period of coverage, for example the likelihood of an insured loss occurring, the likelihood of the builder dying, disappearing or becoming insolvent, the propensity of a claimant to make a claim and the size of the claim.

The Commission has relied on the accuracy and completeness of the data supplied by insurers. Other than the inbuilt data validation checks, the data has not been independently verified or audited. However, it has been reviewed for general reasonableness and consistency and actuarial consultants were engaged to assist in assessing the data. Where possible, the Commission has attempted to verify the data provided by the insurers by comparing it to publicly available information (collected by agencies such as the Building Commission and the Australian Bureau of Statistics).

1.4 Overview of the report

Chapter 2 of this report sets out the data and observations related to builder eligibility and outlines the ability of builders to access DBI. Chapter 3 discusses the number and value of project certificates showing the size and composition of the DBI market. Chapter 4 highlights how total written premium, average premium and premium rates have changed over time. Chapter 5 sets out the trends and observations on insurer claims experience showing how insurers are fulfilling their obligations to consumers and generally how the scheme is performing. Appendix A sets out the terms of reference.

2 BUILDER ELIGIBILITY

In order to be registered as a domestic builder in Victoria, a builder must have established eligibility for DBI cover except where the builder is granted a limited registration for projects with values less than (or equal to) \$12 000.

Eligibility is a form of pre-approval for the issue of a project certificate.¹⁸ Builders can hold eligibility with more than one insurer. Data on builder eligibility and the use of financial securities provides an indication of the ability of builders to access DBI. Without DBI, builders are unable to obtain registration and this may have implications for the supply of builders.

Insurers' enforcement of financial conditions, in the form of securities or indemnities, on builders can impact their ability to access insurance. This may be of particular concern to new builders who may lack the necessary financial credentials to obtain DBI.

With recent changes to the market there may have been concerns about the ability of builders to access DBI.

To determine if access to insurance has been restricted in the lead up and during the recent transition period, the Commission asked insurers to provide a range of quarterly data on eligibility including information on turnover bands and financial securities. Data was provided by all insurers up until September 2010.

The Victorian eligibility data provided by insurers indicates that the recent withdrawal of insurers from the market does not appear to have had a lasting impact on the ability of builders to obtain DBI.

2.1 Access to insurance

From 31 May 2010, the VMIA commenced underwriting DBI in agreement with QBE. For at least the first 12 months of this arrangement, builders who held eligibility with an insurer automatically qualified for eligibility with the VMIA.

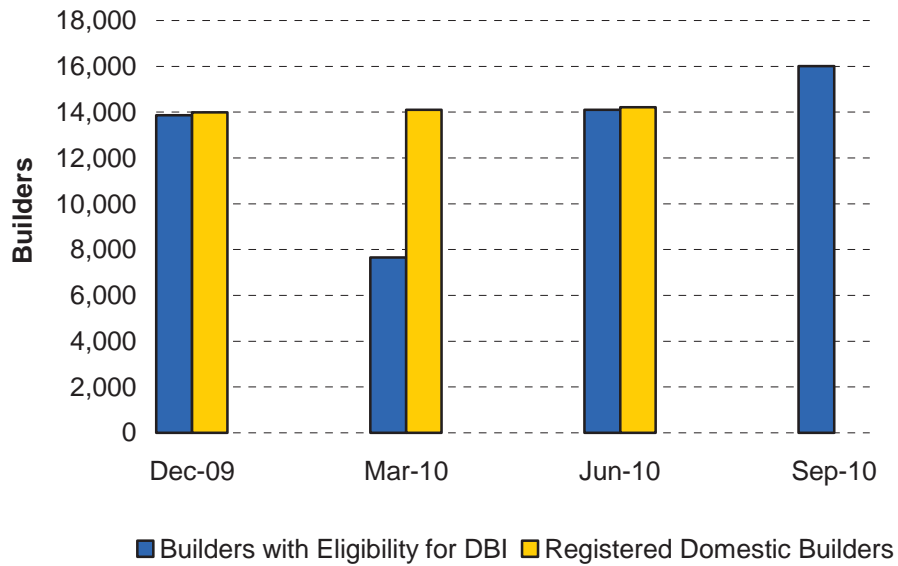
DBI availability can be assessed by comparing the number of registered builders in Victoria to those that have established eligibility with the insurers.¹⁹ Data collected from insurers shows that over 99 per cent of builders had established eligibility for DBI coverage at the end of the June 2010 quarter. Figure 2.1 shows that the number of builders with eligibility decreased in the March quarter following the

¹⁸ A project certificate is issued before building commences and is evidence of the DBI contract.

¹⁹ Based on Building Commission Data, pulse^o (an online reporting tool on the Victorian building industry), June 2010

departure of CGU and Lumley. This decrease could be due to the 'snap shot' nature of the data provided by insurers and reflect delays in processing applications.

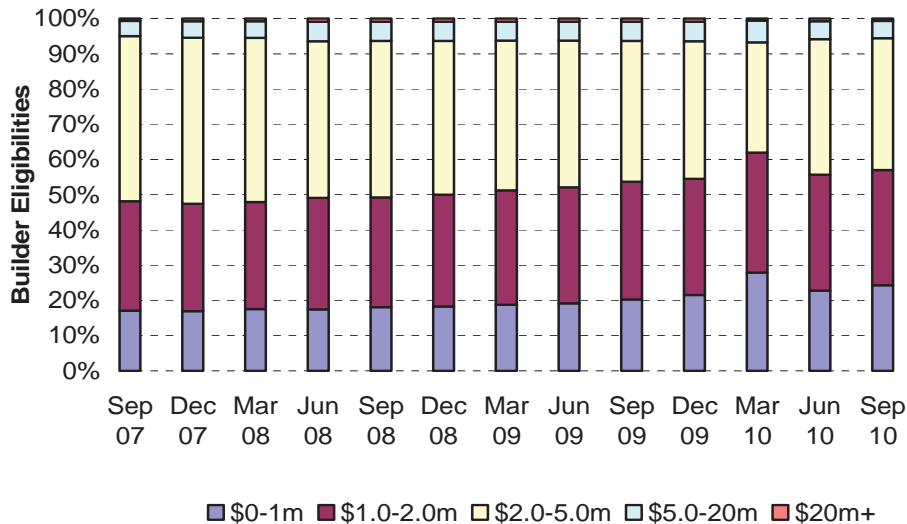
Figure 2.1 **Builders eligibility for DBI**



Source: Building Commission pulse° (an online reporting tool on the Victorian building industry), June 2010.

Figure 2.2 shows the percentage of eligibilities over time by builder turnover band. At 30 September 2010, smaller builders with a turnover of \$2 million or less accounted for 57 per cent of all builder eligibilities. This suggests a significant number of smaller builders have been able to access DBI during the transition period.

Figure 2.2 Eligibility by turnover band



The total number of eligible builders was over 16 000, with no builders having multiple eligibilities. This is consistent with the transition to only two insurers in the market.

2.2 Securities and indemnities

In some circumstances, insurers may require a security or indemnity of some form before granting eligibility to a builder. Insurers were asked to provide information on their use of bank guarantees, indemnities, other securities and multiple securities. Indemnities are the most common form of security required by insurers.

The use of financial securities and indemnities has decreased significantly from June 2008 where 45 per cent of eligible builders in Victoria required some form of security or indemnity to 33 per cent in December 2009. In September 2010 that figure dropped further to 6 per cent. This reflects the withdrawal of two major insurers, Vero and Lumley, which accounted for the majority of required securities and indemnities (see table 2.1).

In comparison, historically the proportion of NSW builders requiring some sort of financial security or indemnity has been much lower than in Victoria. It appears all

insurers required more securities in Victoria than in NSW. The reasons for this historical difference are not obvious considering the same insurers operated in both markets. It is possible a higher level of regulatory oversight in NSW has meant that insurers were able to relax their requirements for financial securities from builders operating in NSW. The large disparity in securities and indemnities between Victoria and NSW appears to have diminished in 2010 while both states have gone through the transition.

Table 2.1 **Securities and indemnities**
Victoria compared to NSW

	<i>Bank guarantee</i>	<i>Indemnity</i>	<i>Other security</i>	<i>Multiple securities</i>	<i>Total securities</i>	<i>Total builder eligibilities</i>	<i>Builder eligibilities (%)</i>
<i>Victoria</i>							
Jun-08	747	4,239	96	129	5,211	11,703	45%
Dec-09	746	4,542	32	43	5,363	16,202	33%
Jun-10	2	900	0	0	902	13,681	7%
Sep-10	2	959	0	0	961	16,008	6%
<i>NSW</i>							
Jun-08	139	1,381	1	120	1,641	17,339	9%
Dec-09	136	1,184	0	53	1,373	16,346	8%
Mar-10	23	539	0	11	573	16,900	3%
Jun-10	22	606	0	11	639	17,398	4%

^a Data for the NSW scheme is only available up to June 2010.

Source: Office of Fair Trading NSW. NSW Home Warranty Insurance Scheme 30 June 2010.

3 PROJECT CERTIFICATES

Insurers issue a project certificate to registered builders before building work commences as evidence of the DBI contract.

Owner builders are only required to take out DBI if they have carried out building work via issue of a building permit.²⁰ An insurance policy is required if the building is sold within six years of completion and becomes effective from the date the property is sold. They are required to apply for a building permit to undertake domestic building work valued at more than \$12 000 on their land and a limit of one is allowed in any three year period.

Project certificates and policies are classified by the type of project being undertaken, and include new single dwellings, new multi dwellings of three storeys or less, alterations and additions, renovations and swimming pools.

Analysis of project certificates and policies issued by insurers provides information about the size and the composition of the DBI market.

The Commission asked insurers to provide information on the number and value of project certificates and policies issued during each quarter for the period 30 June 2008 to September 2010.²¹

3.1 Number of project certificates and policies — registered builder and owner builder

Figure 3.1 shows by quarter the total number of registered builder project certificates and owner builder policies and how this has changed over time. Table 3.1 shows the number of project certificates and policies issued annually by type.

After remaining relatively stable to 2008, the number of project certificates increased in 2009, with a greater proportion of new dwelling projects. This is consistent with the impact of the boost in the First Home Owner Grant during this period.

²⁰ An owner builder is a person who carries out domestic building work on their own land and who is not in the business of building. From 14 June 2005, amendments to the *Building Act 2004* introduced new requirements relating to the activities of owner builders. The legislation requires an owner builder who is undertaking domestic building work to obtain a Certificate of Consent from the Building Practitioners' Board prior to obtaining a building permit.

²¹ For owner builders a DBI contract is referred to as a policy.

Owner builders do not represent a significant segment of the DBI market and accounted for only 4 per cent of all projects during 2010.

For owner builders the data shows a decline in the number of policies issued for alterations/additions and for multi dwellings, with new single dwellings and renovations remaining relatively stable. In the year to September 2010 there were 2 135 policies issued. In the full year of 2009 there were 2 980 policies issued, a slight decrease of 2.8 per cent from the 2008 calendar year.

Figure 3.1 **Project certificates and policies issued per quarter – registered builder and owner builder**

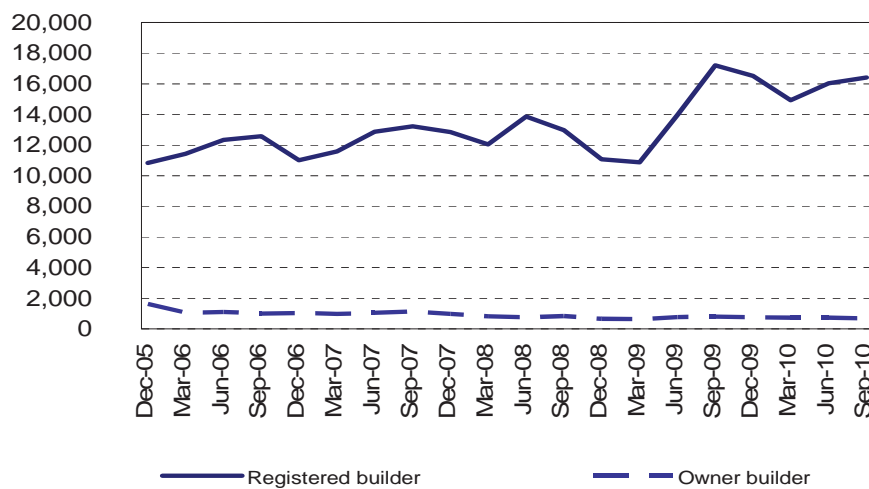


Table 3.1 **Project certificates and policies issued annually by type – registered builder and owner builder**

	New single dwelling	New multi dwelling (≤ 3 storeys) ^a	Alterations/additions ^b	Swimming pools	Renovations ^c	Other	Total
Registered Builder							
2006	23,401	6,283	10,125	3,273	3,887	368	47,337
2007	26,715	5,411	10,832	3,327	3,952	271	50,508
2008	27,702	4,162	9,377	4,113	4,301	291	49,946
2009	36,212	4,168	9,681	3,865	4,298	301	58,525
2010 ^d	27,876	3,377	9,987	2,474	1,952	1,695	47,361
Owner Builder							
2006	1,313	71	2,706	14	66	16	4,186
2007	1,214	34	2,792	24	63	3	4,130
2008	1,605	0	1,361	46	49	4	3,065
2009	1,463	2	1,452	50	10	3	2,980
2010 ^d	1,009	0	1,090	32	4	0	2,135

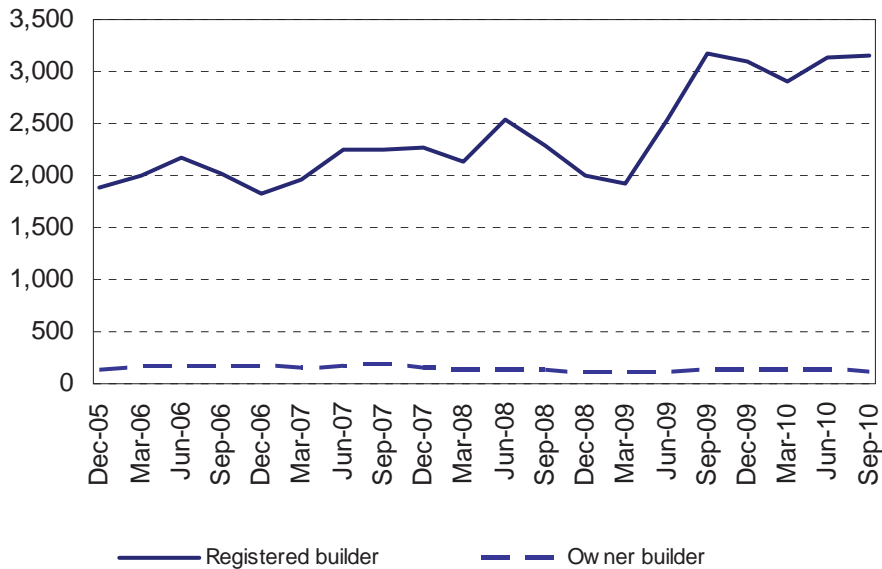
^a Includes units, duplexes and villas. ^b Majority of work is structural. ^c Majority of the work is non-structural, e.g. kitchens and bathrooms. ^d Nine months from 1 January 2010 to 30 September 2010.

3.2 Value of project certificates and policies — registered builder and owner builder

Figure 3.2 sets out the value of project certificates and policies issued per quarter and table 3.2 shows a breakdown of project certificates and policies issued by type on an annual basis.

The value of registered builder project certificates has grown by approximately 67 per cent since December 2005, averaging annual growth of 11 per cent, reflecting the growth in the number of certificates over this period.²²

Figure 3.2 **Value of project certificates and policies issued per quarter - registered builder and owner builder**
\$million



The total value of all owner builder policies issued during the nine months to September 2010 was \$371 million (see table 3.2). By contrast the total value of all registered builder project certificates for the same period was approximately \$918.6 million.

²² The increase is consistent with the introduction of the First Home Owner Boost.

Table 3.2 **Value of project certificates and policies issued annually — registered builder and owner builder**
\$million

	New single dwelling	New multi dwelling (≤ 3 storeys) ^a	Alterations/additions ^b	Swimming pools	Renovations ^c	Other	Total
Registered Builder							
2006	5,315	1,086	1,334	134	136	29	8,035
2007	6,081	937	1,410	142	145	18	8,733
2008	6,554	835	1,178	185	181	21	8,954
2009	8,307	820	1,200	172	190	29	10,718
2010 ^d	6,854	704	1,127	119	59	323	9,186
Owner Builder							
2006	247	13	415	1	7	1	684
2007	249	7	419	1	6	0	682
2008	387	0	128	1	5	0	522
2009	353	1	128	2	1	0	484
2010 ^d	257	0	113	1	0	0	371

^a Includes units, duplexes and villas. ^b Majority of work is structural. ^c Majority of the work is non-structural, e.g. kitchens and bathrooms. ^d Nine months from 1 Jan 2010 to 30 Sep 2010.

3.3 Average value of project certificates and policies — registered builder and owner builder

Table 3.3 shows the average value of registered builder project certificates and owner builder policies. From 2006 to the September 2010 quarter the average value of project certificates increased by approximately 10 per cent with the average value being \$192 000 at 30 September 2010.

The average value of owner builder projects to 30 September 2010 was \$174 000, which was approximately 10 per cent lower than for registered builders.

The difference in average value between owner builder and registered builder projects is mainly due to a different mix of cover types, with owner builders undertaking more alterations/additions and fewer new dwellings. Owner builders rarely undertake swimming pools or multi dwelling projects.

Table 3.3 **Average value of project certificates by type of cover
— registered builder and owner builder**
\$000

	New single dwelling	New multi dwelling (≤ 3 storeys) ^a	Alterations/additions ^b	Swimming pools	Renovations ^c	Other	Total
Registered Builder							
2006	227	173	132	41	35	80	170
2007	228	173	130	43	37	65	173
2008	237	201	126	45	42	71	179
2009	229	197	124	45	44	96	183
2010 ^d	246	208	113	48	30	191	194
Owner Builder							
2006	188	187	154	55	103	93	163
2007	205	194	150	32	94	60	165
2008	241	0	94	32	99	91	170
2009	242	320	88	31	54	14	162
2010 ^d	254	0	104	34	44	0	174

^a Includes units, duplexes and villas. ^b Majority of work is structural. ^c Majority of the work is non-structural, e.g. kitchens and bathrooms. ^d Nine Months from 1 Jan 2010 to 30 Sep 2010.

3.4 Project certificates and policies issued compared with new dwelling approvals — ABS data

Figure 3.4 sets out the number of project certificates and policies issued (new dwellings three storeys or less) in each quarter compared to Australian Bureau of Statistics (ABS) data on total new residential building approvals in Victoria (excluding flats, units and apartments with 4 or more storeys).

The number of project certificates and policies issued generally reflects the seasonality of the industry, with a smaller number of certificates issued in the December and March quarters relative to the June and September quarters. Although seasonal, the number of builder project certificates issued has been relatively stable over the past two years and is broadly consistent with ABS data on new dwelling approvals.²³

The number of DBI project certificates and policies issued over the period from December 2005 to September 2010 has averaged approximately 92 per cent of the number of all new dwelling approvals in Victoria.

²³ The ABS data on dwelling approvals is compiled from permits issued by local government authorities and other principal certifying authorities, contracts let or day labour work authorised by Commonwealth, state, semi-government and local government authorities and major building approvals in areas not subject to normal administrative approval. ABS 8731.0 Building Approvals, Australia, Table 23. Dwelling Units Approved in New Residential Buildings, Number and Value, Original - Victoria.

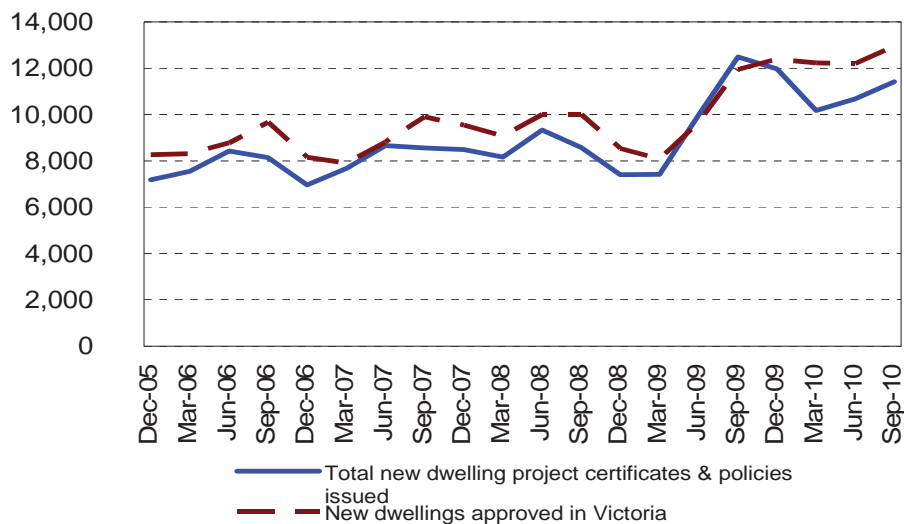
An average of less than 100 per cent is consistent with expectations because the ABS data includes semi-detached dwellings with four or more storeys and building approvals for works under \$12 000, for which DBI cover is not required.

In the second half of 2009 there was a large increase in the number of certificates issued, which corresponded with an increase in the number of new dwellings approved in Victoria. This could be partially attributable to the First Home Owner Boost Scheme.²⁴

From the December 2009 quarter to the March 2010 quarter there was a 15 per cent decline in the number of project certificates issued which may reflect the withdrawal of insurers in late 2009. At this time there may have been some uncertainty in the market that could have led to delays in processing and approval of certificates.

The number of certificates has since increased through to the September 2010 quarter.

Figure 3.4 **New dwelling approvals in Victoria**



Source: ABS 8731.0 Building Approvals, Australia, Table 23. Dwelling Units Approved in New Residential Buildings, Number and Value, Original — Victoria. Includes houses, semi-detached dwellings, and units/apartments ≤ 3 storeys.

²⁴ First Home Owner Boost applied to contracts entered into between 14 October 2008 and 31 December 2009 (inclusive). For owner builders, construction must have commenced between those dates. Under the boost first home buyers purchasing or building a new home were entitled to: \$14,000 - for contracts entered into between 14 October 2008 and 30 September 2009; \$7000 - for contracts entered into between 1 October 2009 and 31 December 2009. This amount was in addition to the existing First Home Owner Grant, the First Home Bonus and the First Home Owner Regional Bonus.

4 | PREMIUMS

The recent reforms to Victoria's DBI scheme were aimed at ensuring continuity and stability in the market.²⁵ A review of key indicators such as total written premium, average premium values and average premium rate, provide some indication of the stability of the scheme over time.

The data presented below indicates that premiums have been relatively stable throughout the transition period. This is consistent with the VMIA adopting QBE's rate structure and eligibility criteria.²⁶ The VMIA is introducing a new rate structure from July 2011.

4.1 Total written premium

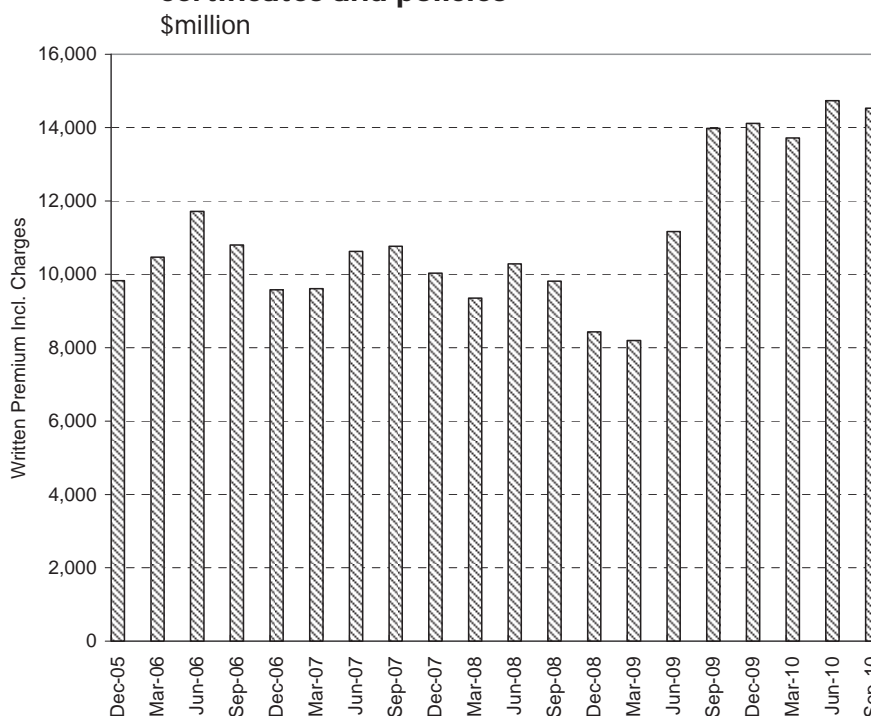
Total written premium data provides an indication of the size of the DBI market for both registered builder and owner builder projects.

The data shows that \$14.5 million worth of project certificates and policies was written in the September 2010 quarter. Total written premiums increased substantially in 2009 and remained relatively stable in 2010 consistent with the levels of residential construction during the period (see figure 4.1).

²⁵ Minister for Finance, Victoria 'Government to take over domestic building insurance', Media release, 29 March 2010.

²⁶ VMIA Media Release 31 May 2010, VMIA reaches agreement with QBE to deliver domestic building insurance.

Figure 4.1 **Total written premium including charges – project certificates and policies**



For the December 2009 quarter, the amount of total written premiums including charges for registered builder project certificates issued was \$13.2 million up 1.6 per cent from the previous quarter and 73 per cent from December 2008 (see figure 4.2).²⁷ The trend in written premiums follows the trend in project certificates issued.

From the beginning of 2010 and up to September 2010, the amount of total written premiums for registered builders including charges was fairly stable at around \$13.7 million per quarter (see figure 4.2).

In September 2010, owner builder policies accounted for approximately 6 per cent of total written premiums and only 4 per cent of project certificates and policies issued reflecting the higher premiums paid on average.

Figure 4.3 shows the total amount of written premiums for policies issued to owner builders, including charges. For the September 2010 quarter the total amount of written premiums including charges was \$864 000, this was 15 per cent lower than the September 2009 quarter.

²⁷ Premium including charges represents the full amount paid including statutory charges.

Figure 4.2 **Total written premium for project certificates issued — registered builder**
\$million

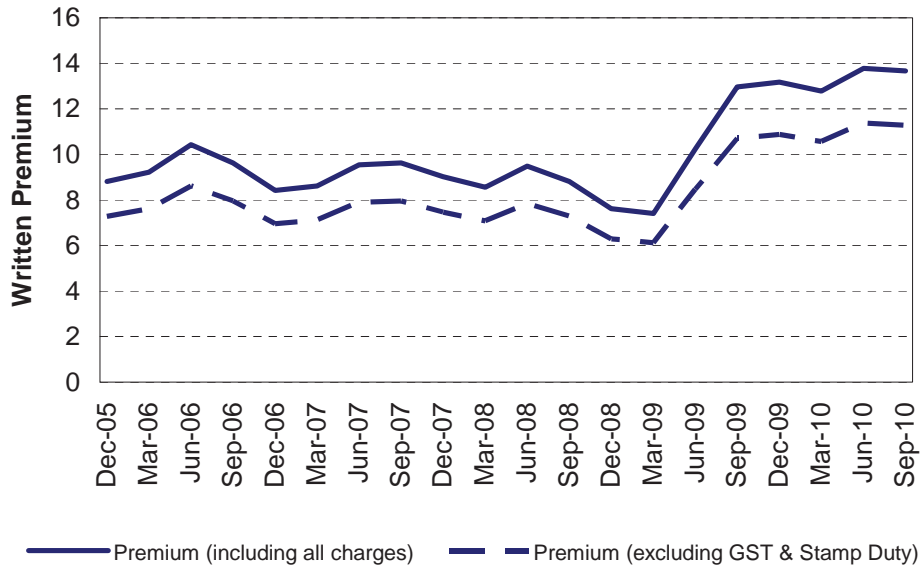
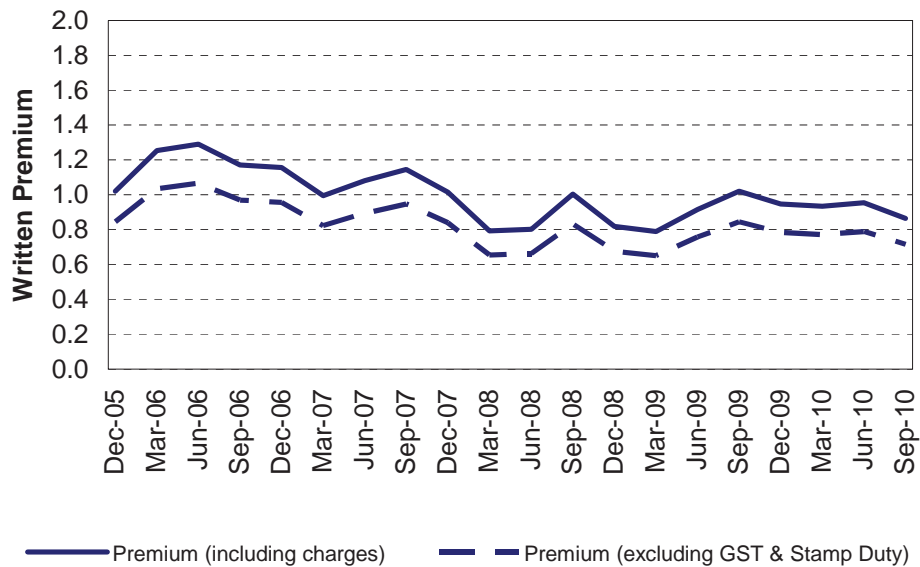


Figure 4.3 **Total written premium for policies issued — owner builder**
\$million

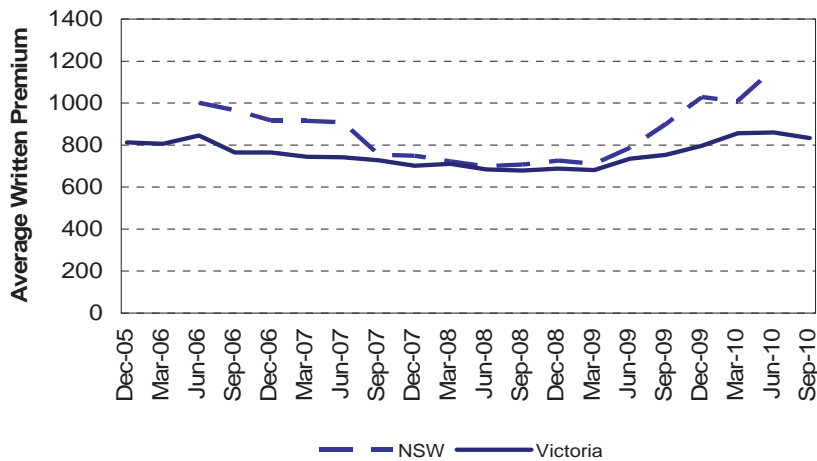


4.2 Average premium

Historical average premiums show the degree to which premiums issued have changed over time and provides a measure as to the continuing affordability of the DBI scheme. Average premiums will be influenced by the number and type of projects being undertaken.

The data provided by insurers suggests that after a steady period of decline to March 2009, average premiums for registered builders increased by 26 per cent to be just under \$860 in March 2010. Average premiums were then stable in June 2010 before decreasing by 3 per cent in September 2010 to an average of \$833 per project (see figure 4.4).

Figure 4.4 **Average premiums (including charges) — registered builder**
\$ of the day



Note: Data for the NSW scheme is only available up to June 2010.

Source: Office of Fair Trading NSW. NSW Home Warranty Insurance Scheme 30 June 2010

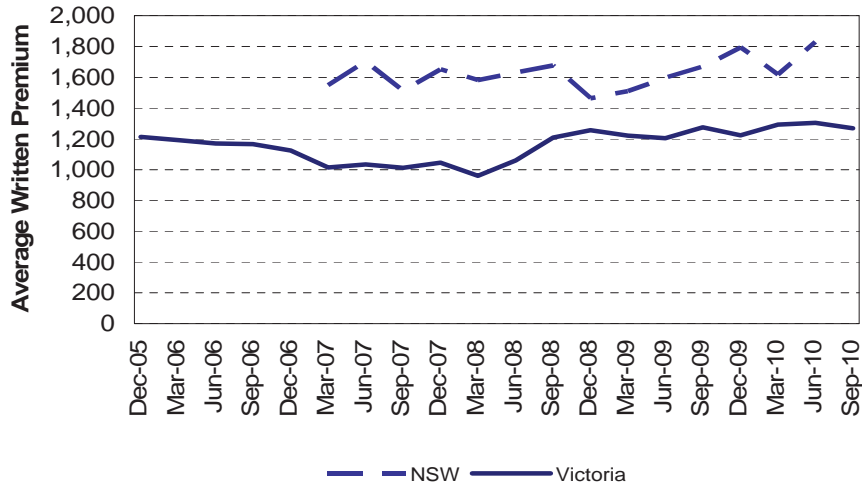
For owner builders, average premiums were \$1 269 in the September 2010 quarter, having increased by 20 per cent since June 2008 (see figure 4.5).

In 2010, both Victoria and NSW transitioned from private market provision of DBI to a state underwritten scheme.²⁸ Contrasting the Victorian experience with NSW, the latest available data shows average registered builder premiums in NSW have increased approximately 47 per cent to be \$1 163 in June 2010 compared to the June 2009 quarter.²⁹ Also, for owner builders, the average premium in NSW was \$1 829 as at 30 June 2010, 15 per cent higher than the same period in 2009.

²⁸ NSW Government Fair Trading, Report: NSW Home Warranty Insurance Scheme, Information on the scheme 30 June 2010.

²⁹ Average premiums may not be easily compared between states in this manner as rates charged will reflect the mix of builders by different cover types and level of cover.

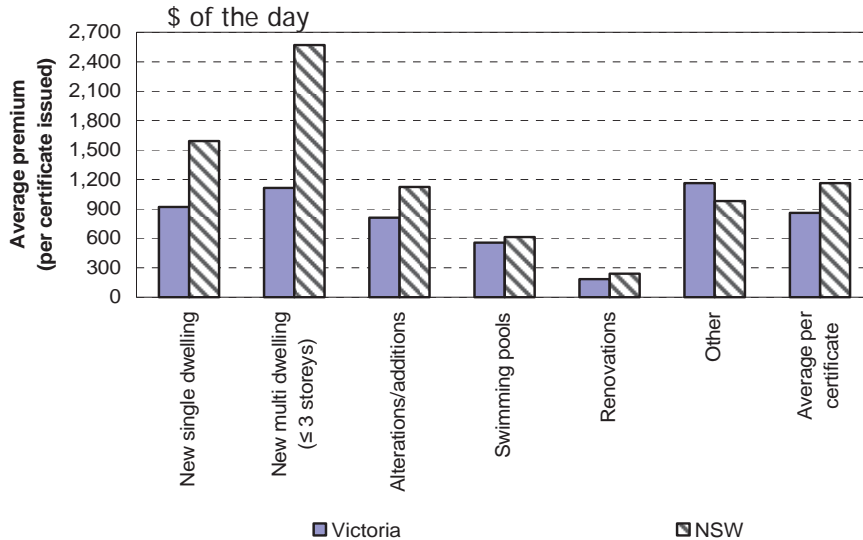
Figure 4.5 **Average premiums (including charges) – owner builder**
\$ of the day



Note Data for the NSW scheme is only available up to June 2010.
Source :Office of Fair Trading NSW. NSW Home Warranty Insurance Scheme 30 June 2010.

Comparing Victorian registered builder average premiums by project type with those from NSW, as at 30 June 2010 (the most recent NSW report), average premiums for new dwellings are significantly lower in Victoria (see figure 4.6).

Figure 4.6 **Average premiums by cover type (including charges) – registered builder – June 2010**



Note: Data for the NSW scheme is only available up to June 2010.
Source: Office of Fair Trading NSW. NSW Home Warranty Insurance Scheme 30 June 2010.

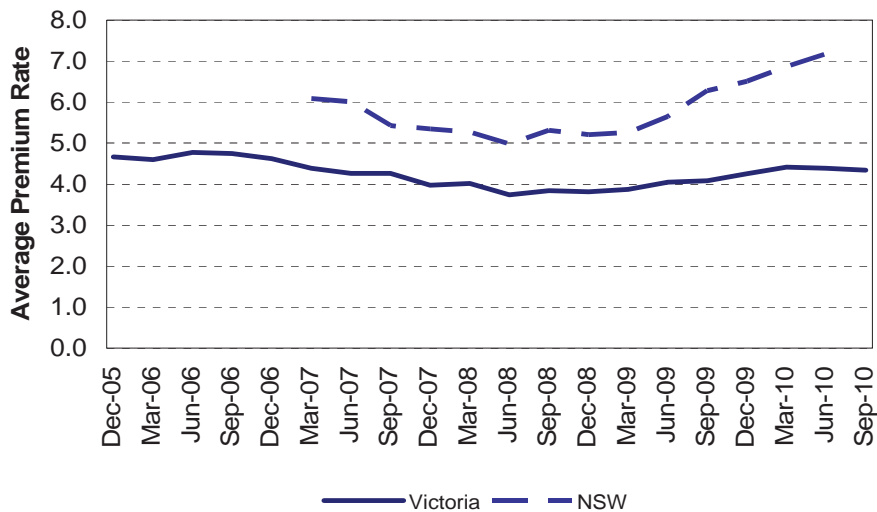
4.3 Premium rates

Premium rates are expressed as average premiums per \$1000 of project value. The premium rate can be used to adjust for differences in premiums that are due to differences in the value of projects.

In comparison with the latest NSW data for registered builder projects, the average Victorian premium rate for the June 2010 quarter of \$4.40 was approximately 39 per cent lower than the NSW rate of \$7.18 (see figure 4.7).³⁰

The most recent data for Victoria shows that for the September 2010 quarter, the premium rate had decreased slightly to \$4.34.

Figure 4.7 **Average premiums rates (including charges) — registered builder**
Per \$000 of project value (\$ of the day)



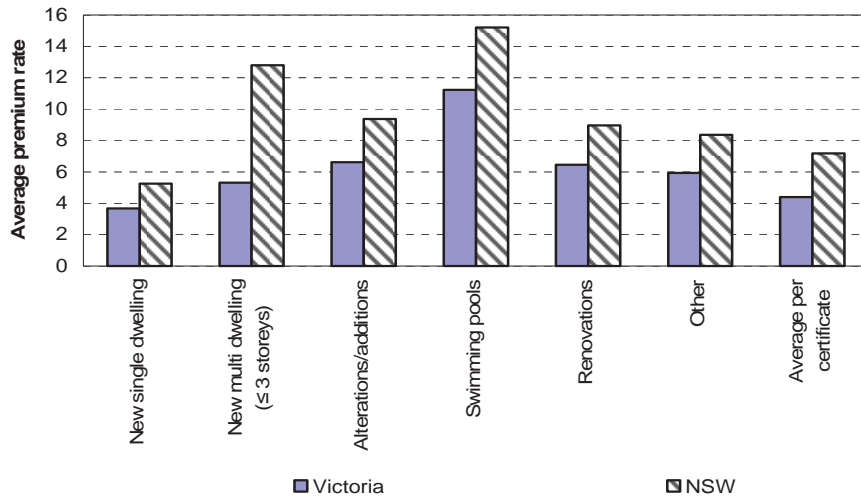
Note: Data for the NSW scheme is only available up to June 2010.

Source: Office of Fair Trading NSW. NSW Home Warranty Insurance Scheme 30 June 2010.

³⁰ NSW Government Fair Trading, Report: NSW Home Warranty Insurance Scheme, Information on the scheme 31 March 2010.

Figure 4.8 shows the differences in registered builder premium rates between states. Comparing the most recent NSW data (June 2010) to the Victorian June 2010 quarter, rates in Victoria were lower for all types.³¹

Figure 4.8 **Average premiums rates by project type – registered builder**
per \$000 of project value (\$ of the day) – June 2010



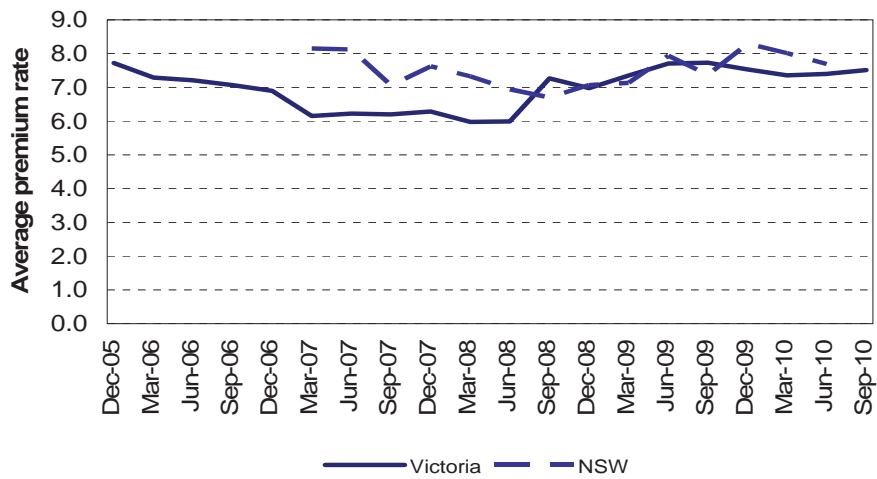
Note: Data for the NSW scheme is only available up to June 2010.

Source: Office of Fair Trading NSW. NSW Home Warranty Insurance Scheme 30 June 2010.

³¹ NSW Government Fair Trading, Report: NSW Home Warranty Insurance Scheme, Information on the scheme 30 June 2010.

Owner builder premium rates (expressed in dollars per \$1000 of project value) have increased by 25 per cent since the June 2008 quarter, as shown in figure 4.9.

Figure 4.9 **Average premium rates (including charges) – owner builder**
per \$000 of project value (\$ of the day)



Note: Data for NSW scheme only available up to June 2010.

Source: Office of Fair Trading NSW. NSW Home Warranty Insurance Scheme 30 June 2010.

In Victoria, a claim can only be made for DBI once a trigger is activated. That is, a home-owner with a home that is not completed or has structural or non-structural defects can make a claim for monetary compensation from their insurer where their builder is found to be either disappeared, dead or insolvent. This is subject to the claim being made in certain time limits and circumstances.

Claims data provides government and consumers with information regarding the number and type of claims that are being triggered and the associated payout costs.

It may also highlight any underlying reliability and quality issues that may be developing within the building industry.

Claims data also provides an insight into the financial performance of the insurers and assists assessing the ongoing viability of the scheme.

Insurers were asked to submit quarterly data relating to claims for the period 30 June 2008 to 30 September 2010.³²

5.1 Claim numbers and value of claims

Table 5.1 shows the number and reported net costs of claims incurred since 2002, for both registered and owner builders. Due to the way claims have been reported, there have been a number of revisions to the claims data that was published in the Commission's previous report. This has resulted in some decreases in claim numbers in older notification quarters and the inclusion of some extra claims for the September 2007, December 2007 and March 2008 quarters.

As at September 2010, a total of 3 337 claims had been made since the scheme commenced in 2002. Of these 765 were notification only claims, 757 claims had liability denied and 180 claims were finalised for no cost.³³ Overall, there have been 1 635 successful claims (approximately half of all claims made under the scheme). Table 5.1 illustrates that the scheme has continued to mature, with a consistent volume of claims being reported each quarter.

³² Australian Unity submitted incomplete claims data.

³³ Unless otherwise noted, all figures and tables in the rest of the claims chapter will exclude claims finalised for no cost.

Table 5.1 **Number of claims by notification quarter**
\$ of the day

	Notification Only	Liability Denied	Nil Finalised	All Other ^a	Total Claims	Net Incurred Costs ^b	Average Claim Size ^c
Sep-02	0	0	0	0	0	0	0
Dec-02	0	2	1	1	4	7,135	7,135
Mar-03	1	1	1	2	5	4,739	2,369
Jun-03	2	2	5	2	11	216,438	108,219
Sep-03	13	5	5	7	30	264,223	37,746
Dec-03	12	3	7	24	46	894,160	37,257
Mar-04	10	2	7	8	27	210,482	26,310
Jun-04	10	13	3	8	34	221,126	27,641
Sep-04	15	7	8	8	38	406,312	50,789
Dec-04	8	4	9	20	41	858,964	42,948
Mar-05	8	12	3	26	49	993,929	38,228
Jun-05	17	11	10	16	54	638,905	39,932
Sep-05	22	22	5	28	77	1,098,929	39,247
Dec-05	21	19	7	24	71	648,391	27,016
Mar-06	20	24	4	14	62	300,814	21,487
Jun-06	25	29	2	47	103	1,752,345	37,284
Sep-06	20	21	4	36	81	1,265,137	35,143
Dec-06	25	15	7	23	70	1,156,627	50,288
Mar-07	21	11	1	18	51	313,264	17,404
Jun-07	20	20	9	47	96	1,560,429	33,201
Sep-07	28	36	4	84	152	3,356,069	39,953
Dec-07	36	34	9	96	175	3,868,421	40,296
Mar-08	14	40	3	95	152	3,184,925	33,526
Jun-08	11	50	4	80	145	2,462,153	30,777
Sep-08	19	41	7	95	162	3,488,444	36,720
Dec-08	27	39	3	63	132	1,953,392	31,006
Mar-09	43	35	18	70	166	2,737,494	39,107
Jun-09	21	51	2	119	193	4,107,732	34,519
Sep-09	17	39	11	126	193	4,368,506	34,671
Dec-09	19	49	17	118	203	6,228,115	52,781
Mar-10	111	33	1	119	264	4,731,788	39,763
Jun-10	100	53	1	114	268	4,489,781	39,384
Sep-10	49	34	2	97	182	3,136,330	32,333
Total	765	757	180	1,635	3,337	60,925,497	37,263

^a Includes claims that have been finalised for an amount, liability being assessed, partially accepted or where liability is in dispute. ^b Includes GST and third party costs on claims with liability denied. ^c Average claim size calculated as net incurred costs, divided by claim number (excl. liability denied, notification only claims, nil finalised claims and Australian Unity claims).

The 1 635 successful claims have resulted in total net costs to the scheme of just over \$60 million including GST of which \$39 million has been paid out to claimants and \$8 million paid to third parties including investigators, loss assessors and to

cover legal costs. In addition to this, there is approximately \$15 million in outstanding cost associated with these claims (see table 5.2).

Table 5.2 **Summary of claims experience**
\$ of the day

	Number of Claims ^a	Paid to claimant ^b	Paid to third party ^b	Total gross paid ^b	Third party recoveries received ^{b,e}	Net Paid ^b	Net outstanding estimate ^{bc}	Net incurred cost ^{bc}
		\$000	\$000	\$000	\$000	\$000	\$000	\$000
2002	1	0	3	3	0	7	0	7
2003	35	1,872	94	1,966	632	1,380	0	1,380
2004	44	1,121	228	1,348	101	1,689	8	1,697
2005	94	3,280	579	3,859	801	3,347	33	3,380
2006	120	3,742	530	4,271	181	4,430	45	4,475
2007	245	8,030	1,171	9,201	590	8,954	144	9,098
2008	333	8,365	1,853	10,218	177	10,187	902	11,089
2009	433	9,386	2,599	11,985	30	12,082	5,359	17,442
2010 ^d	330	3,231	709	3,940	0	3,974	8,384	12,358
Total	1,635	39,026	7,766	46,792	2,511	46,050	14,875	60,925

^a Includes claims that have been finalised for an amount, liability being assessed, partially accepted or where liability is in dispute. ^b Includes GST and third party costs on claims with liability denied. ^c Includes adjustment for GST on case estimates. ^d Includes data for nine months to September 2010. ^e Australian Unity did not provide third party recoveries.

Claims costs are more variable than claim numbers due to variability in actual claim sizes, and numbers reported to date currently provide only an indication of the likely outcomes.

5.2 Average claim sizes

Table 5.3 summarises the net average claim size by notification year. As at 30 September 2010, the average claim size for registered builders was approximately \$38 570, while the average claim size for owner builders is considerably lower at \$23 305.³⁴ The variance in average claim size reflects smaller projects such as renovations or extensions typically undertaken by owner builders. The total average claim size at the end of September 2010 is 36 per cent higher than at 30 June 2008.

³⁴ Average claim size is calculated by dividing total claim costs by claim number (excluding liability denied, notification only claims, nil finalised claims and Australian unity claims).

Table 5.3 **Notification year summary of claims experience**
\$ of the day

	Registered Builder			Owner Builder			All		
	Number of Claims ^a	Net Incurred Cost ^{ab}	Average Claim Size ^{abc}	Number of Claims ^a	Net Incurred Cost ^{ab}	Average Claim Size ^{ab}	Number of Claims ^a	Net Incurred Cost ^{ab}	Average Claim Size ^{ab}
		\$000			\$000			\$000	
2002	0	3	n/a	1	4	3,994	1	7	7,135
2003	28	1,240	44,297	7	139	19,894	35	1,380	39,416
2004	33	1,247	37,799	11	450	40,864	44	1,697	38,566
2005	82	3,087	37,640	12	294	24,469	94	3,380	35,959
2006	102	3,779	37,047	18	696	38,676	120	4,475	37,291
2007	222	8,507	38,322	23	591	25,683	245	9,098	37,135
2008	314	10,846	34,542	19	243	12,768	333	11,089	33,300
2009	394	16,746	42,503	39	695	17,833	433	17,442	40,281
2010 ^d	320	12,206	38,145	10	151	15,140	330	12,358	37,448
Total	1,495	57,663	38,570	140	3,263	23,305	1,635	60,925	37,263

^a Excludes claims finalised for no cost, liability denied or notification only. ^b Includes GST and third party costs on claims with liability denied. ^c Average claim size calculated as net incurred costs, divided by claim number (excl. liability denied, notification only claims, nil finalised claims and Australian Unity claims). ^d Includes data for nine months to September 2010.

Table 5.4 shows the average claim size for finalised and non finalised claims. The average size of finalised claims is lower than those which remain open (\$32 029 and \$45 036 respectively). It may be that easier claims are finalised earlier while the more difficult claims remain open for longer.³⁵

Table 5.4 **Claims by status**
\$ of the day

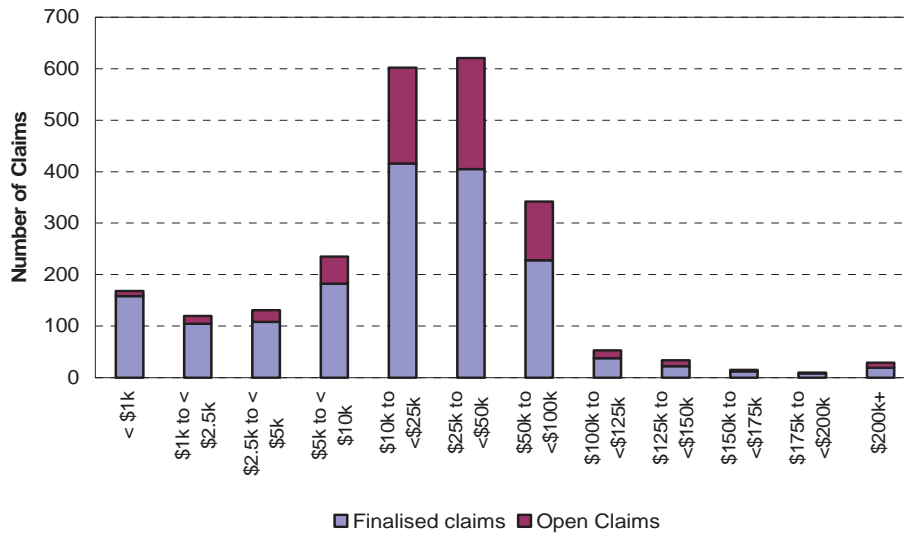
	Number of Claims ^a	Net Incurred Costs ^b	Average Claim Size ^b
		\$000	\$
Finalised	977	31,292	32,029
Open	658	29,633	45,036
Total	1,635	60,925	37,263

^a Excludes claims finalised for no cost, liability denied or notification only. ^b Includes GST and third party costs on claims with liability denied.

³⁵ This could be tested by analysing the average size by delay to finalisation date. However, not all insurers submitted this information which limited further analysis.

Figure 5.1 shows the size distribution of claims reported to date. The vast majority of claims are under \$100 000 with approximately 6 per cent relating to claims with incurred costs in excess of \$100 000 and 1.6 per cent relating to claims over \$175 000.

Figure 5.1 **Claims size distribution**



5.3 Reason for claims

The reason for a claim can illustrate which triggers (death, disappearance or insolvency) are used more frequently when lodging a claim. Figure 5.2 shows the number of claims reported by notification quarter and by cause of claim. The majority (94 per cent) of claims relate to insolvency, with few claims due to death or disappearance. The number of insolvency claims has risen significantly since March 2007, reflecting the scheme's maturity and possibly the adverse economic conditions in 2008 and 2009.

Figure 5.2 Claims reported by cause – registered builder

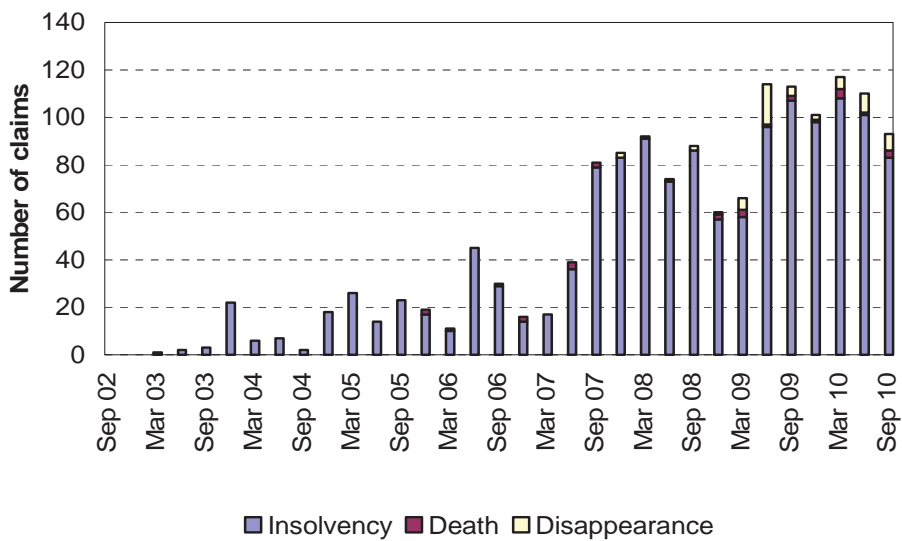


Table 5.5 summarises the registered builder claims experience by claim cause. It includes only claims for which liability has been partially, fully or deemed accepted by insurers and excludes claims which have been finalised for no cost. In total, around \$37 million has been paid out to claimants and a further \$8.7 million was expected to be paid on existing claims. Net incurred costs for insolvency claims were approximately \$47.9 million, representing almost 95 per cent of total scheme cost.

Table 5.5 **Claim experience by cause – registered builder**
as at September 2010 (\$ of the day)

	Number of Claims ^a	Paid to claimant ^b	Paid to third parties ^b	Third party recoveries ^b	Total net paid ^b	Net case estimates ^{b,c}	Net Incurred ^{b,c}	Average claim size ^{b,c}
<u>Finalised & Accepted Claims</u>		\$000	\$000	\$000	\$000	\$000	\$000	\$000
Insolvency	850	25,466	4,314	2,198	27,583	0	27,583	32,451
Death	16	250	52	1	302	0	302	18,885
Disappearance	27	179	290	0	469	0	469	17,370
Total	893	25,896	4,657	2,198	28,354	0	28,354	31,752
<u>Open & Accepted Claims</u>								
Insolvency	468	10,711	1,592	193	12,110	8,158	20,269	43,309
Death	8	233	24	0	258	141	399	49,853
Disappearance	18	358	65	1	423	406	828	46,026
Total	494	11,303	1,682	194	12,790	8,705	21,496	43,514
<u>All Accepted Claims</u>								
Insolvency	1,318	36,178	5,907	2,391	39,694	8,158	47,852	36,306
Death	24	484	77	1	560	141	701	29,207
Disappearance	45	537	355	1	892	406	1,297	28,832
Total	1,387	37,198	6,339	2,392	41,145	8,705	49,850	35,941

^a Excludes claims finalised for no cost, liability denied or notification only. ^b Includes GST and third party costs on claims with liability denied. ^c Includes GST on case estimates.

Table 5.6 shows the number of builder insolvencies by quarter. The insolvency quarter is the quarter in which the first insolvency claims are reported against a builder. All insolvency claims against that builder are then allocated to this insolvency quarter.

The historical insolvency rate (the number of builder insolvencies expressed as a proportion of total number of registered builders) has averaged 0.08 per cent, although the recent average in the past three years has been around 0.12 per cent. The total cost of all insolvencies reported is \$52.9 million. The average cost to the insurer of each builder insolvency is therefore around \$166 000 (including GST).³⁶

³⁶ The number and cost of claims from some of the most recent insolvencies are likely to increase over time, because it is likely that there are still further claims to be reported.

Table 5.6 **Number of insolvencies – registered builder**
\$of the day

	Registered Builders ^a	Reported Insolvencies ^b	Insolvency Rate	Insolvency Claims ^c	Claims per Insolvency	Net Incurred Cost (incl. GST) ^d	Average Claim Cost per Insolvency ^d
Sep-02	11,388	0	0.00%	0	0.0	0	0
Dec-02	11,064	0	0.00%	0	0.0	0	0
Mar-03	11,000	1	0.01%	1	1.0	2,324	2,324
Jun-03	10,809	2	0.02%	2	1.0	215,599	107,799
Sep-03	10,511	3	0.03%	3	1.0	127,904	42,635
Dec-03	10,647	4	0.04%	27	6.8	1,001,906	250,477
Mar-04	10,721	4	0.04%	6	1.5	109,144	27,286
Jun-04	10,761	3	0.03%	13	4.3	321,519	107,173
Sep-04	10,402	0	0.00%	0	0.0	0	0
Dec-04	10,392	8	0.08%	31	3.9	1,053,884	131,736
Mar-05	10,382	11	0.11%	57	5.2	2,021,073	183,734
Jun-05	10,517	5	0.05%	16	3.2	548,482	109,696
Sep-05	10,420	7	0.07%	19	2.7	1,165,476	166,497
Dec-05	10,578	9	0.09%	16	1.8	251,555	27,951
Mar-06	10,648	3	0.03%	7	2.3	100,083	33,361
Jun-06	11,054	13	0.12%	71	5.5	2,377,430	182,879
Sep-06	11,279	7	0.06%	36	5.1	870,691	124,384
Dec-06	11,314	7	0.06%	35	5.0	949,585	135,655
Mar-07	11,558	7	0.06%	17	2.4	393,259	56,180
Jun-07	11,834	17	0.14%	151	8.9	7,270,651	427,685
Sep-07	12,133	18	0.15%	129	7.2	3,994,981	221,943
Dec-07	12,446	13	0.10%	53	4.1	1,814,544	139,580
Mar-08	12,655	11	0.09%	67	6.1	2,237,049	203,368
Jun-08	12,948	22	0.17%	50	2.3	1,875,746	85,261
Sep-08	13,146	15	0.11%	85	5.7	3,097,653	206,510
Dec-08	13,361	14	0.10%	36	2.6	2,508,139	179,153
Mar-09	13,530	10	0.07%	43	4.3	1,721,319	172,132
Jun-09	13,700	23	0.17%	93	4.0	3,553,291	154,491
Sep-09	13,882	17	0.12%	62	3.6	2,037,732	119,867
Dec-09	13,985	12	0.09%	150	12.5	5,473,542	456,128
Mar-10	14,100	20	0.14%	73	3.7	2,420,097	121,005
Jun-10	14,216	19	0.13%	46	2.4	2,404,668	126,561
Sep-10	na	13	na	20	1.5	956,680	73,591
Total - all years		318	0.08%	1415	4.4	52,876,005	166,277
Total - last 3 years	160,102	194	0.12%	887	4.6	33,138,760	170,818

^a Registered Builders data sourced from the Building Commission. ^b Date of insolvency is taken to be the notification quarter relating to the first claim against the builder. ^c Excludes claims finalised for no cost, liability denied or notification only. ^d Includes GST on case estimates. na Not available.

On average each builder insolvency has resulted in approximately 4.4 claims. However, the distribution of claims per insolvency is skewed (see figure 5.3). While the majority of insolvencies have resulted in only one or two claims, 11 per cent of insolvencies have resulted in more than ten claims each.

Figure 5.3 **Number of claims per insolvency – registered builder**
as at September 2010

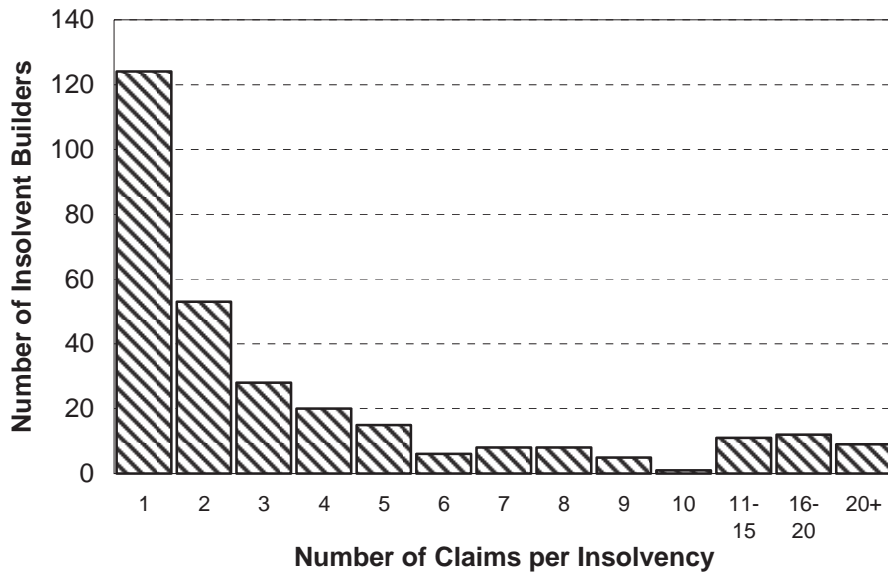


Table 5.7 provides a summary of the reasons for a claim being denied by insurers. The data shows that the greatest proportion of claims are rejected by insurers because the builder was found not insolvent. This is consistent with the data presented in the commission’s 2009 report.

Table 5.7 **Reasons claim denied – registered builder**

	Number of Claims	Proportion (%)
Incorrect insurer	5	0.8
Out of time	44	6.7
Builder found	44	6.7
Builder not dead	3	0.5
Builder not insolvent	239	36.2
Not deemed a defect	326	49.3
Total	661	100.0

Of 661 claims with liability denied, the greatest proportion of claims (286 claims, or 43 per cent) related to cases where the builder was found to be neither dead, insolvent nor missing. 326 claims related to cases where the problem was not deemed a defect and therefore not covered. 44 claims related to cases where the claim was not reported within the required time limits, and 5 claims related to the incorrect insurer being pursued for cover.

The high number of claims involving problems that have been deemed not to be a defect suggests there may be a need for better consumer guidance on what constitutes a defect and how and when to claim using DBI cover. The Standing Committee report identified consumer confusion as an issue, noting that many consumers are not aware of the scheme's limitations.³⁷ Consumer Affairs Victoria has published a building and renovating guide for consumers, which highlights the limitations of the scheme.³⁸

The high number of claims where the consumer incorrectly believes the builder to be dead, insolvent or missing suggests that there may be a need for better processes for consumers to determine their builder's status.

5.4 Type of cover and type of claim

Overall, fewer than 60 per cent of claims relate to new single dwellings, 25 per cent relate to multi dwellings of three stories or less, and 11 per cent relate to alterations/additions. There are very few swimming pool and renovation claims which tend to be much smaller than claims for other cover types (see table 5.8).

Table 5.8 **Claim experience by cause – registered builder**
as at September 2010 (\$ of the day)

	Number of Claims ^a	Paid to claimant ^b	Paid to third parties ^b	Third party recoveries ^b	Total net paid ^b	Net case estimates ^{b,c}	Net Incurred ^{b,c}	Average claim size ^{b,c}
		\$000	\$000	\$000	\$000	\$000	\$000	\$000
Finalised & Accepted Claims								
New single dwelling	512	14,995	2,786	1,537	16,244	0	16,244	31,727
New multi dwelling (≤ 3 storeys)	231	5,702	1,186	130	6,757	0	6,757	29,252
Alterations/additions	119	4,799	616	399	5,015	0	5,015	42,147
Swimming pools	10	78	30	40	68	0	68	6,812
Renovations	21	322	39	91	270	0	270	12,838
Total	893	25,896	4,657	2,198	28,354	0	28,354	31,752
Open & Accepted Claims								
New single dwelling	305	7,199	1,107	76	8,229	5,066	13,295	43,591
New multi dwelling (≤ 3 storeys)	115	2,638	290	73	2,856	2,917	5,772	50,193
Alterations/additions	38	983	181	1	1,162	509	1,672	43,990
Swimming pools	32	418	74	44	448	208	656	20,508
Renovations	4	65	30	0	95	5	100	25,118
Total	494	11,303	1,682	194	12,790	8,705	21,496	43,514
All Accepted Claims								
New single dwelling	817	22,194	3,893	1,614	24,473	5,066	29,539	36,156
New multi dwelling (≤ 3 storeys)	346	8,340	1,476	203	9,613	2,917	12,530	36,212
Alterations/additions	157	5,781	796	400	6,178	509	6,687	42,593
Swimming pools	42	496	104	84	516	208	724	17,247
Renovations	25	387	69	91	365	5	370	14,803
Total	1,387	37,198	6,339	2,392	41,145	8,705	49,850	35,941

^a Excludes claims finalised for no cost, liability denied or notification only. ^b Includes GST and third party costs on claims with liability denied. ^c Includes GST on case estimates.

³⁷ Standing Committee on Finance and Public Administration, Inquiry into Builders Warranty Insurance, Final Report, October 2010, p.27-28.

³⁸ Consumer Affairs Victoria, 2007 Building and renovating: a guide for consumers.

Claims can be made for non completion, and structural or non structural defects (see table 5.9).

Overall, there have been 466 failure to complete claims since 2002. These 'non-performance' claim types are capped at the lesser of \$200 000 or 20 per cent of initial contract value. The average value of these claims is \$48 150 and they contribute to almost half the claims cost of the entire scheme. Failing to commence is the other type of claim that is classified as a 'non performance' type. It has the same cap as above, with a total of 55 being reported and the average value being \$18 650, this type is the smallest contributor to the scheme claims cost.

Additionally, there have been 473 structural defect claims. This number is likely to continue to develop significantly, as these claims can be reported up to six years after project completion. This means claims could potentially be made even 10 years after the project certificate was issued. Structural defect claims are capped at \$200 000, the average size of a structural defect claim reported to date at approximately \$27 200.

There have also been 393 non-structural defect claims. Non-structural defect claims are required to be reported within two years of project completion. As illustrated in figure 5.4 most of these tend to be reported within four to five years of the issue of the project certificate. It is expected that claim numbers will continue to develop although not to the same extent as the structural defect claims. Non-structural claims are also capped at \$200 000, the average size of non-structural defect claims reported to date approximately \$34 500.

Table 5.9 **Claims experience by claim type – registered builder**
as at September 2010 (\$ of the day)

	Number of Claims ^a	Paid to claimant ^b	Paid to third parties ^b	Third party recoveries ^b	Total net paid ^b	Net case estimates ^{b,c}	Net Incurred ^{b,c}	Average claim size ^{b,c}
Finalised & Accepted Claims								
Failure to commence	41	\$000	\$000	\$000	\$000	\$000	\$000	\$000
Failure to complete	303	594	168	6	756	0	756	18,440
Structural defect	228	11,894	2,322	869	13,346	0	13,346	44,047
Non-structural defect	321	4,045	900	210	4,736	0	4,736	20,771
Total	893	9,363	1,267	1,113	9,516	0	9,516	29,646
		25,896	4,657	2,198	28,354	0	28,354	31,752
Open & Accepted Claims								
Failure to commence	14	226	26	0	253	17	270	19,269
Failure to complete	163	5,358	685	32	6,011	3,066	9,077	55,686
Structural defect	245	3,562	675	96	4,142	3,977	8,119	33,139
Non-structural defect	72	2,156	295	66	2,385	1,645	4,030	55,975
Total	494	11,303	1,682	194	12,790	8,705	21,496	43,514
All Accepted Claims								
Failure to commence	55	820	195	6	1,009	17	1,026	18,651
Failure to complete	466	17,252	3,006	901	19,357	3,066	22,423	48,118
Structural defect	473	7,608	1,576	305	8,878	3,977	12,855	27,177
Non-structural defect	393	11,519	1,562	1,180	11,902	1,645	13,547	34,470
Total	1,387	37,198	6,339	2,392	41,145	8,705	49,850	35,941

^a Excludes claims finalised for no cost, liability denied or notification only. ^b Includes GST.

^c Includes GST on case estimates.

5.5 Timing and Frequency of claims

Figure 5.4 illustrates the differences in claim reporting patterns by type of claim. Claims are shown by the delay from underwriting quarter to claim notification quarter for all accepted claims. Overall, the majority of failure to complete and failure to commence claims have been recognised within one to two years of the project certificate being issued with only a small number of claims reported after two years.

There have been relatively few non-structural defect claims reported within one year of the project certificate being issued. Numbers of non-structural defect claims increase one to three years (4 to 12 quarters) after the issuance of a project certificate, but fall steadily in subsequent years, reflecting the two year reporting limit on these claims.

Figure 5.4 **Claim reporting pattern by cover type – registered builder**

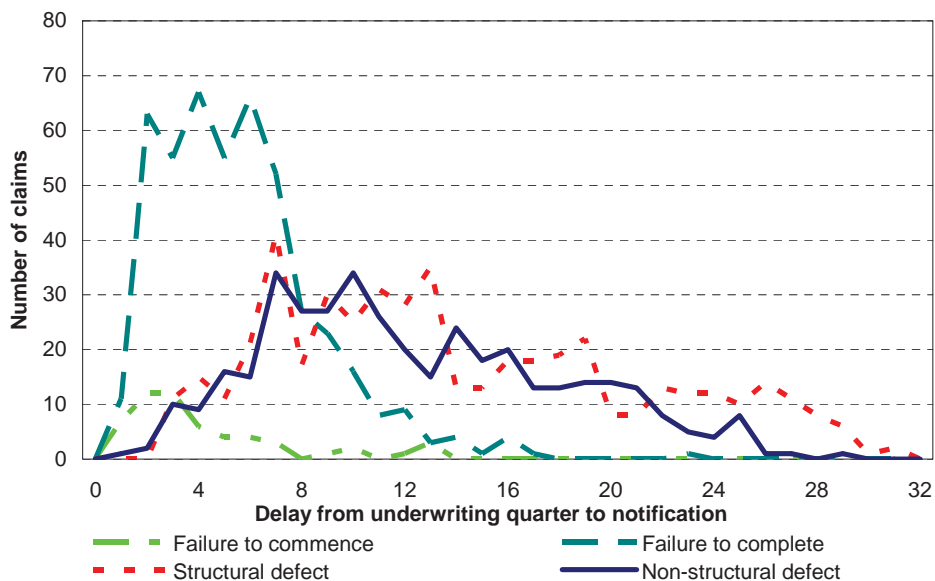
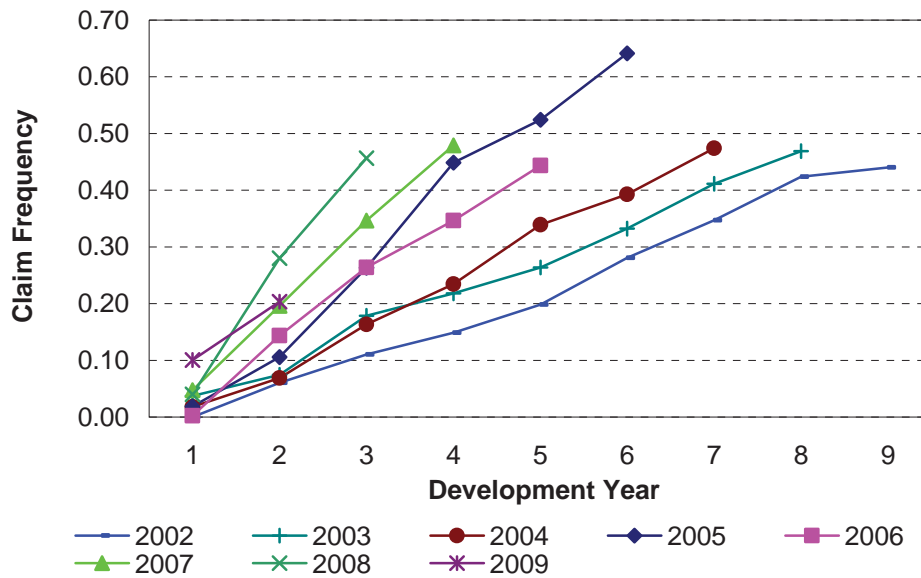


Figure 5.5 shows claims frequency development for registered builders. It shows the number of claims per 100 project certificates written (in each underwriting year) for each year since the project certificate was issued (development year). The data indicates a generally slow pattern of claims development. However, due to the length of policy coverage, the window of time in which claims can be made may be as long as 10 years. This means that the frequency can increase as claims continue to be reported on policies written in the past.

Figure 5.5 **Claim frequency by underwriting year – registered builder**
per 100 project certificates



APPENDIX A | TERMS OF REFERENCE

Essential Services Commission Act 2001

Essential Services Commission

Terms of Reference

Domestic Building Insurance – Premium Validation

I, Tim Holding MP, Minister for Finance, WorkCover and the Transport Accident Commission, request the Essential Services Commission (the Commission) to undertake biennial inquiries into the adequacy and validity of the Victorian Managed Insurance Authority's (VMIA) domestic building insurance (DBI) premiums.

Background

DBI has been compulsory in Victoria since 2002 for all residential building works in excess of \$12,000 carried out by licensed builders.

DBI policies are taken out by the builder in favour of the homeowner and cover loss or damage resulting from non-completion of the work. This includes loss of deposit or breach of statutory warranty if the homeowner cannot recover compensation from the builder because of the death, disappearance or insolvency of the builder.

DBI was provided solely by private insurers. However, after a decrease in the number of private insurers and the associated levels of competition, the Government announced on 29 March 2010 that the VMIA would become a statutory monopoly provider of DBI after a transition period.

Scope of the Inquiries

The biennial inquiries are to be conducted under Part 5 of the *Essential Services Commission Act 2001* (the ESC Act).

The objective of the biennial inquiries is to inform the Government, builders and consumers of the validity of the VMIA's DBI premiums. Specifically, the Commission is to report on whether the VMIA's:

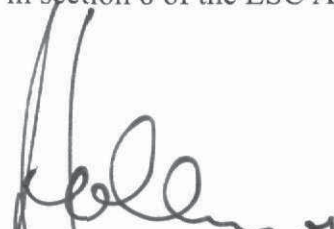
- premiums are sufficient to cover its expenses, risks and long-term claim costs;
- premiums are not set above the level required by the VMIA to cover its expenses and the risks and the long-term claim costs; and
- underwriting standards conform to commercial standards.

The Commission is to have regard to:

- the Government's objective that there is no net cost to taxpayers over time from the scheme;
- to the information used by the VMIA in setting premiums; and
- the methodology and assumptions use by the VMIA in setting premiums.

The first inquiry will cover the period 1 June 2010 to 30 June 2012 and subsequent inquiries will be biennial. The inquiries will report by 30 April of the following year.

In providing this advice, the Commission is to have regard to its statutory objectives in section 8 of the ESC Act.



TIM HOLDING MP
Minister for Finance, Work Cover
and the Transport Accident Commission

Date:

9/07/2010