ESSENTIAL SERVICES COMMISSION

Performance of Victoria's Domestic Building Insurance Scheme 2011-2012

November 2012

An appropriate citation for this paper is:

Essential Services Commission 2012, Performance of Victoria's Domestic Building Insurance Scheme 2011-2012, November.

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PERFORMANCE OF VICTORIA'S DOMESTIC BUILDING INSURANCE SCHEME 2011-2012

November 2012

CONTENTS

EXECUTIVE SUMMARY

The market for domestic building insurance (DBI), also known as builders' warranty insurance, has undergone significant change since this mandatory insurance scheme was introduced in Victoria a decade ago.

DBI is taken out by builders and compensates a home-owner for losses resulting from non-completion or defects in domestic building work where the builder cannot be pursued directly because they have died, disappeared, or become insolvent. It is compulsory for all domestic construction contracts over $12 000 in value.

When the current scheme was introduced in 2002, insurance was provided by five competing private insurers. In 2009, insurers started to exit from the market and, by mid-2010, only one private insurer remained. In response to these changes, the publicly underwritten Victorian Managed Insurance Authority (VMIA) commenced supplying DBI. The private insurers are still liable for claims against the policies they wrote before leaving the market.

To monitor the impact of these changes, the Essential Services Commission (the Commission) has terms of reference to report annually on the performance of Victoria's DBI scheme, covering:

- the number of eligible builders;
- the number of project certificates (policies);
- premium levels; and
- the number and amounts of claims.

The Commission's terms of reference also require it to monitor the pricing of the VMIA and any remaining private insurers, as well as the claims management of private insurers during the run-off period (and of the VMIA once it started receiving claims).

In examining each of these areas, the Commission collects quarterly data from insurers. This data is not audited and the Commission relies on insurers providing accurate data.

This latest performance report covers the period up to June 2012.

OVERALL SCHEME PERFORMANCE

In the period leading up to the exit of the private insurers, there was a jump in the number of project certificates issued, average premium rates were at their lowest and investment returns had been hit by the global financial crisis. There were also several large scale insolvencies between 2007 and 2010, generating hundreds of claims and millions of dollars in costs. The combined impact of these factors is reflected in the deteriorating loss ratios experienced by the scheme around this time.

Although still very early in the liability period, there does appear to be some improvement in the simple loss ratios[1] for certificates and policies issued in 2010 and 2011. This may be due in part to a recent increase in average premium rates, and also to a reduction in the early claims rate compared to previous years.

DBI ELIGIBILITY

Following the change in market structure in 2009 and 2010, the majority of builders now hold DBI eligibility with the VMIA. The exit of the private insurers does not appear to have had a significant impact on the ability of builders to access DBI, as the overall number of eligibilities exceeds the total number of registered builders. Turnover limits set as part of the DBI eligibility process do not appear to be

[1] The simple loss ratio indicates how premium collected by insurers (for a year) is paid out in claims. It excludes the costs of claims that are yet to be made and the costs that the insurer incurs in administering the scheme or income from investments. A lower loss ratio is better for the insurer. With long-tail insurance, a better result in later years may be needed to pay for a worse result in earlier years.

adversely impacting the industry either, with the aggregated turnover limit remaining considerably higher than the value of project certificates issued.[2]

PROJECT CERTIFICATES

With the exception of 2008 and 2011, the number of project certificates issued has increased each year and, until recently, tracked closely with the number of building approvals, reflecting fluctuations in the growth of the building industry. Project certificates for new dwellings account for more than 60 per cent of certificates issued, but there has been considerable variation in the number of certificates issued for other types of projects, such as swimming pools and renovations.

PREMIUMS

After initially adopting QBE's premium pricing schedule, the VMIA introduced a new schedule with higher average premium rates in mid-2011. Although this schedule has not changed significantly since its introduction, there is still some variation in the average premium as a result of different project types and values and builder risk profiles.

Average premium levels are now significantly higher than in 2008 when premiums were at their lowest. The market for DBI was still in its infancy in 2008 and the significant increase in premiums since then could indicate that premiums were not cost reflective due to a lack of information about claims development and costs. Claims data included in this report show that insurers are still receiving claims (albeit a small number) relating to project certificates issued in 2003, indicating that the liability period may be longer than insurers initially expected.[3]

[2] The turnover limit is the insurer's calculation of a builder's capacity to undertake work. This is the total value of construction work that an insurer will issue certificates for in a 12 month period.

[3] DBI insurers are liable for defects that occur up to 6 years after the completion of domestic building work. A project certificate is taken out when a project commences and it is assumed that construction is complete with 12 months giving a 7 year liability period. However, in practice delays in construction and notification can mean that claims are made up to 10 years after the certificate is issued and may be increased further by the application of the *Insurance Contracts Act 1984* (Cth).

CLAIMS

The number of DBI claims remains quite low compared to the numbers of project certificates issued each year, although the claims rate is likely to be higher for project certificates issued in more recent years. The average cost of an accepted and finalised registered builder claim has increased since the Commission's 2010-11 report from $33 310 to around $37 700. This increase is consistent with the increase in the average value of projects undertaken. Insolvency is by far the most common reason that claims on DBI are made for registered builders and almost half the claims received have related to a structural defect. However, claims for non-completion are, on average, the most costly.

Insurers that have left the market are still receiving claims, as they can expect to for at least the next 4 years. As the average time taken to finalise a claim will depend heavily on the type and complexity of the claims being made, it is difficult to compare insurers' performance across years. However, there is no indication that insurers are failing to meet their obligations with respect to claims during the run off period.

To date, there have been relatively few claims received by the VMIA. This is consistent with the typical pattern of claims development, which shows only a small proportion of claims are received within the first one or two years of the liability period. This small number of claims makes it difficult to comment on the VMIA's claims management, particularly given that almost half of the claims received by the VMIA are yet to be finalised.

GLOSSARY

Building Commission	A statutory authority that oversees the building control system in Victoria.
Building Practitioners Board	The licensing arm of the Building Commission.
Claims liability	The cost of a claim to an insurer. This includes money paid out as well as estimates of future costs.
Died, disappeared or insolvent (DDI)	The three triggers for Victoria's DBI scheme.
Domestic building insurance (DBI)	A mandatory insurance that compensates home-owners for non-completion or defect where the builder is unable to rectify the works because they have died, disappeared or become insolvent (also referred to as Builders Warranty Insurance).
Eligibility	Pre-approval from an insurer for a builder to be issued project certificates.
First resort	An insurance scheme that provides compensation regardless of the builder's circumstances (as opposed to a last resort scheme).
Investment returns	The revenue earned by an insurer by investing premium revenue.
Last resort	An insurance scheme where compensation is only available where all other avenues for resolution have been exhausted
Liability period	The period of time that an insurer is liable for claims on a policy.

Long-tail insurance	Insurance products where the full cost of claims is not known for a long time after the premium is charged.
Owner-builder	A person who constructs or renovates a domestic building on his or her own land, who is not in the business of building.
Policy	For owner-builders, DBI coverage is issued in the form of a policy. Owner-builders are only required to take out a policy if they sell the property within six and a half years of completion.
Premium	The charge for insurance coverage.
Private insurers	Independently trading insurance companies that compete in the market. Generally they are publicly listed entities, trading for profit.
Project certificate	For registered builders, DBI coverage is issued in the form of a project certificate that is specific to the domestic building work undertaken in a domestic building contract.
Run-off period	The time after an insurer has stopped issuing insurance, but is still responsible for claims on existing policies.
Simple loss ratio	Net incurred costs relating to claims made on project certificates issued in a year, divided by the total premium earned for that year. Excludes the costs of claims that are yet to be made. Excludes costs that the insurer incurs in administering the scheme or income from investments.
Turnover limit	An insurer's calculation of a builder's capacity to undertake work. This is the total value of construction work that an insurer will issue certificates for in a 12 month period.
Victorian Managed Insurance Authority (VMIA)	A statutory body which operates as the 'captive insurer' for the State of Victoria.

1 INTRODUCTION

Although most people are familiar with house and car insurance, the majority of the population will go through life without ever hearing of ***domestic building insurance*** (DBI). This report was written assuming a certain base level of experience with DBI. This introduction aims to provide the basic background and vocabulary needed to understand this report, for someone new to this sector. Abbreviations and terms included in the glossary are in bold and italics.

DBI compensates a home-owner for losses resulting from non-completion or defects in domestic building work where the builder cannot be pursued directly for redress because they have died, disappeared, or become insolvent. These three triggers are collectively abbreviated as ***DDI***. DBI is known as a ***last resort*** insurance scheme as it is only available where all other avenues for resolution have been exhausted. A ***first resort*** scheme provides compensation for defects even if the builder is still trading (such as the Queensland Home Warranty Scheme administered by the Building Services Authority — see appendix C).

1.2 ELIGIBILITY

All builders are required to have ***eligibility*** with a DBI insurer in order to maintain their registration with the ***Building Practitioners Board*** (BPB). Eligibility is like pre-approval from an insurer to take out DBI ***project certificates***. Insurers use the eligibility process to evaluate the financial position of the builder and impose an annual ***turnover limit***, which is their assessment of the maximum value of building projects the builder can take on without risking insolvency.

1.3 PROJECT CERTIFICATES AND PREMIUM

In Victoria, DBI cover is compulsory for all domestic building works with a contract value over $12 000. When a contract for the work has been agreed, the builder takes out a DBI policy known as a ***project certificate*** on behalf of the customer. The project certificate is specific to the work in the associated contract. A ***premium*** is calculated by the insurer based on the contract value, and is paid by the builder.

1.4 OWNER-BUILDER POLICIES

A home-owner is legally allowed to undertake building work on their property as an ***owner-builder*** subject to certain regulatory requirements. Owner-builders are not registered builders, and must obtain consent from the Building Commission to do any work with a value over $12 000. Owner-builders do not require DBI to commence work, but must take out a policy to cover defects if they sell the property within six and a half years of completion. DBI cover for owner-builders is referred to as a ***policy*** rather than a project certificate.

1.5 CLAIMS

DBI covers a home-owner for defects that occur up to 6 years from the completion of the building project.[1] DBI is referred to as ***long-tail insurance*** because of the length of time faced by insurers between charging a premium and knowing the full cost of claims. This is distinct from home contents policies or car insurance where premiums are calculated annually and the ***claims liability*** is generally known within a few months of the year's end. Insurers earn ***investment returns*** on the premium pool while they wait to pay out claims. In long-tail insurance this revenue can be significant over the years it takes for claims to occur.

The period of time that insurers must consider claims against a policy is known as the ***liability period***.[2] For its analysis, the Commission assumes that construction is

[1] Claims for 'failure to commence' or 'failure to complete' can be made if the builder is DDI before the project is completed.

[2] In some circumstances, a home-owner can make a claim after the liability period has expired (s.54, *Insurance Contracts Act 1984* (Cth)).

complete 12 months after the certificate issue date, but the construction of a domestic dwelling could take 3 years while a renovation could be completed in 2 or 3 months. Insurers do not collect data on completion times from builders.

There is no limit in legislation on the time that can elapse between notification of a claim and the submission of information required to open a claim. Over 90 per cent of claims to date have been received within 90 days of the first notification, but closed notifications can be re-opened for assessment years after being received by an insurer.

It is difficult to calculate the length of the liability period on a project certificate given that the construction period varies and notifications can be re-opened. The Commission considers 7 years to be a reasonable assumption for analysis, while accepting insurers' comments that the liability period could extend to 10 years or even longer. To date, only about 5 per cent of claims have been lodged more than 7 years beyond the certificate issue date.

Insurers who leave the market are still liable for claims on the project certificates they issued before they left. This is known as a ***run-off period***, and will continue for at least 6 or 7 years after the issue of a project certificate as claims are made by home-owners.

There are several key dates used to track a claim's progress (see table 1.1).

TABLE 1.1 KEY DATES IN THE DBI CLAIM PROCESS

Date	Description
Certificate issue date	The date the project certificate is issued by the insurer. This is at the commencement of construction. This date is also known as the 'underwriting date' as it is the point where the premium is charged.
Loss date	The date a claimant became aware of a defect or failure. This date is supplied by the claimant.
Notification date	The date the insurer first receives notification in writing of a potential claim. These 'notification only claims' can be escalated into claims on provision of minimum information. If the notification has not been escalated within 90 days it is closed on the insurer's system, but can be re-opened at any time.
Claim received date	The date the insurer receives the minimum information required to open a DBI claim on their system.
Liability decision date	The date the insurer made the decision to accept or deny a claim. If no decision is made within 90 days, the claim is deemed to be accepted.
Claim finalised date	The date the claim was closed on the insurer's system with all costs paid out.

2 DBI IN VICTORIA

2.1 HISTORY AND RECENT MARKET CHANGES

Each state in Australia has its own arrangements for DBI (see appendix C). Victoria operated a first resort scheme — the Housing Guarantee Fund — between 1984 and 1996. This was replaced by a new first resort scheme underwritten by private insurers until 2002 when the arrangements were altered to a last resort scheme, still provided by the private insurance market (see table 2.1).

TABLE 2.1 DEVELOPMENTS IN DBI IN VICTORIA

Date	Event
July 1984	HIA and MBAV builders warranty schemes combined to create the Housing Guarantee Fund (HGF)
June 1996	HGF replaced by mandatory first resort scheme provided by private insurers
March 2001	HIH collapse
September 2001	September 11 terrorist attacks unsettle insurance markets
July 2002	New mandatory last resort scheme introduced — underwritten by competing private insurers
October 2005	Final report — VCEC Inquiry into regulation of the housing construction sector and related issues
July 2009	CGU and Lumley exit the DBI market
March 2010	Victorian Government announces underwriting of DBI scheme through the VMIA
May 2010	Arrangements made with QBE to act as agent issuing DBI cover underwritten by VMIA
June 2010	Vero — the market leading private insurer offering DBI — exits the market One private insurer — Calliden — remains in the market
October 2010	Final report — Victorian Parliamentary enquiry into Builders Warranty Insurance
April 2012	Victorian Government releases consultation paper on the domestic building consumer protection framework

Between 2002 and 2010, DBI was offered by five competing, private sector insurers. As DBI is statutory insurance, the terms of cover are governed by legislation. Insurers competed on the basis of premiums and service, and builders were free to choose their insurer.

By June 2010, all but two of the insurers had withdrawn from the market. The Victorian Government intervened to underwrite DBI policies through the Victorian Managed Insurance Authority (VMIA). QBE ceased writing DBI at this time but continues to act as the agent for the VMIA. Calliden continues to offer DBI. Private insurers who withdrew from the market are nevertheless still liable for claims against the certificates they issued.

2.2 OBSERVATIONS FROM COMMISSION'S 2010-11 REPORT

The Commission's previous performance report, released in April 2012, covered the period up to June 2011. The report made a number of observations including that:

- An increase in builder insolvencies (between 2007 and 2010), likely brought on, at least in part, by the global financial crisis (GFC), resulted in an increase in DBI claims.
- The simple loss ratios for certificates issued between 2007 and 2009 were as high as or higher than for certificates issued in earlier years, despite still having a number of years of the liability period remaining.
- Despite the exit of private insurers there was no evidence to suggest that builders were suffering from a lack of access to DBI.
- Average premiums had started to rise and were at their highest since 2008.
- Although the rate of claims and the average cost of claims had risen, the total number of claims received remained low in the context of the number of project certificates issued.

2.3 THEMES EXPLORED IN THE COMMISSION'S 2011-12 PERFORMANCE REPORT

In the period covered by the Commission's last report, the market was still settling after the withdrawal of most of the private insurers and the entry of the VMIA in May 2010. It was therefore difficult to comment on how the change in market structure would affect access to DBI and average premiums, and how insurers would handle claims in the run-off period.

When the VMIA entered the market, it announced that builders who held DBI eligibility with an insurer would automatically be eligible with the VMIA on comparable underwriting terms and conditions for at least the first 12 months.[1] Further, when QBE began issuing policies underwritten by the VMIA, it continued to apply its existing premium structure. Therefore, the VMIA's entry was unlikely to have had any impact on eligibility and premiums until late in the Commission's last reporting period.

The data collected for this report provides the first opportunity to look at eligibility levels now that the VMIA has assessed builders and applied its own underwriting criteria. Given the VMIA's market dominance, it is important that its entry has not adversely affected access to DBI (eligibility) and that turnover limits continue to be set at levels that do not impede the growth of the sector. In undertaking its analysis for this report, the Commission has explored these issues and, where relevant, commented on changes that may be linked to the entry of the VMIA.

This report is also the first opportunity to look at average premium levels after the revision of QBE's rates and the introduction of a new schedule by the VMIA. Efficient premiums — those that reflect the underlying risk and provide sufficient revenue (when combined with investment returns) to cover future claims costs and operating expenses — are fundamental to the sustainability of the DBI product. The VMIA increased its premiums in 2011.

As indicated in its previous report, and required by its terms of reference, the Commission has continued to examine the claims handling of insurers during the run-off period. A decrease in claims handling timeframes by these insurers may be

[1] VMIA 2010, 'VMIA reaches agreement with QBE to deliver domestic building insurance', *Media Release*, 13 May.

of particular concern, suggesting that home-owners were not receiving the level of protection and service intended when the scheme was established.

For this report, the Commission has also undertaken a more detailed analysis of the scheme's simple loss ratios, particularly for project certificates issued in the years prior to the withdrawal of the private insurers. Such an examination may shed some light on the reasons for their withdrawal.

In its last report, the Commission noted that claims rates in relation to project certificates issued in 2007 and 2008 were higher than claims rates for project certificates issued in earlier years, despite having a longer remaining liability period. The Commission's last report also showed that average premiums had been at their lowest in 2009, despite increasing claims rates and costs.

Insurers would have forecast worsening loss ratios, knowing that premium and investment revenue had been low but claims rates and costs were rising. These worsening loss ratios would have contributed to the insurers' decision to exit the market. The level of market competition at the time limited the ability of insurers to increase premiums and contributed to the low profit margins that characterised the DBI product.

The Commission's analysis of simple loss ratios presented in this report will still not be conclusive as project certificates issued between 2008 and 2010, before the exit of the private insurers, are still maturing with more than half their liability period remaining. However, it is still useful to compare claims development and loss ratios for different project certificate years, to indicate how they are tracking.

The remainder of this report examines the performance of Victoria's DBI scheme from five different perspectives:

- DBI scheme performance (chapter 3) — combines data on premium revenue and claim costs to give a picture of scheme profitability.
- Builder eligibility (chapter 4) — discusses the relationship between builder registration and eligibility for DBI and presents the eligibility data obtained from insurers.
- Project certificates and premiums (chapter 5) — presents information on the number of project certificates issues to registered builders, the value of projects undertaken and the premium pool collected by insurers.
- Claims made against the scheme (chapter 6) — presents information on claim frequency and cost.

- DBI arrangements for owner-builders (chapter 7) — presents information on owner-builder policies, premiums and claims.

3 SCHEME PERFORMANCE

KEY FINDINGS

In the lead up to the exit of the private insurers, there was a jump in the number of project certificates issued, and premiums were at their lowest. There was an increase in builder insolvencies between 2007 and 2010.

The simple loss ratio is an indicator of the viability of the DBI scheme. For long-tail insurance schemes such as DBI, insurers will target a loss ratio of around 40 per cent on average over the liability period. For certificates and policies issued in 2008 (at the onset of the global financial crisis), the loss ratio stands at 62 per cent, with at least 3 years of liability still remaining.

Poor investment returns between 2007 and 2009 are likely to have further impacted negatively on insurer profitability.

Although still early in the liability period, the loss ratios for certificates and policies issued in 2010 and 2011 are significantly lower than those experienced in the lead up to the exit of the private insurers after similar liability periods. This coincides with the VMIA entering the market and increasing average premium levels and may also be partly due to a reduction in early claims rates. The fall in the loss ratio in the years following 2009 suggests premiums may have been previously under-priced in the competitive market.

An insurer’s profitability will depend on whether revenue — that is premiums combined with investment returns — covers the cost of claims expenses and other operating expenses.

The premium revenue for project certificates and policies[1] issued in any given year should meet the expected cost of claims arising from these certificates and policies. Because DBI is a long-tail insurance, an insurer must estimate the likely

[1] Project certificates are issued to registered builders and policies are issued to owner-builders.

total cost of claims over many years into the future. Insurers will invest a proportion of the premium revenue to help provide for the cost of future claims.

To estimate the future cost of claims, an insurer must make some assessment of the level of risk associated with a builder and each certificate or policy issued. They also have to take into account other external factors such as the broader state of the domestic construction market.

This chapter examines the risk factors that an insurer must assess and what, if any, steps an insurer can take to mitigate these risks. The chapter then presents some data on insurers’ performance in recent years and contextual data on investment returns which is likely to have affected insurers’ profitability.

3.1 RISK FACTORS IN DBI

Whether or not a successful DBI claim is made will depend on a number of factors: the building work must be incomplete or defective causing loss to the consumer; and the builder must be either dead, disappeared or insolvent.

This translates into two main types of risk — specific risks (those associated with the builder or project) and systemic risks(those associated with the building industry, the cost of material or the availability of credit). Table 3.1 describes the mechanisms for each type of risk and how they relate to DBI. If premiums do not reflect risk and are set too low compared to the expected cost of claims, insurer profitability and ability to make payments to claimants will be affected.

Insurers may mitigate builder specific risk in several ways the first of which is the granting of eligibility for DBI (see chapter 4). Insurers may choose not to grant eligibility to builders who they decide are too risky (based on work quality, claims history and financials). Having granted eligibility, insurers can also manage their exposure by setting turnover limits and imposing conditions on eligibility such as the requirement for financial securities.

Insurers can (and do) charge different premiums where different types and levels of risk are present — for example, they levy different premiums for different classes of builder, and for different types and values of project (see chapter 5).

Systemic risks reflect broader economic factors and are harder for insurers to manage. The cyclical nature of the building industry and the state of financial markets can have a significant impact on the profitability of the insurance scheme.

TABLE 3.1 RISK FACTORS FACING DBI INSURERS

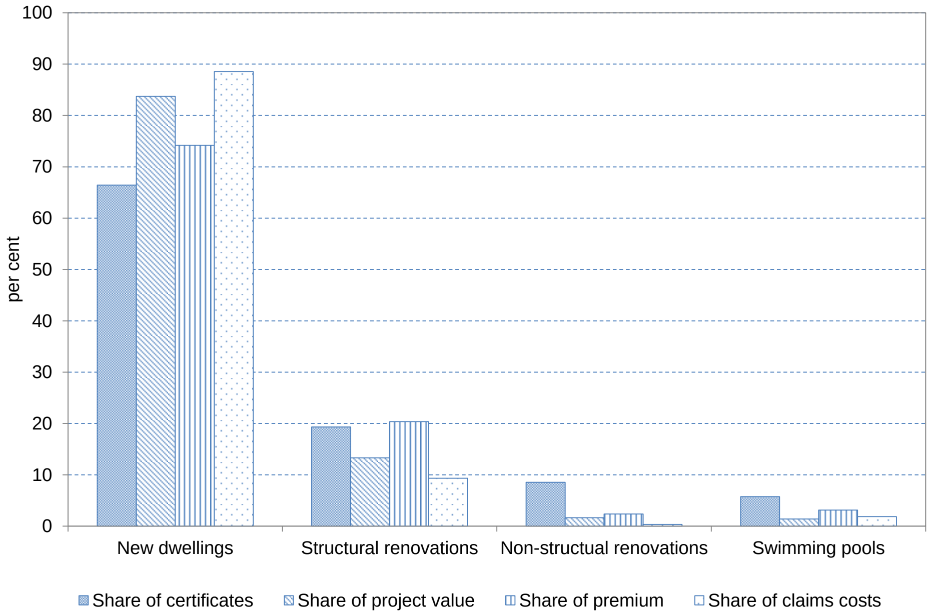
Specific risks	
Builder's financial position	A builder with a precarious financial position has a greater chance of becoming insolvent than a builder in a very healthy position.
Builder's financial history	A builder with a history of poor financial management is typically considered more likely to become insolvent.
Type of project	Some types of jobs have a history of higher claims costs. E.g. Swimming pool construction vs non-structural renovations.
Quality of builder's work	A builder whose work is technically competent is less likely to generate claims costs for defects even if DDI.
Systemic risks	
Domestic real estate market	A downturn in domestic building activity could lead to a rise in the rate of builder insolvencies.
Availability of credit	Builders rely on credit to manage their cash flow and supply of materials. A tightening of creditor requirements could push some entities toward insolvency.
Cost of materials	Increases in the cost of materials can affect builders' finances and the costs to the insurer of paying out claims.

The majority of the insurers' premium pool (and hence the major source of their revenue) comes from issuing project certificates for new dwellings. In terms of project type, they represent more than 70 per cent of the premium pool and almost 90 per cent of claims cost (see figure 3.1).

Any slowdown in the economy and the number of building approvals will have a significant impact on the ability of the insurers to generate revenue. At the same time, a slowdown in the economy and a tightening of credit markets can also result in increased builder insolvencies. To date, over 90 per cent of claims are as a result of a builder becoming insolvent. Moreover, the insolvency of a single large builder can have a significant impact on profitability because it has the potential to affect a large number of home-owners.

FIGURE 3.1 RELATIVE SHARES BY PROJECT TYPE

January 2002 – June 2012



3.2 SIMPLE LOSS RATIOS

The nature of long-tail insurance means that claims continue to come in over a long period of time after the issuing of the policy — for DBI this could be up to 10 years from certificate issue date.[2] Because of this, insurers must forecast the sufficiency of the premiums collected in one year to meet claims costs of subsequent years and to assess if their product is financially viable.

A key indicator in this assessment is the simple loss ratio which is the net incurred costs relating to claims made on project certificates issued in a year, divided by the total premium earned for that year. The simple loss ratio indicates how much premium collected by insurers (for a year) is paid out in claims. It does not take into

[2] DBI insurers are liable for defects up to 6 years after the completion of domestic building work. A project certificate is taken out when a project commences and it is assumed that construction is complete within 12 months giving a 7 year liability period. However, in practice delays in construction and notification can mean that claims are made up to 10 years after the certificate is issued. In some circumstance a home-owner can make a claim after the liability period has expired (s.54, *Insurance Contracts Act 1984* (Cth)).

account the other expenses incurred by insurers such as the cost of managing claims, nor does it include the costs associated with claims that are yet to be made.

For long-tail insurance, the simple loss ratio can be quite variable from year to year and insurers may need a better result in later years to pay for a worse result in earlier years. In discussions with actuarial consultants, the Commission has been advised that for long-tail insurance, insurers will target a simple loss ratio of around 40 per cent. The simple loss ratio calculation does not include costs that the insurer incurs in administering the scheme or income from investments.

As illustrated in table 3.2, loss ratios for certificates issued in later years are higher than the early years of the scheme. For certificates issued in 2008 (at the time of the GFC) the loss ratio stands at 62 per cent. This corresponds with a spike in the number of claims and claims costs. There was also a rise in the number of project certificates issued from 2008 to 2009, correlating with a jump in building approvals and low premiums (see chapter 5).

TABLE 3.2 SCHEME PERFORMANCE — SIMPLE LOSS RATIO

Registered builder and owner-builder, closed and finalised claims

Year	Number of project certificates	Premium excluding charges ($000)	Number of claims accepted[a]	Sum of net incurred costs ($000)	Years of liability remaining[b]	Loss ratio (%)
2002	17 731	10 661	102	4 168	0	39
2003	40 305	27 521	242	9 215	0	33
2004	34 720	27 536	250	15 189	0	55
2005	46 975	31 986	362	15 651	0	49
2006	53 142	32 119	349	13 202	1	41
2007	54 690	30 574	397	13 041	2	43
2008	53 113	27 650	391	17 091	3	62
2009	61 555	34 251	298	16 775	4	49
2010	65 101	41 881	177	7 798	5	19
2011	60 815	43 830	62	845	6	2
2012 Jan-Jun	28 246	22 826	2	0	7	0

a Excludes notification only claims, and denied claims. Claims have been assigned to the year in which the project certificate was issued. **b** Assumes 12 month construction period plus 6 year liability period.

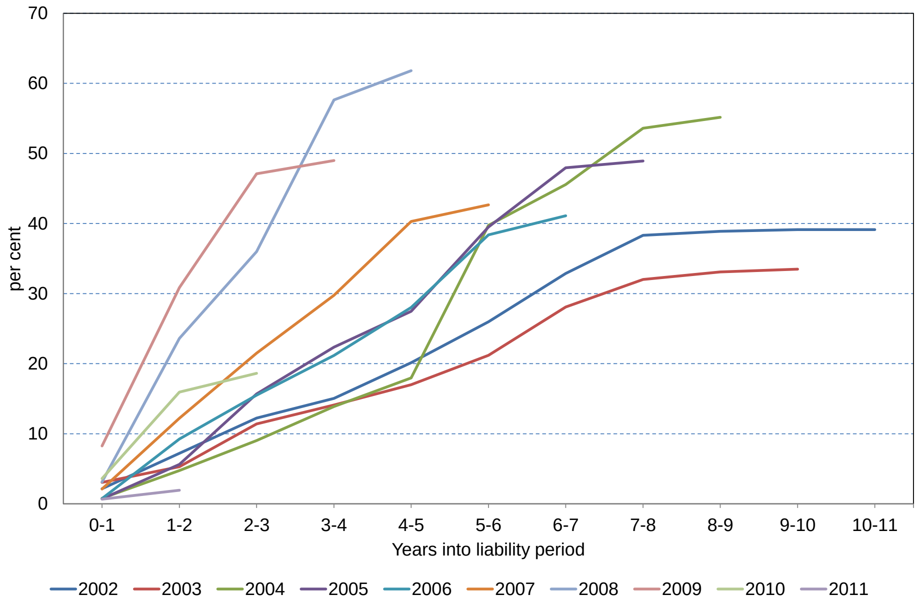
For project certificates issued in 2008, there are still at least three full years of policy coverage (liability) remaining. This means that if further claims are made against certificates and policies issued in that year, the loss ratio will continue to increase.

Figure 3.2 presents data on the development of the simple loss ratio over time and shows how loss ratios have risen quickly for certificates issued after 2003. There is a steep rise in the loss ratio for certificates issued in 2004 at around 4 years after the date of issue (2008). This coincides with the GFC. It is likely that at this time insurers may have been assessing the financial sustainability of the DBI product.

The period from 2007 through to 2009 appears to have been particularly poor for the financial viability of the DBI product. During this time the costs of claims made on the scheme were making a substantial impact into the premiums collected, affecting insurer profitability. These years are developing as much higher cost years than the earlier years of the scheme.

The loss ratios for certificates issued in 2010 and 2011 are lower compared to certificates issued in 2008 and 2009, after similar liability periods. This suggests that these years may develop as more profitable years for the scheme, but it is still very early in the liability period. This coincides with the VMIA entering the market (June 2010) an increase in average premium levels and a decrease in the early claims rate. The fall in the loss ratio in the years following 2009 suggests that premiums may have been previously under-priced, indicating that competition in the market may have driven them down to unsustainable levels or that there was an inappropriate assessment of risk.

FIGURE 3.2 SIMPLE LOSS RATIO OVER TIME



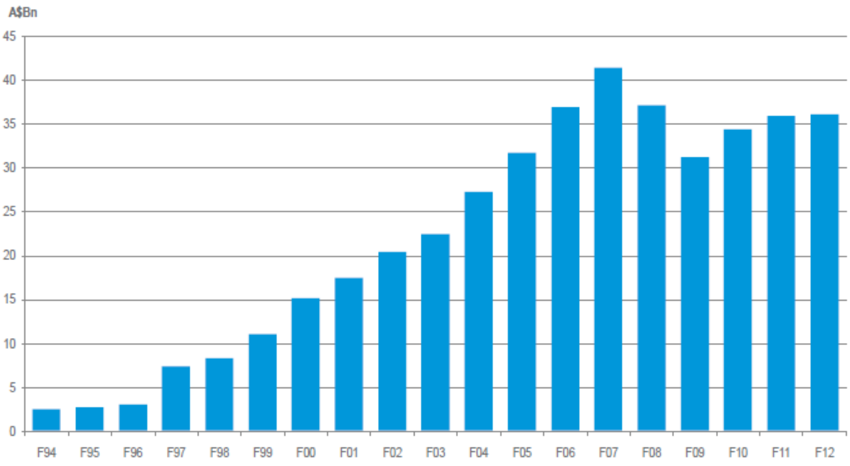
3.3 INVESTMENT PERFORMANCE

Investment returns are an important factor in ensuring an insurer’s ongoing profitability. To account for and manage future costs, a portion of the premium revenue that is collected is invested. While the Commission doesn’t have any data on individual insurers’ investment returns, general investment performance data can be used as an indicator.

The Victorian Funds Management Corporation (VFMC) manages investment portfolios for a number of government insurers including the VMIA. The VFMC’s investment performance should provide a good indication of the investment returns generally available to insurers in recent years. As seen in figure 3.3 the investments managed by the VFMC declined between 2007 and 2009. This decline was primarily driven by the large negative market returns associated with the GFC. This decline, as well as the increase in simple loss ratios (as discussed in section 3.2) would have impacted on insurer profitability in the lead up to 2009.

FIGURE 3.3 VICTORIAN FUNDS MANAGEMENT CORPORATION INVESTMENT PERFORMANCE OVER TIME

Financial years 1994 to 2012



Source: VFMC Annual Report 2011-2012, page 5.

4 ELIGIBILITY

KEY FINDINGS

The withdrawal of insurers from the market does not appear to have had an impact on the ability of builders to obtain DBI eligibility. Indeed, the data shows a greater number of builders eligible for DBI than are registered with the Building Practitioners Board.

At the time the VMIA entered the market, it announced that it would accept any builder that had an existing eligibility. Since then, the VMIA has adopted its own underwriting criteria and issued revised eligibility guidelines to be applied by QBE (which acts as an agent and issues policies underwritten by the VMIA)

Insurers impose annual turnover limits to cap the total value of contracts an eligible builder can make in a year. The eligibility data from insurers includes individual limits that when summed, exceed the total annual value of domestic construction undertaken in the State.

Insurers apply pre-conditions conditions for eligibility in the form of bank guarantees, securities and indemnities to approximately 10 per cent of eligible builders.

Before a builder takes out a DBI project certificate in relation to a specific building project, they must first have 'eligibility' with an insurer, which sets out the terms and conditions under which the insurer will offer DBI to the builder. Obtaining eligibility with an insurer is also a pre-requisite to a builder's registration, without which they cannot enter into a domestic building contract with a consumer or perform work for another builder.

This chapter sets out the relationship between builder registration and eligibility for DBI and presents the eligibility data obtained from insurers. This data can provide insights into the operation of the DBI market and the domestic building industry more generally.

4.1 WHAT DOES DBI ELIGIBILITY MEAN?

Eligibility with an insurer for DBI is a form of pre-approval for taking out project certificates. Under the *Domestic Building Contracts Act 1995*, each time a builder enters a domestic building contract over $12 000 with a customer, they must take out a project certificate specific to the works covered by the contract.

Before granting eligibility, an insurer reviews a builder's business history and finances to assess their risk, taking into account the risk factors highlighted in table 3.1 (see chapter 3). Insurers impose an annual turnover limit on builders based on their assessment of the value of works that a builder can prudently undertake given their financial position. In some circumstances insurers require a financial security or indemnity of some form before granting eligibility.

In any given year, an eligible builder can take out project certificates up to the value of their turnover limit. DBI eligibility is reassessed annually by the insurer, and builders also have the option of applying to reassess their turnover limit at any time through the year.

4.2 BUILDER REGISTRATION WITH THE BUILDING PRACTITIONERS BOARD

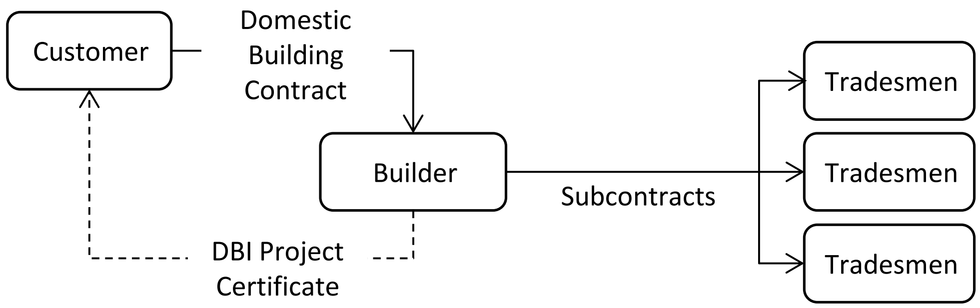
To enter domestic building contracts (or perform work for another builder), a builder must be registered with the Building Practitioners Board (BPB).[1] The BPB is an independent statutory body, established to oversee the quality and standard of professional services in the industry.

Approval for BPB registration is based on an initial application and involves examinations and interviews with an assessor. The applicant must also provide proof of DBI eligibility with an insurer. The recommendation of the assessor is then made to a full meeting of the Board as to the suitability of the applicant for registration. Subsequent renewal of registration is based on the ability to provide proof of DBI eligibility and payment of an annual fee.

[1] If the contracted building work is over $5000 then builders must be registered, and if the value of the building work is over $12 000 the builder is also required to provide DBI.

DBI eligibility is compulsory for builders in order to maintain registration. However not all registered builders routinely enter domestic building contracts with consumers and so not all registered builders will end up taking out project certificates. Figure 4.1 illustrates the parties and relationships in a standard domestic building contract.

FIGURE 4.1 PARTICIPANTS IN A DOMESTIC BUILDING CONTRACT



The ‘builder’ on the domestic building contract (who is required to take out a project certificate) can range from a sole trader undertaking the bulk of construction personally up to a large corporate entity employing registered builders and tradesmen to perform work on their behalf.

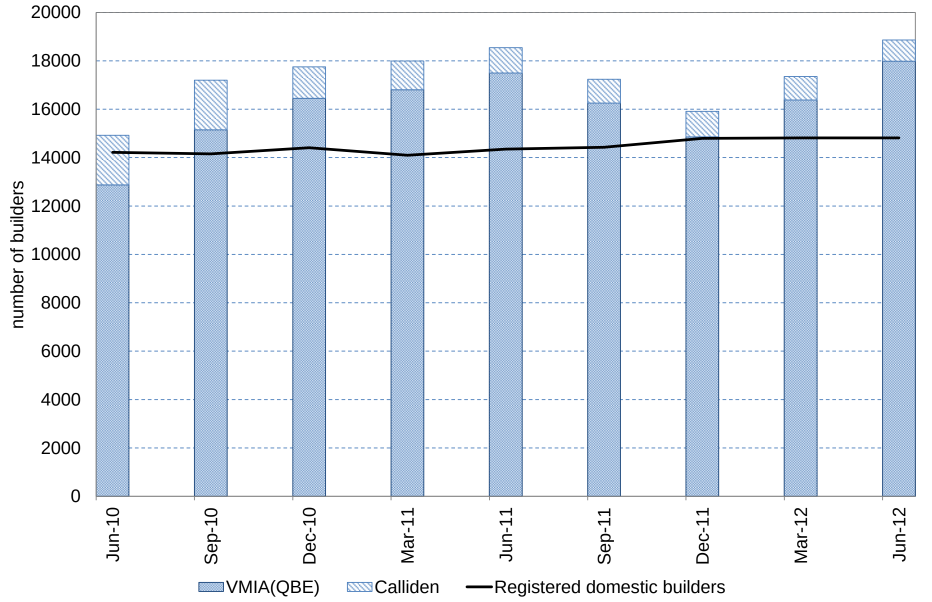
4.3 OBTAINING DBI ELIGIBILITY

Builders may apply and take out eligibility with one of the two remaining insurers in the Victorian market — VMIA or Calliden.

The VMIA has a commercial arrangement with QBE, who acts as its agent issuing policies and assessing builder eligibility for DBI via insurance brokers. When the VMIA entered the market in May 2010 following the exit of most private insurers, it maintained the same eligibility and turnover limits for each builder that were in place before the transition. Since then, the VMIA has adopted its own underwriting criteria and issued revised eligibility guidelines to QBE.

Figure 4.2 shows the aggregate eligibility data provided by the two insurers. Although the number of registered builders is relatively stable, eligibility for DBI has varied over time. The overall number of eligibilities exceeds the total number of builders, which suggests that generally builders are not experiencing difficulties in obtaining DBI, (although the Commission cannot comment on the experience of individual builders, given the available data).

FIGURE 4.2 DBI ELIGIBILITY AND DOMESTIC BUILDER REGISTRATIONS



Note: QBE began issuing the VMIA's policies from May 2010.

Data source: Data on builder registrations is from the Building Commission — pulse.

Discussions with the VMIA have shed light on several factors that may explain why the data shows a greater number of builders eligible for DBI than are actually registered with the BPB.

- A proportion of people that are completing building qualifications are purchasing the eligibility option for DBI but not making an application for registration by the BPB. (In the case of the VMIA this totals almost 10 per cent of eligible builders.)
- A single registered builder may be the principal for multiple building companies or may hold a number of eligibilities (known as facilities) within a single building company. This is because eligibility for DBI and the ability to enter into domestic building contracts is available to legal entities such as companies, partnerships and sole traders (as set out in the *Domestic Building Contracts Act 1995*), so long as a party in the entity is a registered builder.

4.3.1 THE ROLE OF BROKERS

DBI insurers do not accept applications for eligibility directly from builders, requiring them to engage an insurance broker. The broker acts as an intermediary with the insurer and charges a fee to the builder on successfully gaining eligibility. The broker receives a commission for each project certificate that is issued to the eligible builder. The Commission does not collect information on these fees, but submissions to the 2010 Parliamentary Inquiry into Builders Warranty Insurance suggested that some builders consider the fees excessive.[2]

4.4 CONDITIONS ON ELIGIBILITY

Insurers attempt to mitigate risks through imposing limits or conditions on builder eligibility. The VMIA and Calliden both set turnover limits and may accept securities and indemnities from builders to ensure that they have access to financial assets for compensation should the builder die, disappear or become insolvent.

4.4.1 TURNOVER LIMITS

Annual turnover limits effectively cap the total value of contracts an eligible builder can make with customers in a year. From an insurer's perspective, the turnover limit is necessary to mitigate against a builder taking on more work than they can support financially, and becoming insolvent. Domestic building is capital intensive and cash flow is lumpy, and attempts to 'trade out of trouble' by taking on extra projects could be seen as risky by insurers who will be liable for the cost of unfinished work if the builder becomes insolvent.

[2] Legislative Council Standing Committee on Finance and Public Administration, *Inquiry into Builders Warranty Insurance*, Final Report, 2010.

FIGURE 4.3 NUMBER OF ELIGIBLE BUILDERS BY TURNOVER BAND

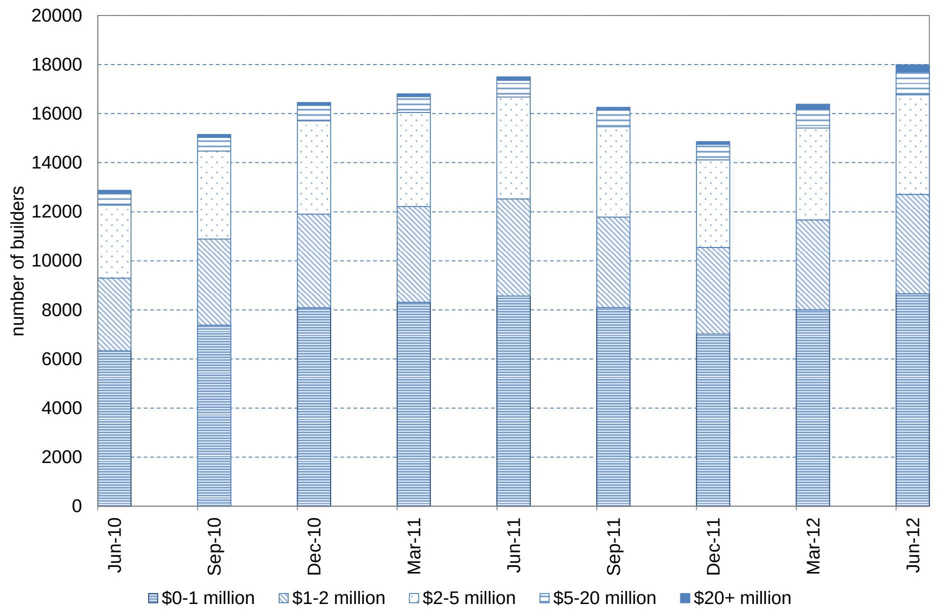


Figure 4.3 shows the number of eligible builders in each turnover band. From the overall data it would appear that the market for DBI is concentrated in small to medium builders with a turnover of up to $5 million; however there is a relatively small number of builders issuing more than 50 per cent of all project certificates. The greatest volume of domestic building activity is concentrated among a few larger building firms (made up of a number of registered builders with individual eligibility) that issue the bulk of the project certificates. Because of this they pose a significant risk to the DBI scheme should they become insolvent.

The Commission's analysis of aggregate turnover limit (see table 4.1) against the value of project certificates issued shows a significant difference in the annual turnover limits imposed by insurers and the actual value of all projects undertaken.

TABLE 4.1 PROJECT VALUE AGAINST TOTAL TURNOVER LIMIT

Registered builders as at December

	Value of projects ($m)	Total turnover limit ($m)
2009	10 718	59 810
2010	12 195	40 245
2011	12 059	38 812
2012 (Jan-Jun)	5 359	64 130

The eligibility data from insurers includes individual limits that when summed, exceed the total annual value of domestic construction undertaken in the State. This indicates that turnover limits for some builders are set considerably higher than the value of projects they will turnover in any given year. There are also over 1000 builders with turnover limits set at one or zero dollars. This would appear to be a way for insurers to give eligibility but at the same time restrict the ability to issue project certificates. Builders with a one dollar limit can keep their registration, but would not be able to enter contracts requiring DBI (i.e. over $12 000).

The Commission does not consider the setting of a turnover limit on builders unreasonable. An insurer will determine each individual builder’s turnover limit, independently of any other builder. To do this they must strike a balance between setting the limit too low, thereby constraining the builder’s ability to trade, or setting it too high and risking greater losses if the builder becomes insolvent. While aggregate numbers don’t show a problem, it may well be the case that some individual builders may be constrained.

4.4.2 SECURITIES AND INDEMNITIES

As shown in the Commission's previous performance reports, prior to June 2009 pre-conditions for eligibility in the form of bank guarantees, securities and indemnities were required for over 30 per cent of eligibilities. The data submitted by insurers shows that this has subsequently fallen over time to approximately 10 per cent as at June 2012.

5 PROJECT CERTIFICATES AND PREMIUMS

KEY FINDINGS

A builder must take out a project certificate with a DBI insurer whenever they enter a contract for domestic building work with a value of more than $12 000. Given the mandatory nature of DBI, the number of certificates fluctuates with trends in the domestic building market. The number of project certificates issued has increased each year since 2005, with the exception of 2008 and 2011.

The bulk of certificates — more than 60 per cent — are issued for new dwelling projects.

Premiums are calculated on the basis of project type, the value of the project and the risk rating of the builder. The total annual premium pool has risen steadily since 2008, driven by the increase in the number and average value of projects.

Average premium rates (i.e. dollar amount per $1000 of project value insured) were at their lowest before June 2009. At this time, competition between insurers was strong, but the market for DBI was still in its infancy, and a lack of information about costs could have driven premiums below cost reflective levels.

A lack of information about brokerage charges means that it is not possible to assess the total cost of DBI to the building industry.

Each domestic building contract valued over $12 000 requires the builder to take out a DBI policy, which is referred to in the industry as a ‘project certificate’. After obtaining eligibility with an insurer, a builder can apply for project certificates in relation to specific building contracts.[1]

As with other types of insurance, a premium is paid for the project certificate, which varies according to the value of the insurance and the level of risk associated with

[1] Building Practitioners Board - Domestic Builders Insurance, 1 April 2012, http://www.buildingcommission.com.au/www/html/514-domestic-building-insurance.asp.

the policy. In relation to DBI project certificates, the premium paid by the builder can vary according to the type of building project, the value of the project and the insurer's categorisation of the builder's risk.

This chapter presents information on the number of DBI project certificates that have been issued to registered builders, and the value and types of building projects insured. It also examines the total premium pool collected by insurers and the average premiums and premium rates being charged by insurers.

5.1 DBI PROJECT CERTIFICATES

Insurers will calculate a premium for each certificate which is specific to the work specified in the contract. The premium for the project certificate is based on the value of the contract. Certificates are issued in several categories depending on the type of building work undertaken.

Table 5.1 shows the relative contribution of each category over time to the total number of project certificates issued. The vast majority of project certificates are issued for new dwellings. Because of this dominance, the impact of new dwelling certificates on the DBI scheme will be examined in greater detail in section 5.1.2.

TABLE 5.1 NUMBER OF PROJECT CERTIFICATES ISSUED BY TYPE

Year	New dwellings	Structural renovations	Non-structural renovations	Swimming pools	Total
2005	27 978	8 105	3 424	3 049	42 556
2006	30 052	10 125	3 887	3 273	47 337
2007	32 400	10 905	3 959	3 310	50 574
2008	32 155	9 377	4 301	4 113	49 946
2009	40 681	9 681	4 298	3 865	58 525
2010	43 474	12 357	3 418	3 165	62 414
2011	40 241	10 263	6 706	2 046	59 256
2012 Jan-Jun	17 153	5 938	3 763	564	27 418

Given the mandatory nature of DBI certificate numbers should fluctuate with trends in the domestic building market. Since 2005, the number of project certificates issued has increased each year with the exception of 2008 and 2011. In 2009, there was nearly 17 per cent growth in the number of project certificates issued, possibly as a result of the boost in the first home-owners grant.[2] This coincides with the beginning of the withdrawal of the private insurers.

5.1.1 CONCENTRATION OF PROJECT CERTIFICATES

As discussed in chapter 4, the BPB registers only individual builders but eligibility and the ability to enter into domestic building contracts is available to all legal entities — companies, trusts, etc — as long as a party in the entity is a registered builder. A small number of large builders account for the vast majority of project certificates issued (as discussed in chapter 4).

5.1.2 NEW DWELLING PROJECT CERTIFICATES

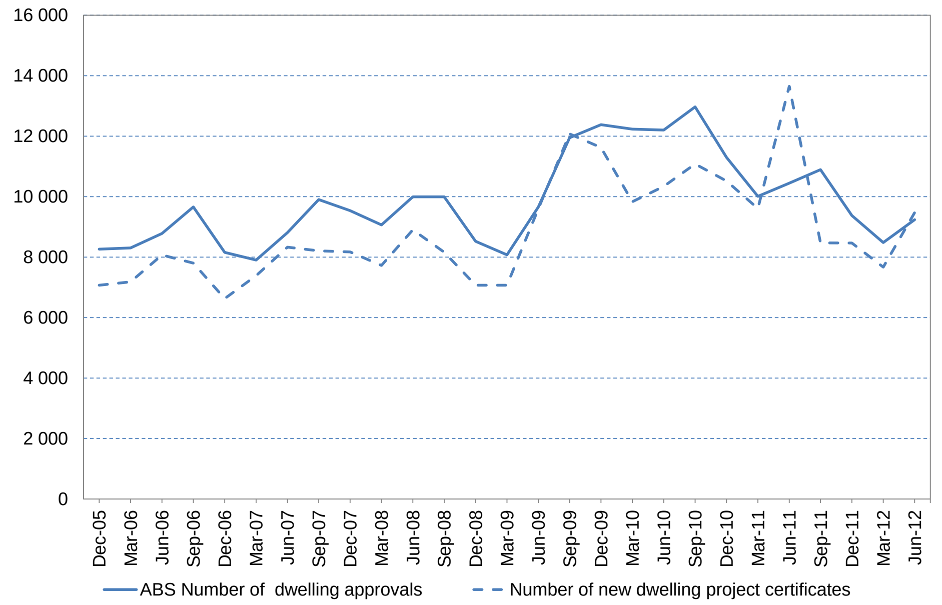
New dwelling project certificates issued to registered domestic builders are the largest contributor to the overall number of DBI project certificates and the overall premium pool. They make up more than 60 per cent of certificates issued, and over 70 per cent of total premium collected.

Figure 5.1 compares the number of project certificates issued for new dwellings with ABS quarterly data on building approvals. It is a way to check that builders are taking out insurance as required. The data series will not be an exact match mainly because the ABS uses compiled survey data.

The two data sets in figure 5.1 tracked closely until December 2009, when the withdrawal of insurers from the market may have led to delays in processing of project certificates, creating a time lag between the issue of a building permit and the issue of a DBI certificate.

[2] The First home-owner Boost Scheme (the Boost) was an Australian Government initiative to assist first home buyers purchase or build their first home. The scheme is administered by the Victorian Government (State Revenue Office) and is in addition to the $7,000 First Home-owner Grant. It covered contracts entered into between 14 October 2008 and 31 December 2009.

FIGURE 5.1 NUMBER OF NEW DWELLING APPROVALS IN VICTORIA



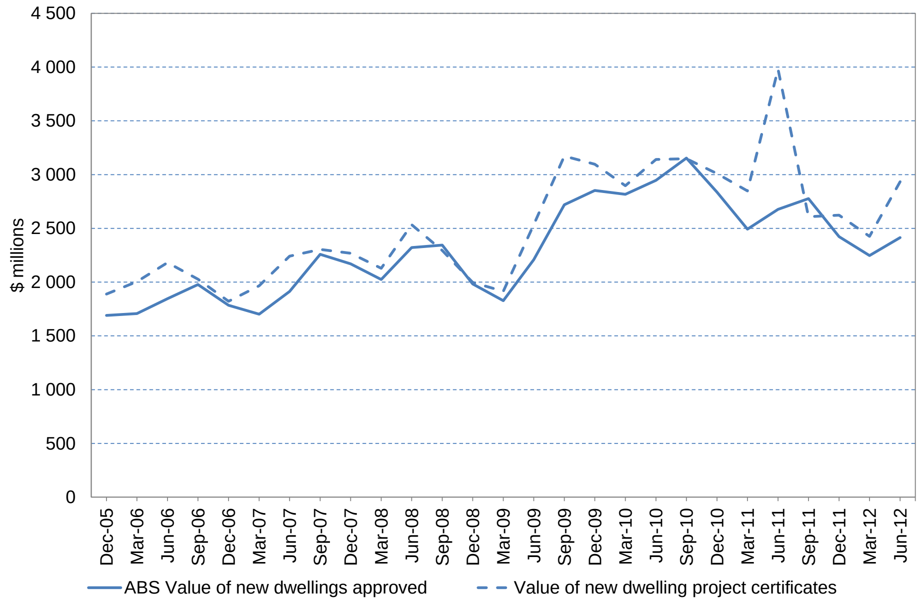
Data source: ABS 8731.0 Building Approvals, Australia, Table 23. Dwelling Units Approved in New Residential Buildings, Number and Value, Original — Victoria. Includes houses, semi-detached dwellings, and units/apartments ≤ 3 storeys.

Data from insurers shows there was a jump in the number of new dwelling project certificates issued in June 2011 as highlighted in the Commission's 2010-11 DBI performance report. By itself this peak seems unusual, but it could be explained by timing differences between the two sets of data given the relatively low number of project certificates issued in 2010 compared to ABS building approvals. The number of project certificates has since stabilised and appears to be tracking the ABS data.

Figure 5.2 shows the value of building approvals reported by the ABS together with the value of project certificates for new dwellings issued by the insurers. The peak in the value of project certificates correlates with the peak in figure 5.1 in the number of project certificates issued in June 2011.

Figure 5.1and 5.2 illustrate that the number and value of project certificates vary seasonally. More certificates are typically issued in the June and September quarters relative to the March and December quarters.

FIGURE 5.2 VALUE OF NEW DWELLING APPROVALS IN VICTORIA



Data 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.

5.2 PREMIUMS

As outlined in chapter 3, insurers set premiums so that premium revenue, combined with investment and other income, adequately covers the expected future cost of claims and administration costs to ensure profitability.

5.2.2 AGGREGATE PREMIUM

Premiums differ according to project type, builder risk rating and project size (value). The total premium pool in any year is a combination of the rates being charged and the total amount of domestic construction that commences. Table 5.2 shows the total premium pool collected each year since 2005. Collectively, insurers have received between $25 million and $43 million each year.

TABLE 5.2 TOTAL ANNUAL PREMIUM

Registered builder (excludes GST, stamp duty and brokerage)

Year	Number of project certificates	Value of projects ($m)	Premium ($m)	Average project value ($)	Average cost of a project certificate ($)
2005	42 556	6 839.01	27.36	160 706	643
2006	47 337	8 034.60	28.32	169 732	598
2007	50 574	8 778.59	27.29	173 579	540
2008	49 946	8 953.82	25.18	179 270	504
2009	58 525	10 717.94	31.95	183 134	546
2010	62 414	12 195.22	39.68	195 392	636
2011	59 256	12 058.64	42.34	203 501	714
2012 Jan-Jun	27 418	5 359.31	22.02	195 467	803

Table 5.3 shows the average value of projects over time. New dwellings are typically higher value projects than others and with the exception of 2009, their average value has grown steadily over time.

TABLE 5.3 AVERAGE PROJECT VALUES

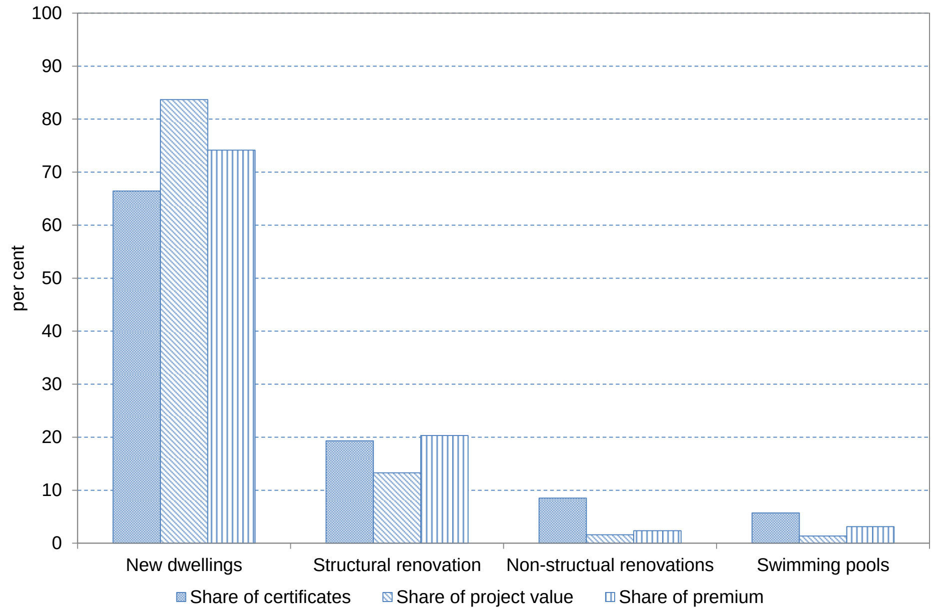
Registered builder ($000)

	New dwellings	Structural renovations	Non-structural renovations	Swimming pools	Total
2005	202.6	116.4	33.7	37.0	160.7
2006	214.0	131.7	35.1	40.9	169.7
2007	218.4	129.6	37.1	42.8	173.6
2008	230.5	125.6	42.1	44.9	179.3
2009	225.1	123.9	44.2	44.6	183.1
2010	241.3	117.5	30.8	47.3	195.4
2011	256.1	141.0	30.9	49.1	203.5
2012 Jan-Jun	260.0	128.9	27.3	54.6	195.5

Figure 5.3 shows the share of project certificates issued by project type indicating their relative contribution to the overall premium pool. The bulk of certificates are issued for new dwellings and structural renovations. Non-structural renovations (such as kitchen and bathroom remodelling) and swimming pools combined make up around 15 per cent of certificates issued, and between 5 and 10 per cent of total premium charges.

FIGURE 5.3 SHARE OF PROJECT CERTIFICATES BY PROJECT TYPE

Registered builder - September 2005 to June 2012



5.2.3 PREMIUM RATES — REGISTERED BUILDER

Premium rates (expressed as the cost per $1000 of project value) can be used to compare premiums between insurers and over time, taking into account differences in the value of projects being undertaken.

A fundamental principle of any insurance scheme is to spread the risk of an uncertain event among a group of individuals. Insurers use a pool of premiums they collect from the group to cover the cost of individual claims, should an uncertain event occur. The more likely an event may occur for a particular subgroup, the higher the premium should be to cover the cost of claims. Insurance premiums that do not adequately reflect the risk of a claim by individual, or a subgroup of insured individuals, are likely to result in claims cost that exceed the pool of funds available. That is, premiums will not be sufficiently cost reflective.

The challenge for insurers is therefore to set an efficient premium structure — to match the premium paid by a builder for the project certificate with the risk to the insurer that is presented by the particular builder and the particular project covered by the certificate.

The VMIA publishes its premium schedule on its website (see appendix B) and it is based on the following parameters:

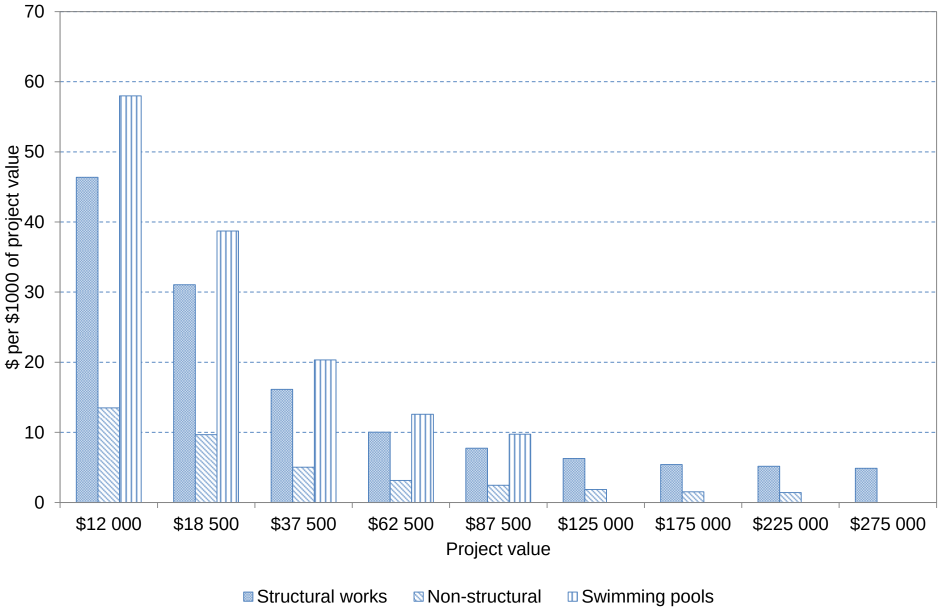
- the value of the contracted works (in bands)
- the category of work (structural, non-structural, swimming pools) and
- the insurer's rating of the builder's individual risk (A, B, or C).

When the VMIA premium schedule is converted to premium rates, it shows that the premium rate depends primarily on the sum insured, with higher value projects having lower premium rates (see figure 5.4).[3]

[3] As individual premiums are determined by the builder's rating, construction category and value of the building works, it should be noted that dividing the total premium by the number of certificates issued only gives a rough indication of actual premium levels.

FIGURE 5.4 VMIA PREMIUM RATE PER $1000 OF PROJECT VALUE

Excludes GST, stamp duty and brokerage



Note: Premium rate calculated based on a ‘B rate’ certificate charge for projects of values listed.

Source: VMIA Domestic Building Insurance Rate Chart, June 2012.

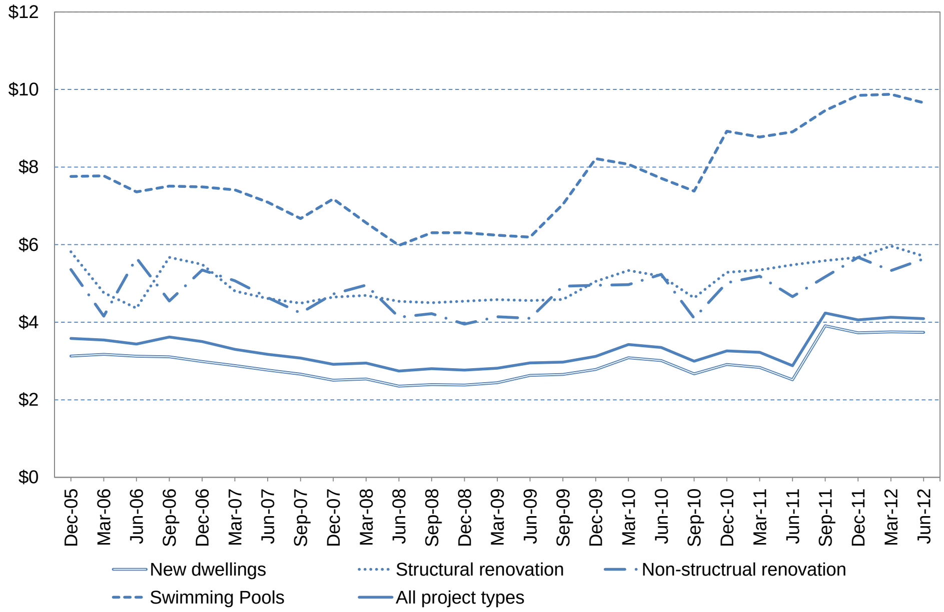
New dwellings and structural renovations fall in the same category of the VMIA’s premium schedule (structural works). Even though structural and new dwellings fall in the same VMIA category they appear as separate lines in figure 5.5 because of the typically much higher value of a new dwelling (average project value being around $260 000 from table 5.3) compared with the average value of structural renovations ($129 000). Swimming pools have the highest rates, but they make up only 3 per cent of the premium pool and account for less than 1 per cent of total project value.

Figure 5.5 shows premium rates for all insurers for different project types over time. The premium rate for all project types was at its lowest before September 2008. At this time competition between insurers was strong, but the market for DBI was still in its infancy, and a lack of information about costs could have driven premiums below cost reflective levels.

The rates for renovations seem similar regardless of whether the project is structural or non-structural, despite the fact that non-structural claims can only be made for two years after completion while structural claims have a 6 year claim period. Swimming pool construction has the highest premium charges.

FIGURE 5.5 AVERAGE PREMIUM RATE PER $1000 PROJECT VALUE — ALL INSURERS

Excludes GST, stamp duty and brokerage



5.2.4 THE EFFECT OF BROKERS

The effects of brokerage on the insurance scheme are not well understood. The Commission has no data, except for anecdotal reports, on the amount paid to brokers for DBI project certificates. In the absence of this information there are limits on the useful analysis that can be carried out. The premium without fees and charges is valuable for understanding the pool of money available to insurers for paying claims, but in the absence of brokerage estimates, the Commission cannot evaluate the total cost of the insurance to the building industry. Any meaningful study of the costs and benefits of the current DBI arrangements would necessitate a comprehensive investigation into the role of brokers and their charges.

6 CLAIMS

KEY FINDINGS

Since the introduction of the DBI scheme in 2002, insurers have received 3387 claims. Builder insolvency is by far the most common reason for claims, and almost half of claims relate to a structural defect.

As to be expected given the length of the liability period, the number of DBI claims has risen over time, with over 600 claims per annum received in both 2010 and 2011.

The average cost to an insurer of a finalised accepted DBI claim is around $37 700, but costs vary significantly by type of claim, with claims for 'failure to complete' the most costly to insurers.

Claim turnaround times are an important indicator of insurer performance. Since the DBI scheme began in 2002, the average time from receiving a notification to a claim being finalised is 545 days. On average, the decision by the insurer about whether or not to accept liability is made 52 days from the claim being received.

Claims under Victoria's DBI scheme can only be made under certain circumstances. The *Domestic Building Contracts Act 1995*, contains a number of implied warranties concerning a builder's work. DBI claims are only available where rights under these warranties cannot be pursued because the builder has died, disappeared or become insolvent. These three triggers are collectively abbreviated as DDI.

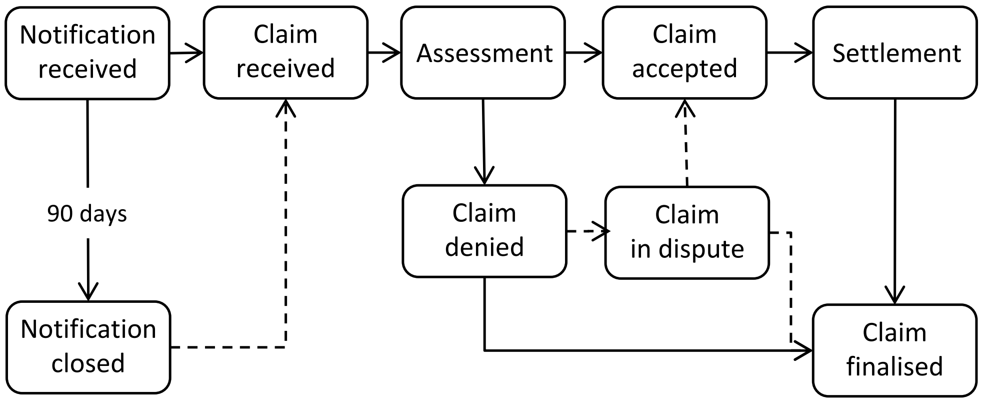
This chapter presents high level data relating to claims frequency and costs since the current scheme began for registered builders in 2002. As has been mentioned in our previous reports, the long liability period for DBI means that it is difficult to present claim numbers in their true context until at least 6 years after the issue date of project certificates.

6.1 DBI CLAIMS PROCESS

Claims are relatively infrequent in relation to the number of project certificates issued, but each one represents a major inconvenience for the customer whose home building project is incomplete or defective and whose relationship with their building contractor has completely deteriorated.

When a consumer notifies their insurer they would like to make a claim, it passes through multiple stages in its development, as illustrated in figure 6.1.

FIGURE 6.1 DBI CLAIMS PROCESS



A policy holder may notify an insurer of a fault at any time after a project certificate has been issued by providing very basic information. This notification escalates into a claim if the claimant provides minimum claims information within 90 days. If the minimum information is not received within this time, the notification is closed, but remains on file. The notification may be re-opened at a later stage and escalated into a claim with provision of minimum information. The Commission's analysis concentrates on claims that have graduated beyond this notification stage.

The insurer assesses a claim when minimum claims information has been provided. This involves investigating the builder to determine if they are DDI, and examining the claimed defect or non-completion to see if it qualifies for compensation. The assessment period may be a matter of days or months depending on the individual circumstances. The insurer then accepts or denies liability for the claim. If the claim is denied, the claimant has the opportunity to dispute the insurer's decision, otherwise the claim is finalised. If the insurer accepts the claim, a settlement period begins in which the compensation is calculated and paid. When the claim is fully settled with the claimant it is considered finalised, and closed.

DBI is considered to be a long-tail insurance as claims can be made for up to 2 years after completion in relation to non-structural defects, and for up to 6 years after completion in relation to structural defects.[1] As there is a lag between when the project certificate is issued and when the work is completed, DBI claims can sometimes be made as late as 10 years after a certificate is issued. Therefore, the total number and cost of claims relating to certificates issued in any given year will not be known for a long period of time.

6.2 OVERVIEW OF CLAIMS

Table 6.1 shows the overall number of claims relating to registered builders since the introduction of the DBI scheme in 2002. Since the scheme began, insurers have received 3387 claims.

TABLE 6.1 CLAIM NUMBERS BY STATUS

Registered builder — January 2002 to June 2012

	Open	Closed/finalised	Total
Claims			
Accepted[a]	592	1677	2269
Pending[b]	215		215
Total accepted or pending	**807**	**1677**	**2484**
Liability denied	19	884	903
Total claims	**826**	**2561**	**3387**

Note: Excludes notification only claims. [a] Includes deemed, full, and partially accepted claims. [b] Includes claims being assessed and claims in dispute.

[1] In some circumstances a home-owner can make a claim after the liability period has expired ((s.54, *Insurance Contracts Act 1984* (Cth)).

Table 6.2 splits all claims received against registered builders, whether accepted or not, by the reported cause and claim type. Insolvency is by far the most common reason that claims on DBI are made for registered builders and almost half the claims received related to a structural defect.

TABLE 6.2 CLAIMS RECEIVED BY TYPE AND CAUSE

Registered builder only — January 2002 to June 2012

	Death	Disappearance	Insolvency	To be determined	Total
Failure to commence	2	4	89	2	97
Failure to complete	19	34	921	13	987
Structural defect	27	85	1415	8	1535
Non-structural	13	24	714	2	753
Other loss			5	10	15
TOTAL	**61**	**147**	**3144**	**35**	**3387**

Table 6.3 illustrates the progressive build-up of claims since the scheme was first introduced. The annual total by the year of claim notification (running vertically down the right) shows more claims coming in every year. Along the horizontal total, the same claims have been distributed by the year in which the project certificate being claimed against was issued.

TABLE 6.3 CLAIMS RECEIVED OVER TIME

Registered builder only

	Project Certificate issue year											
Notif. Year	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**Total**
2002	2											2
2003	21	19										40
2004	15	35	7									57
2005	23	79	34	12								148
2006	21	41	60	62	3							187
2007	20	40	44	97	90	26						317
2008	30	60	56	115	84	90	24					459
2009	18	60	30	69	54	116	157	72				576
2010	4	41	49	69	82	125	113	121	26			630
2011	2	9	60	59	112	108	106	106	84	14		660
2012 (Jan-Jun)		2	6	15	37	23	32	34	86	74	2	311
TOTAL	**156**	**386**	**346**	**498**	**462**	**488**	**432**	**333**	**196**	**88**	**2**	**3387**

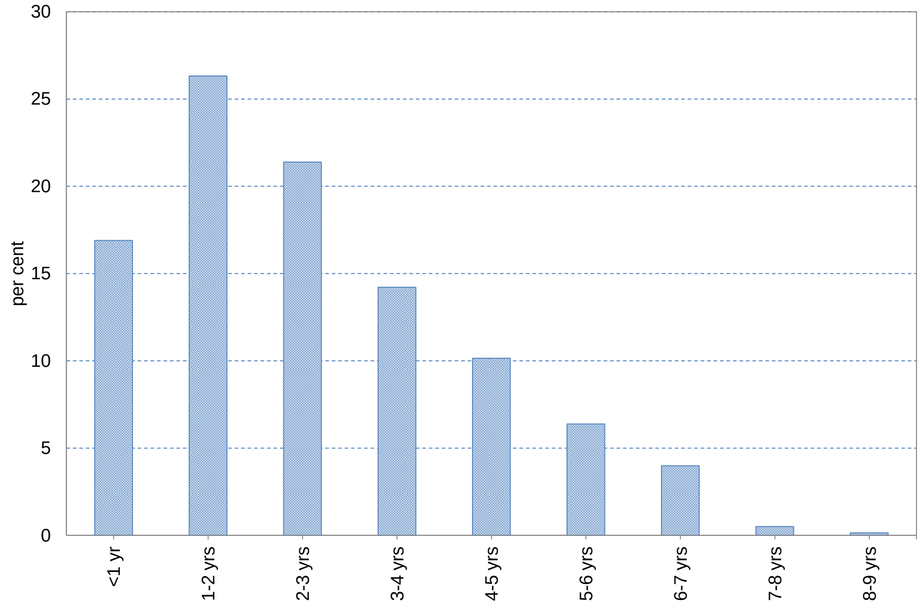
Note: Data revised since previous report. Includes all open and finalised claims. Excludes notification only claims.

Due to the shorter liability period, any non-completion claims can expect to be notified within around 3 years of a project certificate being issued. Non-structural defect claims are also likely to be notified within a shorter period than structural claims, which are often latent and may take years to manifest.

Figure 6.2 shows how DBI claims develop over time. It indicates that, on average, the majority (89 per cent) of successful registered builder claims are received within 5 years of the issue of project certificate and then taper off to almost nothing after 7 years. Over the life of scheme than 95 per cent of accepted registered builder claims were received and finalised within 7 years.

FIGURE 6.2 CLAIM DEVELOPMENT FROM CERTIFICATE ISSUE DATE

Finalised and accepted claims against certificates issued before 1 January 2008



Note: Certificates issued before 2008 are at least 5 years into their liability period which was considered sufficient for analysis. Accepted claims only.

6.3 CLAIM COSTS

As the number of claims for each project certificate year increases (see table 6.3), so will the cost of claims from those years. The development of claim costs over time will depend on the number of claims, as well as the type of claims (e.g. non-completion or structural).

Insurers record costs against each claim. Net incurred costs is the main measure of claim costs. This is made up of several categories and represents the insurer's total liability at any given point in time (see box 6.1).

BOX 6.1 CALCULATION OF NET INCURRED COSTS

	$ Paid to claimant	Payments made directly to the home-owner to date.
Plus	$ Paid to third party	Includes cost of investigation, structural assessments, legal fees.
Less	Third party recoveries	Monies recovered from builders, suppliers, other insurances etc.
Plus	Outstanding estimate	Insurer's estimate of the future costs relating to the claim. A finalised claim has no outstanding costs.

Some claims will be accepted and finalised with no costs, and a claim may incur costs even if it is not accepted. The total cost is more significant to insurers than the number of claims received, as it is the test of their premium setting and risk assessment and drives their profitability.

Table 6.4 shows that the average claim cost for finalised accepted registered builder claims has increased since the Commission's previous report ($37 700 compared to $33 310 in June 2011). Claims made on the scheme will depend among other things on the value of the project, and as discussed in chapter 5 average project values have also increased over time.

TABLE 6.4 CLAIMS COSTS BY STATUS

($000) Registered builder only — as at June 2012

	Open			Closed		Total
	Accepted	Denied	Pending	Accepted	Denied	
Number of claims (no.)	592	19	215	1 677	884	**3 387**
Sum paid to claimant	21 264	54	242	59 180	1 069	**81 808**
(plus) sum paid to third parties	2 647	94	290	7 141	922	**11 094**
(less) sum of third party recoveries received	272	0	0	3 101	59	**3 432**
(plus) sum of net outstanding estimate	16 109	288	5 180	0	0	**21 645**
Sum of net incurred cost	39 747	436	5 712	63 288	1 932	**111 115**
Average claim cost	67.1	22.9	26.6	37.7	2.2	**32.8**

Average costs are much lower in finalised registered builder claims compared to open and accepted claims, where the insurer is estimating the cost of the outstanding liability. This could indicate that actual costs tend to come in under the insurer’s estimate.

Even though the average cost of an accepted DBI claim for a registered builder is around $37 700 the costs vary significantly by claim type as shown in table 6.5. Claims for failure to complete are the most costly to insurers, making up around one third of all claims finalised.

TABLE 6.5 AVERAGE CLAIM COST BY CLAIM TYPE

Registered builder — January 2002 to June 2012

	Number of claims	Net incurred costs ($)	Average cost per claim ($)
Failure to commence	64	1 453 892	22 717
Failure to complete	583	32 051 463	54 977
Structural defect	655	18 839 051	28 762
Other (non-structural) defect	375	10 943 671	29 183
Total	**1 677**	**63 288 077**	**37 739**

Note: Finalised, accepted claims.

6.4 CLAIMS MANAGEMENT

6.4.1 CLAIMS TURNAROUND

The time it takes for a claim to go through each stage of the claim process could be used to examine how the scheme is operating in general and may give an indication of how well consumers are being served. Looking at the claims that have been accepted and finalised since the scheme started in 2002 (see table 6.6), the average time between receiving a notification and a claim being finalised is 545 days, or about a year and a half. The bulk of this time seems to be between the liability decision being made and the claim being finalised.

On average, the decision about whether to accept liability is made 52 days from receipt of a claim. This could be seen as a better measure of insurer performance, than the time taken to finalise a claim because the liability decision the consumer will be informed if their claim is successful or not. In general, it may take an insurer longer to finalise claims because of factors outside their direct control.

TABLE 6.6 AVERAGE TIME FROM CLAIM NOTIFICATION TO FINALISATION

Finalised, accepted claims January 2002 to June 2012

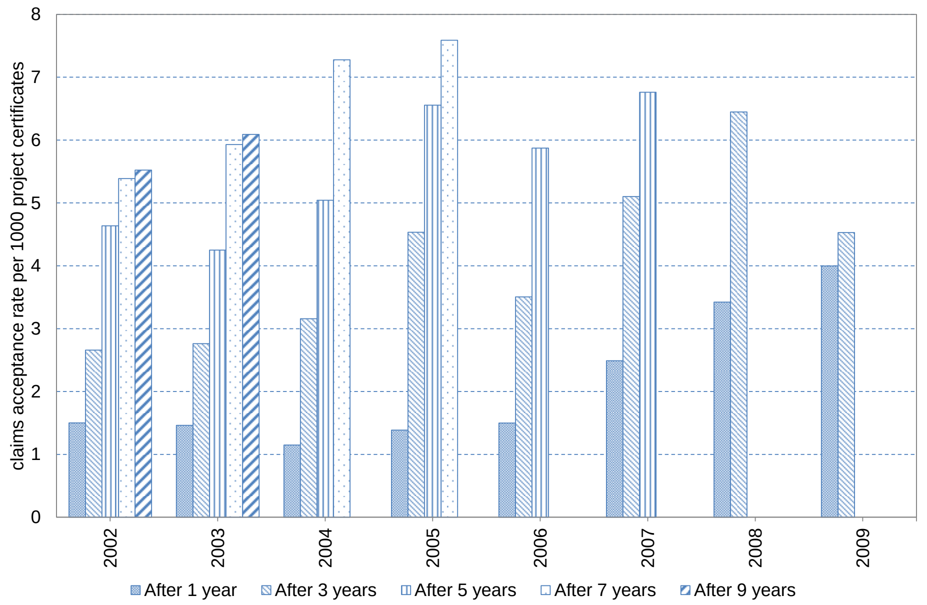
	Number of claims	Notification to claim receipt (days)	Claim received to liability decision (days)	Liability decision to finalisation (days)	Total (days)
All insurers	**1677**	**24**	**52**	**469**	**545**

Note: Some claims data from Vero was excluded from the analysis, due to a disproportionate number of claims being finalised on 31 March 2011 that had liability decisions prior to 2006.

6.4.2 CLAIMS ACCEPTANCE OVER TIME

Figure 6.3 normalises claims by the number of certificates issued in a particular year as a rate per 1000 certificates. As illustrated, the rate rises as the liability period extends. The rate of claims after 3 years for certificates issued in 2008 is almost as high as that of 2007 after 5 years.

FIGURE 6.3 CLAIM ACCEPTANCE RATE PER 1000 PROJECT CERTIFICATES
Registered builder only



6.4.3 CLAIMS DENIED

Insurers can deny claims on the basis of several criteria. As shown in table 6.7, most claims are denied either because the fault reported was not deemed a defect, or because the builder was not insolvent. Previous reports have highlighted the need for consumer education to help home-owners understand what is covered under DBI.

TABLE 6.7 REASONS FOR CLAIMS DENIED

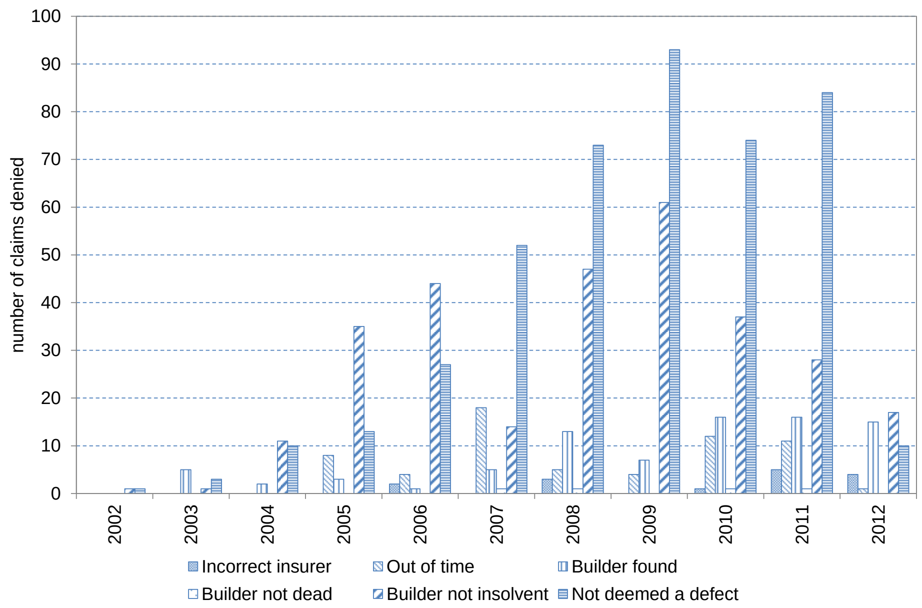
Registered builder only

	Claims (number)	Proportion (%)
Incorrect Insurer	16	1.8
Out of time	61	6.9
Builder found	83	9.4
Builder not dead	4	0.5
Builder not insolvent	294	33.3
Not deemed a defect	426	48.2
TOTAL	**884**	**100.0**

Over time the reasons why claims have been denied has varied from year to year. A peak in the number of denied claims occurred in 2009, also coinciding with the year the insurers decided to leave the market. In 2005 and 2006 most claims were denied because the builder was not insolvent. In contrast, over the period 2007 to 2011, the primary reason for claims being denied was that a defect was not found. This could indicate that insurers have tightened up their claim handling processes in more recent years, but could also reflect the changing mix of claims received.

FIGURE 6.4 REASONS CLAIM DENIED BY YEAR OF NOTIFICATION

Registered builder



Note: 2012 covers the period from January to June.

7 OWNER-BUILDERS

KEY FINDINGS

Owner-builders carry out building on their own property, and require DBI if they sell the home that they have constructed within six and a half years of completion.

Insurers treat owner-builders as a separate risk category from registered builders and charge different premiums, even though the insurance coverage is very similar.

The number of owner-builder policies has been declining steadily since 2006, but has remained a stable proportion of total annual owner-builder building permits in the last few years, at around 10 per cent.

An owner-builder is defined as someone who carries out building on their own property. Owner-builders are generally not in the building industry and must obtain a Certificate of Consent from the Building Practitioner's Board to obtain a building permit for domestic building work valued at more than $12 000. In doing so, owner-builders take on all the risks and responsibilities of a registered building practitioner.

Owner-builders require DBI if they sell the home that they have constructed within six and a half years of completion. They are required to provide the purchaser with evidence of a DBI policy and a report on any building defects by a prescribed building practitioner. In this way it is quite distinct from DBI purchased by a registered builder.

The insurance policy (an owner-builder policy is not called a project certificate) is for the benefit of the purchaser and subsequent owners, in the event that the owner-builder dies, disappears or becomes insolvent, and the building work is defective.

To obtain DBI they must provide details of the cost of work, building inspections and certificate of occupancy date and location of the property. They must also provide a current defects report and a copy of the building permit. The DBI policy does not commence until the contract of sale is signed.

7.1 POLICIES AND PREMIUMS

Table 7.1 compares the number and value of building permits issued to owner-builders for new domestic buildings with owner-builder DBI policies issued. The majority of domestic building permits issued to owner-builders do not require DBI as the property is not sold within the relevant time frame.

TABLE 7.1 OWNER-BUILDER ACTIVITY

	Number of building permits[a]	Value of building permits ($000)	Number of DBI policies	Value of DBI policies ($000)	Total premium ($000)
2002	28 600	1 761 732	3 068	363 702	645
2003	29 791	1 923 515	3 370	405 389	744
2004	29 545	1 982 845	3 388	457 190	3 714
2005	26 807	1 683 667	4 419	672 393	4 625
2006	24 714	1 438 931	5 805	952 246	3 804
2007	24 776	1 318 842	4 116	674 972	3 285
2008	24 396	1 374 818	3 167	549 537	2 470
2009	22 674	1 277 676	3 030	492 269	2 301
2010	24 107	1 478 535	2 687	471 311	2 196
2011	20 616	1 364 132	2 099	373 092	1 992
2012 Jan-Jun	9 216	638 037	828	145 851	806

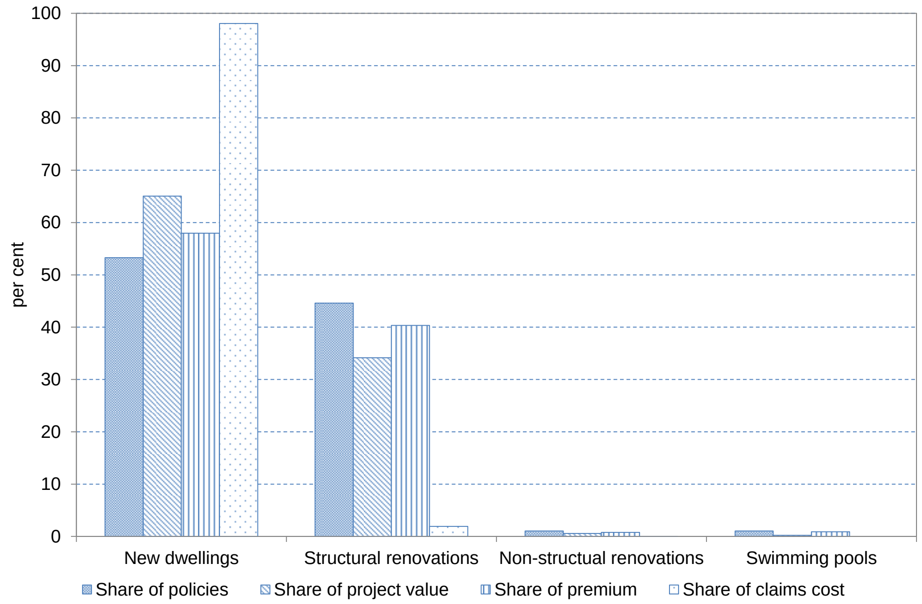
a Includes permits for new dwellings and renovations/alterations.

Data source: Data for number and value of building permits from Building Commission Pulse.

Figure 7.1 shows the relative contribution of each type of owner-builder policy to the share of premium and claims costs. New dwelling policies contribute the largest share to the premium pool and claims cost.

FIGURE 7.1 RELATIVE SHARES BY PROJECT TYPE

Owner-builders - January 2005 to June 2012



Insurers treat owner-builders as a separate risk category from registered builders and have different premiums although the insurance coverage is very similar. Owner-builder policies cover structural and non-structural faults under the same rules as registered builder project certificates, but do not cover ‘failure to commence’ and ‘failure to complete’. The liability period may be shorter because the policy is only taken out when the house is sold. Insurers also have more information to assess risk because construction is typically complete and a defect report is available.

Figure 7.2 shows the number of owner-builder policies being issued has been declining since 2006, but has remained fairly stable in the last few years at around 10 per cent of total annual owner-builder building permits.[1]

[1] The number of building permits issued to owner-builders for the period January to June 2012 was 9216. (Building Commission Pulse, Domestic building permits by status of builder, November 2012.)

FIGURE 7.2 NUMBER OF OWNER-BUILDER POLICIES ISSUED

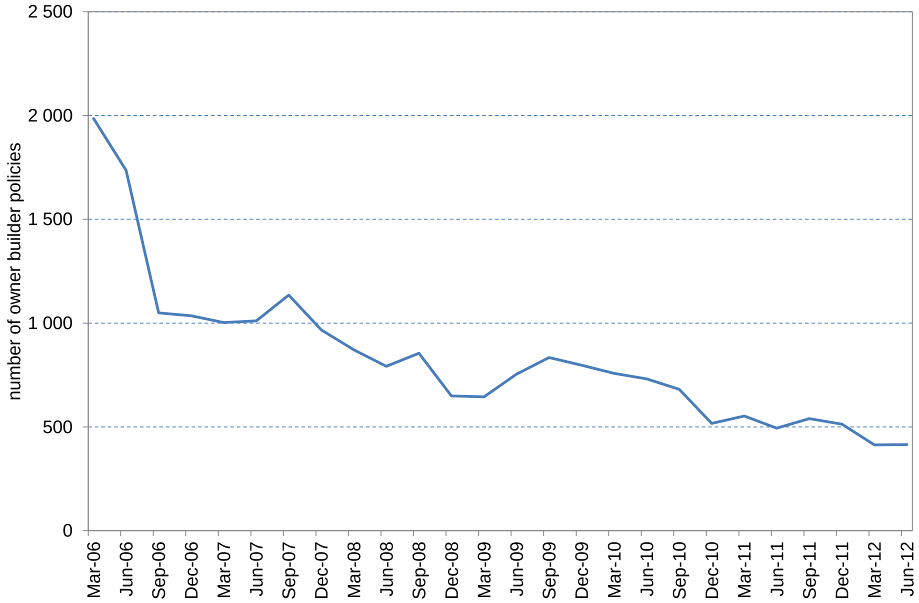
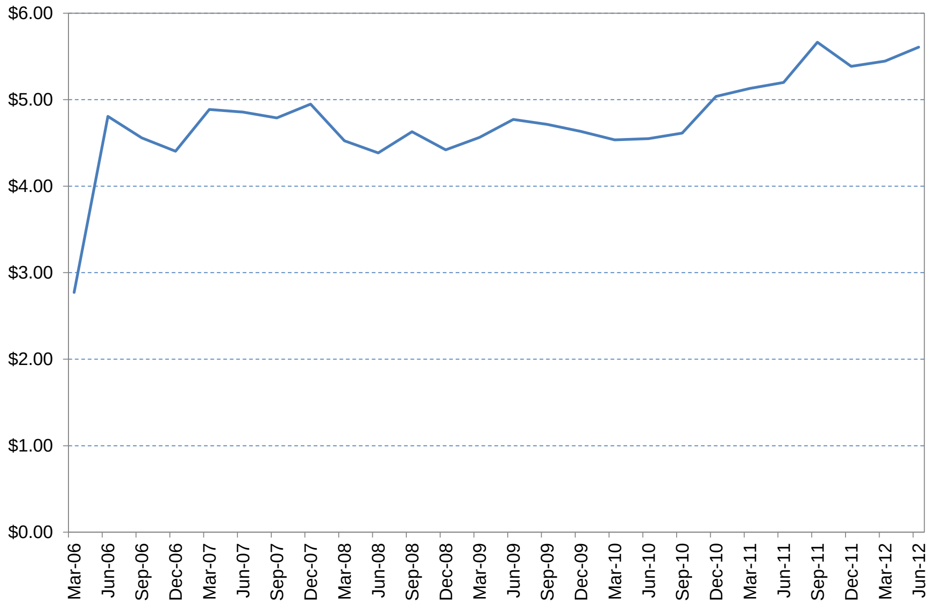


Figure 7.3 shows how the average premium per $1000 of project value has changed over time. When compared to registered builders owner-builders pay a higher average premium rate.

There has been little volatility in this rate over the last 5 years, although since late 2010 it has been increasing, which may be due to the VMIA adjusting its premium structure. In the earlier years of the scheme, there were insurers who specialised in DBI for owner-builders. Both Calliden and VMIA will issue policies to owner-builders.

FIGURE 7.3 AVERAGE PREMIUM PER $1000 OF PROJECT VALUE

Owner-builders



7.2 CLAIMS

Owner-builders have a higher rate of claims than registered builders even though the number of claims is very small. The most common reason for claims against owner-builders is disappearance. In the absence of a central licensing body, as exists for registered builders, it is more difficult for new owners of a property to track down the original owner-builder to rectify faults. This may also be the reason for owner-builder having higher average premium rates per $1000 of project value.

TABLE 7.2 CLAIMS DEVELOPMENT AND COSTS

Owner-builders

Time from policy issue date	Number of claims	% of total claims	Net incurred cost ($000)	Average claims cost ($000)
Within 12 months	5	3	455 904	91.18
1-2 years	24	16	335 564	13.98
2-3 years	26	17	1 107 529	42.60
3-4 years	33	22	473 587	14.35
4-5 years	30	20	739 963	24.67
5-6 years	24	16	718 723	29.95
6-7 years	7	5	8 635	1.23
TOTAL	**149**	**100**	**3 839 903**	**25.77**

APPENDIX A TERMS OF REFERENCE

Essential Services Commission Act **2001**

Essential Services Commission

Terms of Reference

Domestic Building Insurance – Data and Performance Monitoring

I, Tim Holding MP, Minister for Finance, WorkCover and the Transport Accident Commission, request the Essential Services Commission (the Commission) to provide ongoing monitoring reports on the pricing and performance of the Victorian Managed Insurance Authority's (VMIA) provision of domestic building insurance (DBI). The reports will cover claims management, the pricing of private domestic building insurers during the transition period from 29 March 2010 to the establishment of the new arrangements, and the claims management of the private domestic building insurers during the run-off period of their insurance policies.

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 Advice – Data and Performance Monitoring

The Commission is to annually monitor and report on the pricing and performance of the VMIA and private insurer's provision of DBI on an ongoing basis. The scope of the monitoring is to cover the:

- pricing and claims management of the VMIA;
- pricing of private domestic building insurers during the transition period; and
- private domestic building insurers' claims management during the run-off period.

The ongoing reporting is to be delivered in the form of annual reports.

The purpose of the annual reports is to inform the public of the performance of DBI.

The Commission will be required to publish a monitoring report each year that will be made publicly available. Any confidential or commercially sensitive material should be included in a separate attachment.

The purpose of the annual reports with the attachment is to inform the Government's consideration of DBI developments.

The annual reports will analyse quarterly data, including the number of eligible builders, project certificates, premiums levels, the number and amounts of claims for both the VMIA and private domestic building insurers and any other metrics the Commission and the Department of Treasury and Finance consider relevant.

Advice Process – Performance Monitoring

The monitoring reports are to be prepared independently by the Commission, under subsection 10(g) of the *Essential Services Commission Act* 2001 (the ESC Act), which provides the Commission with a general function to provide advice to the Minister for Finance.

The first data monitoring report is to cover the period from 1 July 2008 to 30 June 2010. Subsequent reports are to cover data for each financial year from 2010-11 onwards. The reports are to be provided by 30 November each 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, WorkCover
and the Transport Accident Commission

Date: 9/07/2010

APPENDIX B VMIA PREMIUM SCHEDULE

Domestic Building Insurance Rate Chart

vmia
Risk Management and Insurance

CAT A

STRUCTURAL WORKS

	Base	GST	Stamp Duty	Total
$12,000	$ 340.00	$ 34.00	$ 37.40	$ 411.40
$12001-$25000	$ 350.00	$ 35.00	$ 38.50	$ 423.50
$25,001 - $50000	$ 373.00	$ 37.30	$ 41.03	$ 451.33
$50,001 - $75000	$ 384.00	$ 38.40	$ 42.24	$ 464.64
$75,001 -$100,000	$ 417.00	$ 41.70	$ 45.87	$ 504.57
$100,001 -$150,000	$ 483.00	$ 48.30	$ 53.13	$ 584.43
$150,001 - $200,000	$ 582.00	$ 58.20	$ 64.02	$ 704.22
$200,001 - $250,000	$ 714.00	$ 71.40	$ 78.54	$ 863.94
$250,001 - $300,000	$ 823.00	$ 82.30	$ 90.53	$ 995.83
$300,001 - $350,000	$ 933.00	$ 93.30	$ 102.63	$ 1,128.93
$350,001 - $400,000	$ 1,043.00	$ 104.30	$ 114.73	$ 1,262.03
$400,001 - $450,000	$ 1,153.00	$ 115.30	$ 126.83	$ 1,395.13
$450,001 - $500,000	$ 1,205.00	$ 120.50	$ 132.55	$ 1,458.05
$500,001 - $750,000	$ 1,315.00	$ 131.50	$ 144.65	$ 1,591.15
$750,001 - $1,000,000	$ 1,425.00	$ 142.50	$ 156.75	$ 1,724.25
$1,000,000 - $1,500,000	$ 1,495.00	$ 149.50	$ 164.45	$ 1,808.95
$1,500,000 - $2,000,000	$ 1,570.00	$ 157.00	$ 172.70	$ 1,899.70
$2,000,000 - $2,500,000	$ 1,650.00	$ 165.00	$ 181.50	$ 1,996.50
$2,500,000- $999,999,999	$ 1,730.00	$ 173.00	$ 190.30	$ 2,093.30
	POA			

NON-STRUCTURAL WORKS

	Base	GST	Stamp Duty	Total
$12,000	$ 98.00	$ 9.80	$ 10.78	$ 118.58
$12001-$25000	$ 109.00	$ 10.90	$ 11.99	$ 131.89
$25,001 - $50000	$ 115.00	$ 11.50	$ 12.65	$ 139.15
$50,001 - $75000	$ 120.00	$ 12.00	$ 13.20	$ 145.20
$75,001 -$100,000	$ 131.00	$ 13.10	$ 14.41	$ 158.51
$100,001 -$150,000	$ 142.00	$ 14.20	$ 15.62	$ 171.82
$150,001 - $200,000	$ 164.00	$ 16.40	$ 18.04	$ 198.44
$200,001 - $250,000	$ 197.00	$ 19.70	$ 21.67	$ 238.37
Above $1m	POA			

SWIMMING POOLS

	Base	GST	Stamp Duty	Total
$12,000	$ 424.00	$ 42.40	$ 46.64	$ 513.04
$12001-$25000	$ 439.00	$ 43.90	$ 48.29	$ 531.19
$25,001 - $50000	$ 465.00	$ 46.50	$ 51.15	$ 562.65
$50,001 - $75000	$ 480.00	$ 48.00	$ 52.80	$ 580.80
$75,001 -$100,000	$ 520.00	$ 52.00	$ 57.20	$ 629.20
Above $100,000	POA			

CAT B

STRUCTURAL WORKS

	Base	GST	Stamp Duty	Total
$12,000	$ 460.00	$ 46.00	$ 50.60	$ 556.60
$12001-$25000	$ 475.00	$ 47.50	$ 52.25	$ 574.75
$25,001 - $50000	$ 500.00	$ 50.00	$ 55.00	$ 605.00
$50,001 - $75000	$ 518.00	$ 51.80	$ 56.98	$ 626.78
$75,001 -$100,000	$ 561.00	$ 56.10	$ 61.71	$ 678.81
$100,001 -$150,000	$ 650.00	$ 65.00	$ 71.50	$ 786.50
$150,001 - $200,000	$ 785.00	$ 78.50	$ 86.35	$ 949.85
$200,001 - $250,000	$ 963.00	$ 96.30	$ 105.93	$ 1,165.23
$250,001 - $300,000	$ 1,110.00	$ 111.00	$ 122.10	$ 1,343.10
$300,001 - $350,000	$ 1,260.00	$ 126.00	$ 138.60	$ 1,524.60
$350,001 - $400,000	$ 1,410.00	$ 141.00	$ 155.10	$ 1,706.10
$400,001 - $450,000	$ 1,555.00	$ 155.50	$ 171.05	$ 1,881.55
$450,001 - $500,000	$ 1,630.00	$ 163.00	$ 179.30	$ 1,972.30
$500,001 - $750,000	$ 1,780.00	$ 178.00	$ 195.80	$ 2,153.80
$750,001 - $1,000,000	$ 1,930.00	$ 193.00	$ 212.30	$ 2,335.30
$1,000,000 - $1,500,000	$ 2,025.00	$ 202.50	$ 222.75	$ 2,450.25
$1,500,000 - $2,000,000	$ 2,125.00	$ 212.50	$ 233.75	$ 2,571.25
$2,000,000 - $2,500,000	$ 2,230.00	$ 223.00	$ 245.30	$ 2,698.30
$2,500,000- $999,999,999	$ 2,345.00	$ 234.50	$ 257.95	$ 2,837.45

NON-STRUCTURAL WORKS

	Base	GST	Stamp Duty	Total
$12,000	$ 134.00	$ 13.40	$ 14.74	$ 162.14
$12001-$25000	$ 148.00	$ 14.80	$ 16.28	$ 179.08
$25,001 - $50000	$ 156.00	$ 15.60	$ 17.16	$ 188.76
$50,001 - $75000	$ 163.00	$ 16.30	$ 17.93	$ 197.23
$75,001 -$100,000	$ 178.00	$ 17.80	$ 19.58	$ 215.38
$100,001 -$150,000	$ 192.00	$ 19.20	$ 21.12	$ 232.32
$150,001 - $200,000	$ 222.00	$ 22.20	$ 24.42	$ 268.62
$200,001 - $250,000	$ 266.00	$ 26.60	$ 29.26	$ 321.86
Above $1m	POA			

SWIMMING POOLS

	Base	GST	Stamp Duty	Total
$12,000	$ 575.00	$ 57.50	$ 63.25	$ 695.75
$12001-$25000	$ 592.00	$ 59.20	$ 65.12	$ 716.32
$25,001 - $50000	$ 630.00	$ 63.00	$ 69.30	$ 762.30
$50,001 - $75000	$ 650.00	$ 65.00	$ 71.50	$ 786.50
$75,001 -$100,000	$ 705.00	$ 70.50	$ 77.55	$ 853.05
Above $100,000	POA			

CAT C

STRUCTURAL WORKS

	Base	GST	Stamp Duty	Total
$12,000	$ 735.00	$ 73.50	$ 80.85	$ 889.35
$12001-$25000	$ 760.00	$ 76.00	$ 83.60	$ 919.60
$25,001 - $50000	$ 805.00	$ 80.50	$ 88.55	$ 974.05
$50,001 - $75000	$ 830.00	$ 83.00	$ 91.30	$ 1,004.30
$75,001 -$100,000	$ 900.00	$ 90.00	$ 99.00	$ 1,089.00
$100,001 -$150,000	$ 1,042.00	$ 104.20	$ 114.62	$ 1,260.82
$150,001 - $200,000	$ 1,255.00	$ 125.50	$ 138.05	$ 1,518.55
$200,001 - $250,000	$ 1,540.00	$ 154.00	$ 169.40	$ 1,863.40
$250,001 - $300,000	$ 1,780.00	$ 178.00	$ 195.80	$ 2,153.80
$300,001 - $350,000	$ 2,015.00	$ 201.50	$ 221.65	$ 2,438.15
$350,001 - $400,000	$ 2,255.00	$ 225.50	$ 248.05	$ 2,728.55
$400,001 - $450,000	$ 2,490.00	$ 249.00	$ 273.90	$ 3,012.90
$450,001 - $500,000	$ 2,610.00	$ 261.00	$ 287.10	$ 3,158.10
$500,001 - $750,000	$ 2,850.00	$ 285.00	$ 313.50	$ 3,448.50
$750,001 - $1,000,000	$ 3,080.00	$ 308.00	$ 338.80	$ 3,726.80
$1,000,000 - $1,500,000	$ 3,240.00	$ 324.00	$ 356.40	$ 3,920.40
$1,500,000 - $2,000,000	$ 3,400.00	$ 340.00	$ 374.00	$ 4,114.00
$2,000,000 - $2,500,000	$ 3,570.00	$ 357.00	$ 392.70	$ 4,319.70
$2,500,000- $999,999,999	$ 3,750.00	$ 375.00	$ 412.50	$ 4,537.50

NON-STRUCTURAL WORKS

	Base	GST	Stamp Duty	Total
$12,000	$ 213.00	$ 21.30	$ 23.43	$ 257.73
$12001-$25000	$ 237.00	$ 23.70	$ 26.07	$ 286.77
$25,001 - $50000	$ 249.00	$ 24.90	$ 27.39	$ 301.29
$50,001 - $75000	$ 261.00	$ 26.10	$ 28.71	$ 315.81
$75,001 -$100,000	$ 284.00	$ 28.40	$ 31.24	$ 343.64
$100,001 -$150,000	$ 308.00	$ 30.80	$ 33.88	$ 372.68
$150,001 - $200,000	$ 355.00	$ 35.50	$ 39.05	$ 429.55
$200,001 - $250,000	$ 425.00	$ 42.50	$ 46.75	$ 514.25
Above $1m	POA			

SWIMMING POOLS

	Base	GST	Stamp Duty	Total
$12,000	$ 920.00	$ 92.00	$ 101.20	$ 1,113.20
$12001-$25000	$ 950.00	$ 95.00	$ 104.50	$ 1,149.50
$25,001 - $50000	$ 1,005.00	$ 100.50	$ 110.55	$ 1,216.05
$50,001 - $75000	$ 1,035.00	$ 103.50	$ 113.85	$ 1,252.35
$75,001 -$100,000	$ 1,125.00	$ 112.50	$ 123.75	$ 1,361.25
Above $100,000	POA			

Note: Rates are inclusive of GST and Stamp Duty, and exclusive of broker fees

APPENDIX C JURISDICTIONAL COMPARISONS

TABLE C.1 SUMMARY OF BUILDERS WARRANTY INSURANCE — NATIONAL

	Eligibility conditions for builders	Type of scheme[a]	Min value of works	Max value payable	Coverage period	Premiums	Underwriting and number of insurers	Owner builders
NSW *Home Building Act 1989* *Home Building Regulation 2004* *Home Building Amendment Act 2011*	All licensed domestic builders must be eligible. Exemptions granted under special license where contract price does not exceed $20 000. DBI must be purchased if contract price is greater than $20 000.	Last resort	$20 000	$340 000 or 20% of contract value	Non-structural 2 years. Structural up to 7 years from completion, maximum of 10 years from issue of policy. Up to 12 months for incomplete work.	Premiums are set by insurers based on risk assessment and value of project.	NSW Home Warranty Insurance Fund, underwrites policies issued by QBE and Calliden insurance agents via approved brokers.	Required by law on sale of property if within 6 years of completion of building works
QLD *Queensland Building Services Authority (BSA) Act 1991*	All contractors must be licensed with BSA, for contract value greater than $3 300.	First resort	$3 300	$400 000	Non-structural 6 months. Structural 6 years and 6 months.	Contract price is the basis for determining premium. Premiums set by BSA.	Queensland Home Warranty Scheme - Building Services Authority (BSA)	Exempt
VIC *Building Act 1993* *Domestic Building Contracts Act 1995*	All licensed domestic builders must be eligible. DBI must be purchased where contract price exceeds $12 000.	Last resort	$12 000	$200 000 or 20% of contract	Non-structural 2 years. Structural 6 years from the date of completion.	Premiums are set by insurers based on risk assessment and value of project	VMIA and Calliden via approved brokers.	Required by law on sale of property if within 6 years of completion of building works

	Eligibility conditions for builders	Type of scheme[a]	Min value of works	Max value payable	Coverage period	Premiums	Underwriting and number of insurers	Owner builders
SA *Builders Licensing Act 1986*	All licensed domestic builders must be eligible or provide evidence of at least $100 000 in tangible net assets and solvency.	Last resort	$12 000	$80 000	3 months from handover until 5 years from completion.	Premiums are set by insurers based on risk assessment and value of project	QBE and Calliden via approved brokers.	Required by law on sale of property if within 5 years of completion of building works
NT *Building Amendment (Registration and other matters) Act* 2012 *Building Amendment (Residential Building Consumer Protection) Act* 2012	Eligibility is required for registration. Insurance Certificate is required before completion is approved by certifier. Builder registration requires $50 000 in net assets be maintained as part of pending legislation.	Pending legislation introduces Last resort and includes dispute resolution to close gap between first and last resort.	$12 000	$80 000	6 years from completion for structural, 2 years for non-structural	Premiums are set by Insurers based on risk assessment and value of project	HIA – brokerage services (underwritten by QBE) and MBA (Fidelity Fund) are the proposed administrator	
WA *Home Building Contracts Act (1991)*	All licensed domestic builders must be eligible.	Last resort	$20 000	$100 000	6 years from date of completion.	Premiums are set by Insurers based on risk assessment and value of project	QBE and Calliden via approved brokers.	Required by law on sale of property if within 6 years of completion of building works

	Eligibility conditions for builders	Type of scheme[a]	Min value of works	Max value payable	Coverage period	Premiums	Underwriting and number of insurers	Owner builders
TAS *Building Act (2000)* *Housing Indemnity Amendment Act 2008* Residential Building Work Quality (Warranties and Disputes) Bill 2012	Public liability insurance and contract works insurance is a requirement for accreditation as a builder. The *Housing Indemnity Amendment Act 2008* removed the mandatory requirement for domestic builders to purchase DBI. Bill setting up consumer protection and dispute resolution framework introduced into parliament.	Purchase of insurance is voluntary. Residential Building Work Quality (Warranties and Disputes) Bill 2012 enables dispute resolution process.						Register is maintained by Director of Building Control. Require details of workers compensation and public liability insurance.
ACT *Building Act 1972*	Eligibility required for registration.	Last resort	$12 000	$85 000	Non-structural 2 years, Structural 6 years from the date of completion.	Premiums are set by Insurers based on risk assessment and value of project	Master Builders Fidelity Fund underwrites insurance policies issued through MBA and HIA brokers	Must be licensed. Fidelity certificate is valid from sale/transfer up to a period of 5 years from Certificate of occupancy being issued

a First Resort Schemes cover defects and workmanship and operate like normal insurance contracts; Last resort schemes only come into effect if a builder dies, disappears or becomes insolvent.