ESSENTIAL SERVICES COMMISSION

Victoria's domestic building insurance scheme

Performance report 2017-18

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Contents

Summary

This is our eighth annual report on the performance of Victoria's domestic building insurance (DBI) scheme.

DBI is taken out by builders on behalf of home owners. It is insurance to provide compensation to home owners 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.[1] In Victoria, it is compulsory for builders to obtain DBI in all domestic construction contracts over $16,000 in value.[2]

Insurers may have incurred some DBI losses

The simple loss ratio provides a general measure of the sufficiency of the DBI scheme. For certificates and policies issued in a given year, it represents the cost of claims as a percentage of the premium revenue that was collected. Although not exact, this ratio provides a general indication of the collective performance of the market's ability to price DBI profitably.

The simple loss ratios for certificates and policies issued in 2008, 2009 and 2010, are over 100 per cent. This means that claims costs for the certificates and policies issued in these years exceed the premium revenue collected. On this basis, it would appear that collectively, insurers made a loss on DBI in each of these years. However, this may not necessarily be the case, as the simple loss ratio does not account for any income insurers may have earned from investing premium revenue while they wait to pay out claims.

Most registered builders seek eligibility with the Victorian Managed Insurance Authority

Builders are required to obtain eligibility with a DBI insurer in order to be registered. They must get pre-approval from an insurer to be able to purchase DBI project certificates. Insurers use the eligibility process to evaluate the financial position of builders and impose an annual turnover limit, which is their assessment of the maximum value of building projects that builders can take on without risking insolvency.

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[1] Since 1 July 2015, the Victorian Managed Insurance Authority (VMIA) has added a fourth condition by which a homeowner can make a DBI claim — failure to comply with a Tribunal or Court Order.

[2] This required amount was increased from $12,000 on 1 July 2014.

As the main provider of DBI, most registered builders seek eligibility with the Victorian Managed Insurance Authority (VMIA), with AssetInsure and Berkshire Hathaway Speciality Insurance (BHSI) only recently entering the DBI market.

Project certificate numbers have increased

Following a peak at just over 62,414 in 2010, and falls in 2011 and 2012, the total number of certificates has since increased each year (reaching 78,391 in 2017). Project certificates for new dwellings account for the largest share of total DBI certificates issued.

Recent average premium decreases

In 2017 and 2018, the average premium for a project certificate decreased with two new insurers entering the DBI market and the VMIA establishing a new system for selling DBI. Before this, the annual rate of change decreased from 2005 to 2008, reflecting competitive pressures. The average premium was volatile from 2009 to 2010, as a result of all but one private insurer exiting the market. It then increased steadily from 2011 to 2016, reflecting a stable market where the majority of the certificates were issued by the VMIA.

While the annual rates of change have varied, the average premium increased by 28 per cent (in nominal terms) between 2005 and 30 June 2018.

Claims are infrequent

As DBI is a long-tail insurance product, it is difficult to present claim numbers in their true context until at least seven years after the issue date of project certificates and policies. Nevertheless, on the whole it appears that claims are relatively infrequent in relation to the number of project certificates issued. The revised data for registered builders show that insurers have received 11,951 claims (compared to 814,407 certificates issued) since the DBI scheme commenced in 2002.

Insolvency is by far the most common reason for DBI claims. Around half of the claims (received to date) relate to a structural defect.

The average cost of closed and finalised claims for work undertaken by a registered builder is around $33,000 (on a per-dwelling basis).

The time it takes for a claim to go through each stage of the claim process can be used to examine how the scheme is generally operating. It may also indicate how well consumers are being served. Since the scheme started in 2002, the average time between receiving a notification and a claim being finalised is 422 days, or just under 14 months.

Owner-builder policies are declining

The number of owner-builder policies has been declining for 10 years, from a peak of almost 6,000 issued per year to less than 2,000 per year, although there was a small increase in 2017. Owner-builders are considered a higher risk category than registered builders and have a higher rate of claims, even though the total number of claims is very small (just 192 since 2002). The most common reason for claims against owner-builders is disappearance of the previous owner.

1. Introduction

This chapter outlines our role and provides some general concepts needed to understand the Victorian domestic building insurance (DBI) market. Abbreviations and terms included in the glossary are highlighted in bold and italics.

1.1. What have we been asked to do?

Under terms of reference issued in July 2010 (see Appendix A), the commission's role is to conduct an annual examination of the Victorian Managed Insurance Authority (VMIA) and private insurers' provision of DBI.

We collect quarterly data from insurers. Although we undertake a series of checks, the data is not audited, so we rely on the accuracy of the data insurers provide. This latest performance report covers the period up to 30 June 2018.

We also have another ongoing role in reporting on DBI. This is to undertake reviews every two years into the adequacy and validity of the VMIA's premiums. Our third review, covering premiums for the period 1 July 2014 to 30 June 2016, was released in April 2017, with our next review to be released in April 2019.

1.2. What is domestic building insurance?

Domestic building insurance (DBI) — also known as builders warranty insurance — is compulsory on all domestic construction contracts over $16,000 in value,[3] such as ***new dwellings***, renovations and swimming pools. It compensates a home-owner for losses resulting from non-completion or defects, where their builder cannot be pursued directly for redress because they have died, disappeared, or become insolvent.[4]

DBI is provided in the form of a ***project certificate***, which is issued by an insurer to a registered builder for each building project. An insurer calculates the price of DBI — the ***premium*** — based on factors such as the contract value of the project, the type of work undertaken and the builder's risk rating. Insurers then earn ***investment returns*** on the premium revenue they have collected, while they wait to pay out possible claims on the certificates they have issued.

[3] This amount was increased from $12,000 on 1 July 2014.

[4] Since 1 July 2015, the VMIA has added a fourth condition by which a homeowner can make a DBI claim — failure to comply with a Tribunal or Court Order.

DBI is taken out by builders on behalf of home-owners. It is paid by the builder, on behalf of the home-owner. A home-owner then has six years from a project's completion to make a claim, although experience shows it is possible for claims to be made up to 11 years following the issuing of a certificate.[5]

An ***owner-builder*** is a home-owner who is legally allowed to undertake building work over $16,000 in value on their property. They must also take out DBI 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.

1.3. The development of domestic building insurance

The current DBI scheme was first introduced in 2002, when the market was served by five competing private sector insurers. In 2010, all but one of these insurers announced that they would cease issuing DBI. This was likely due to uncertainty about the profitability of DBI. At this point, the VMIA began offering DBI following an official mandate from the government. Arrangements were made with QBE, for it to act as the agent that sold DBI for the VMIA, with the VMIA initially adopting QBE's premium schedule. The VMIA has since developed its own premium schedule and established a new system for selling DBI which meant QBE ceased to act as its agent[6].

One private insurer, Calliden, continued to offer DBI to registered builders until 31 December 2013 and to owner-builders until 31 December 2015. Since these dates, the VMIA has been the main provider of DBI. However, a new private insurer, AssetInsure, began offering DBI to owner-builders in late 2015 and to registered builders in late 2016. Another private insurer, Berkshire Hathaway Speciality Insurance (BHSI), began offering DBI to registered builders in 2018. Aside from these insurers, no private insurers provide DBI to either registered builders or owner-builders, although they are still liable for any eligible claims made against DBI they issued before leaving the market.

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5 An insurer is liable for a claim from the time a certificate is issued at the start of a project, until six years after the project has been completed. Therefore, the period for which the insurer is liable varies with the length of the project. In some circumstances, a home-owner can make a claim after the liability period has expired (s.54, *Insurance Contracts Act 1984* (Cth).

6 The new system, introduced on 1 July 2017, includes a VMIA appointed panel of distributors to sell DBI and an online portal for builders to access their certificates and policies.

1.4. What are the requirements for builders to be eligible for domestic building insurance?

All builders are required to obtain ***eligibility*** with a DBI insurer in order to maintain their registration with the ***Victorian Building Authority.***[7] Eligibility is a 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.

1.5. How are home-owners covered by domestic building insurance?

DBI provides cover to a home-owner for defects in building work that occur up to six years from the completion of a building project.[8] It is referred to as ***long-tail insurance*** because of the long period of time faced by insurers between charging a premium and knowing the full cost of claims. This is distinct from other insurance products, like 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.

The period of time that insurers must consider home-owners' claims against a policy is known as the ***liability period***.[9] As noted above, this period can vary between 6 and 11 years. The construction of a domestic dwelling could take three years while a renovation could be completed in two or three months. For our analysis, we assume that construction is completed 12 months after the certificate issue date. Insurers do not collect data on completion times from builders.

There is no limit in legislation on the time that can elapse between when a home-owner notifies an insurer of a claim and the submission of information required to open the claim. It is also possible for notifications that have been closed, to be re-opened for assessment years after they are first 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. We consider seven years to be a reasonable assumption for analysis, while accepting that the liability period could extend to 10 years or even longer.

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7 Registration prior to 1 September 2016 was with the Building Practitioners Board. Their functions, powers and responsibilities have since been transferred to the Victorian Building Authority.

8 Claims for 'failure to commence' or 'failure to complete' can be made if the builder has died, disappeared or become insolvent before the project is completed.

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

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 six or seven years after the issue of a project certificate.

There are several key dates used to track a claim's progress that are used throughout this report (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, at the start of construction. This date is also known as the 'underwriting date' as it is the time when 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 of a potential claim. These 'notification-only claims' can be escalated into claims once the insurer has received the minimum information it needs to process it. If the notification has not been escalated within 90 days, it is closed on the insurer's system, but it 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. Scheme performance

Key messages

A general measure of the sufficiency of the domestic building insurance (DBI) scheme is the simple loss ratio. It shows the cost of claims as a percentage of premium revenue collected.

There is a lag between when premium revenue is collected and when claims can be made, which we assume to be seven years. The lag means a comparable assessment of scheme sufficiency cannot yet be made for certificates or polices issued after 2011.

The simple loss ratio for certificates and policies issued in 2008, 2009 and 2010 is over 100 per cent. While insurers collectively made a loss on DBI for each of these years, the simple loss ratio does not account for the income insurers may have earned from investment returns on the premium revenue they collected in those years.

This chapter examines the overall performance of the domestic building insurance (DBI) scheme in Victoria through a simple measure of overall profitability that compares costs of claims to income from premiums.

Note, the analysis includes private insurer Berkshire Hathaway Speciality Insurance (BHSI), although the data we received from it is limited, given the short period of time since it entered the DBI market.

2.1. We assume a seven year lag in assessing profitability

Insurers' profitability depends on whether their revenue — that is, premiums combined with investment returns — sufficiently covers the cost of their claims expenses and other operating expenses. In order to cover these costs, insurers rely on predicting the number and cost of claims that could be made.

As DBI is a type of long tail insurance, the cost of insurers' claims expenses will be unknown for several years. That is, there is a lag between when premium revenue for policies and certificates issued in a given year are collected and when claims can be made. For the purposes of our analysis, we assume this lag to be seven years.

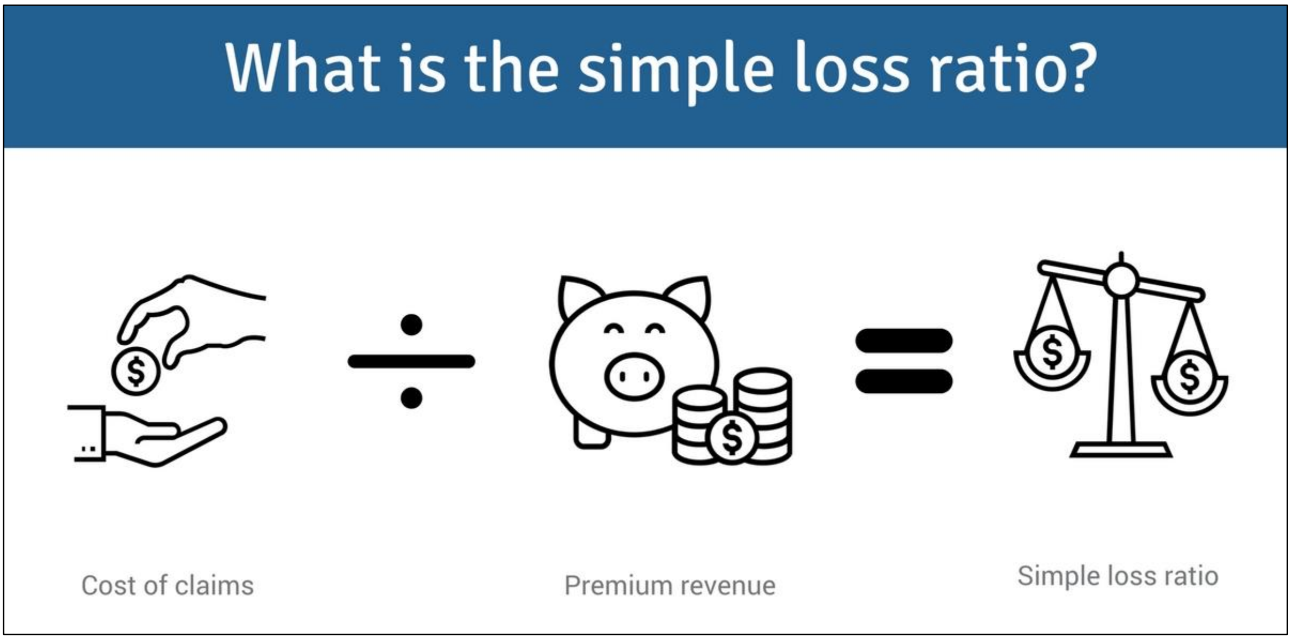
The lag means that a reliable assessment of the overall profitability for certificates issued in a given year cannot be made until at least seven years after they have been issued. In the case of this report, such an assessment cannot be made for certificates or polices issued after 2010. The liability period for these certificates and policies is assumed to have not yet expired, meaning more claims could be made; hence further costs could be incurred in the future.

2.2 Insurers may have incurred DBI losses in 2008, 2009 and 2010

A measure of scheme sufficiency is the simple loss ratio, which shows the cost of claims as a percentage of premium revenue collected. It provides an indication of how much premium revenue insurers have available to meet their claims costs. However, the ratio does not account for inflation, investment returns or any other operating expenses.

The simple loss ratio (as represented in Figure 2.1) compares, as a percentage, the total premium revenue collected against the total costs of claims for certificates and policies issued in a given time period. This report uses calendar years as the given time period.

Figure 2.1 The simple loss ratio



The simple loss ratio for a given year usually increases over time until all claims on the certificates and policies from that given year have been exhausted. This is because the total premium revenue collected remains the same each year – as premium revenue is collected when DBI is issued – whereas the cost of claims changes over time as new claims come in. The simple loss ratio for a given year should stop increasing when the liability period has ended. We assume this period to end seven years after the project certificate and policy has been issued.

Table 2.1 shows the premium revenue received in each calendar year that certificates and policies were issued. It also shows the total claims costs incurred for those certificates and policies as at 30 June 2018. These two data sets are used to calculate the simple loss ratios for each year.

For reference, we have also provided the assumed number of years of liability remaining and the number of certificates issued in each year. (The data covers all insurers and both registered builders and owner-builders.)

Table 2.1 Scheme performance – Simple loss ratios
All insurers

Calendar year	Number of certificates / policies	Premium excluding charges ($000)	Net incurred costs ($000) [a]	Assumed years of liability remaining [b]	Simple loss ratio (%)
2002	17,731	10,661	4,728	-	44.3
2003	40,305	27,521	13,828	-	50.2
2004	34,720	27,536	17,467	-	63.4
2005	46,975	31,986	20,855	-	65.2
2006	53,142	32,119	22,718	-	70.7
2007	54,690	30,574	30,172	-	98.7
2008	53,113	27,650	39,599	-	143.2
2009	61,555	34,251	45,259	-	132.1
2010	65,101	41,881	50,912	-	121.6
2011	61,355	44,330	36,306	-	81.9
2012	57,701	46,678	27,962	1	59.9
2013	61,221	54,925	21,575	2	39.3
2014	66,818	67,688	18,212	3	26.9
2015	71,119	75,715	29,493	4	39.0
2016	74,524	81,127	20,713	5	25.5
2017	80,034	76,061	2,185	6	2.9
2018 Jan-Jun	42,313	34,967	-	7	-

[a] Includes all claim costs including for denied claims and notification only claims. Costs have been assigned to the year in which the project certificate was issued.
[b] Assumes a 12 month construction period plus a six year liability period.

Figure 2.2 plots the simple loss ratios for each calendar year as at 30 June 2018 (as listed in the table above). For example, in 2015, $75.7 million of premiums were received for certificates and policies issued during that year. There has also been a total of $29.5 million in claims costs assigned to those certificates and policies as at 30 June 2017. This provides a simple loss ratio of 39.0 per cent.

The figure shows that at 30 June 2018, the simple loss ratios for certificates and policies issued in 2008, 2009 and 2010, are over 100 per cent. This means claims costs for the certificates and policies that were issued in these years exceed the premium revenue that was collected. On this basis, it would appear that collectively, insurers made a loss on DBI in each of these years. This may however not necessarily be the case, as the simple loss ratio does not account for income insurers may have earned from investment returns on the premium revenue they collected.

Figure 2.2 Simple loss ratios for each calendar year

All insurers – As at 30 June 2018

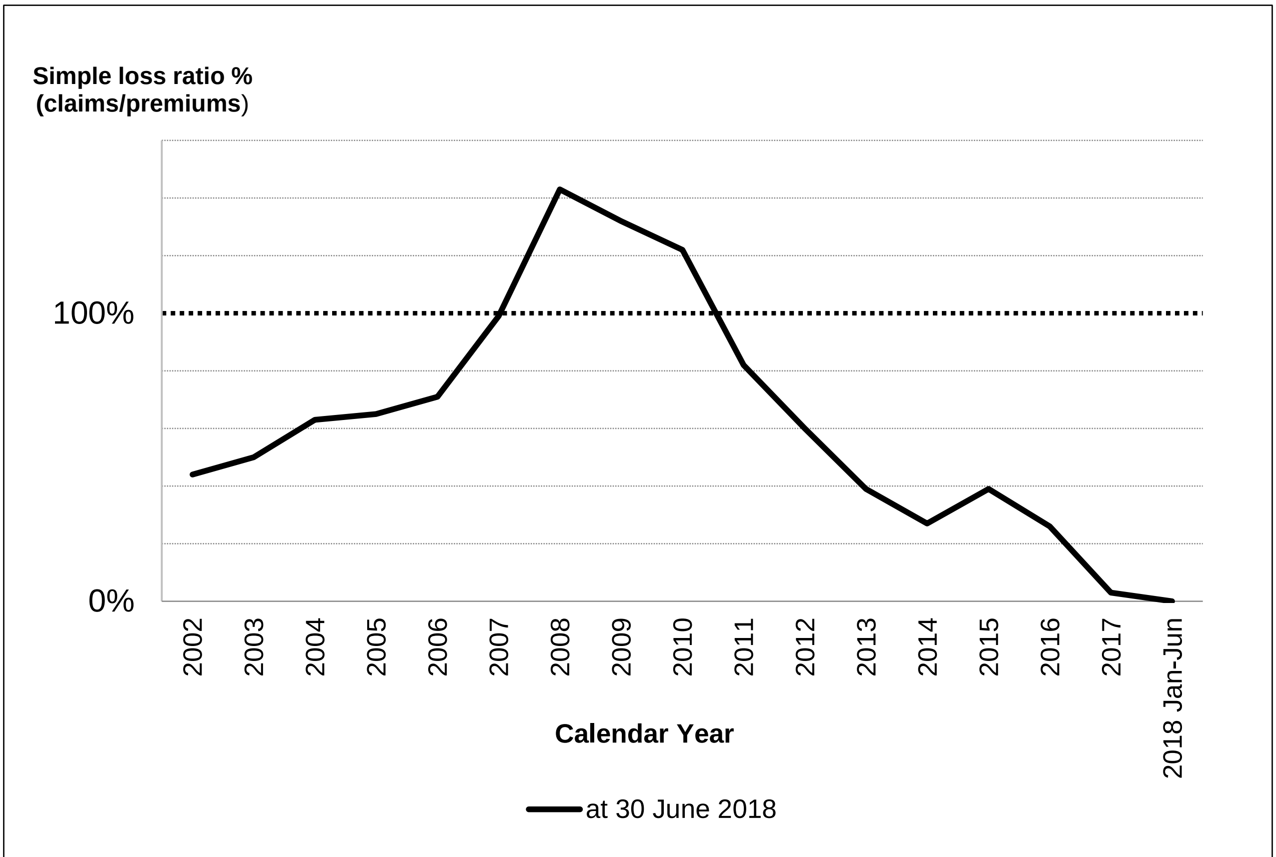


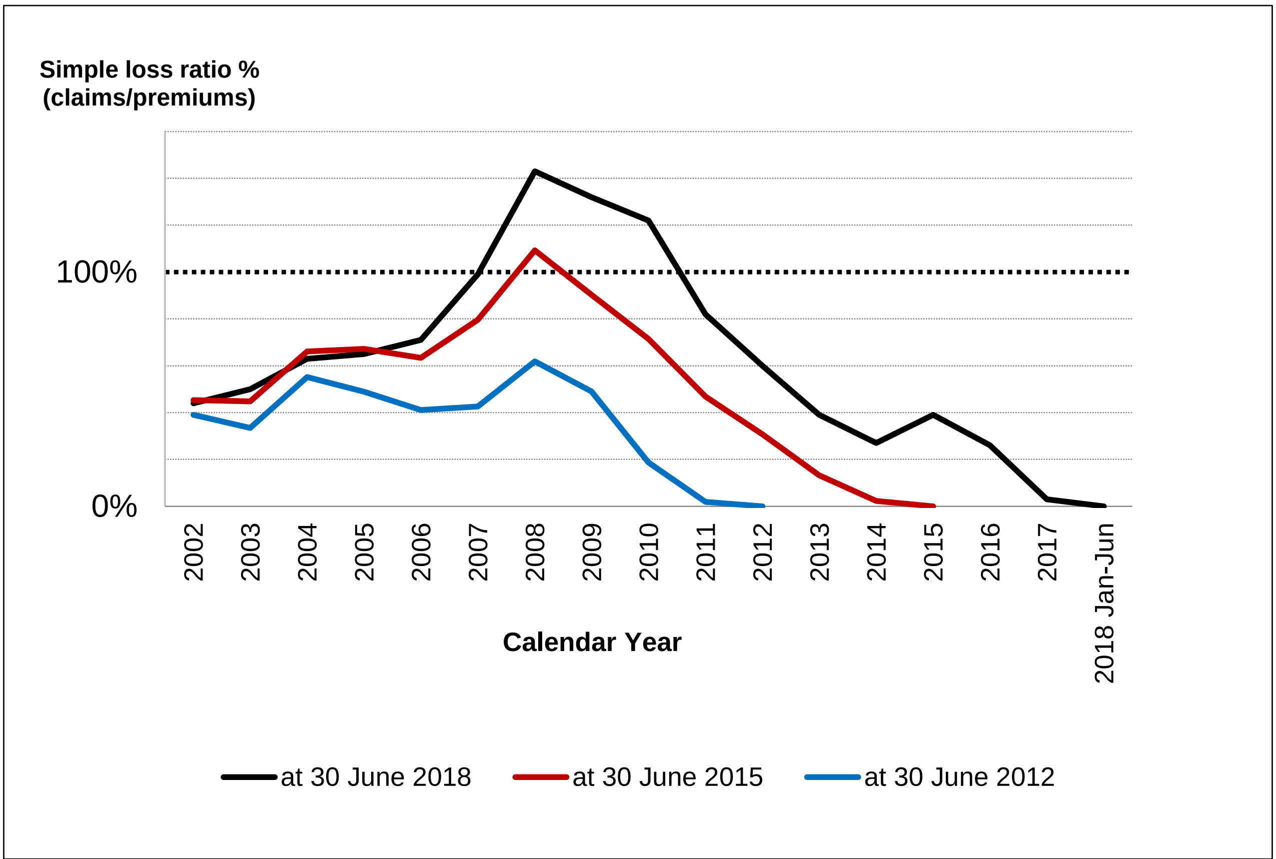
Figure 2.3 expands on Figure 2.2 and shows how the simple loss ratios have changed over time for project certificates and policies received in every third calendar year between 2012 and 2018.

Figure 2.3 plots the simple loss ratios as at 30 June 2018 in black (as listed in Table 2.1), as at 30 June 2015 in red, and as at 30 June 2012 in blue.[10]

The figure shows, as at 30 June 2018 (on the black line), three years being in excess of 100 per cent (2008, 2009 and 2010), whereas three years earlier, as at 30 June 2015 (the red line), only one year was in excess of 100 per cent. These changes in simple loss ratios lines illustrate the long tail nature of DBI, with the years in excess of 100 per cent only becoming apparent towards the end of the observed period. In comparison, none of these years were in excess as at 30 June 2012 (the blue line).

Figure 2.3 Change in simple loss ratios over time

All insurers – as at 30 June, 2012, 2015 and 2018



[10] The data used to plot the simple loss ratios as at 30 June in other years is available in previous year's reports.

3. Eligibility, project certificates and premiums

Key messages

Since 2011, the Victorian Managed Insurance Authority (VMIA) has been the main insurer offering domestic building insurance (DBI) to registered builders in Victoria, with AssetInsure and Berkshire Hathaway Speciality Insurance (BHSI) only recently entering the DBI market.

The total number of project certificates issued has increased. Although this number fell annually between 2010 and 2012, this trend has since reversed.

New dwelling project certificates issued to registered domestic builders account for the largest share of the total number of DBI project certificates issued.

The average premium for a project certificate decreased in 2017 and 2018. This coincided with two new insurers entering the DBI market and the VMIA establishing a new system for selling DBI. However, the average premium increased by 28 per cent (in nominal terms) between 2005 and 30 June 2018.

High volume, high value categories of building (such as new dwellings) have always had the lowest premium rates, while swimming pools have had the highest (on a per $1,000 of project value basis).

This chapter presents domestic building insurance (DBI) metrics for registered builders related to eligibility, project certificates and average premiums. It also compares the number of new dwelling project certificates to approval numbers as published by the Australian Bureau of Statistics.

Note, the analysis includes private insurer Berkshire Hathaway Speciality Insurance (BHSI), although the data we received from it is limited, given the short period of time since it entered the DBI market.

3.1. Most registered builders seek eligibility with the Victorian Managed Insurance Authority

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 $16,000 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 potential risk to the scheme. Insurers impose an annual turnover limit (the maximum value of building works the builder can undertake), based on their assessment of the value of works that a builder can prudently undertake given their financial position. In some circumstances, insurers require financial security or indemnity of some form before granting eligibility.

Most registered builders seek eligibility with the Victorian Managed Insurance Authority (VMIA), as it is the main provider of DBI. When the VMIA entered the market in May 2010, it adopted the eligibility and turnover limits from each builder’s previous insurer to ensure continuity of cover. Since then, the VMIA has introduced its own underwriting criteria and now has a commercial arrangement with a panel of distributors, who act on the VMIA’s behalf to issue policies.

Turnover limits

The VMIA imposes conditions on builder eligibility, using turnover limits to protect against over-exposure to builders at risk of insolvency.

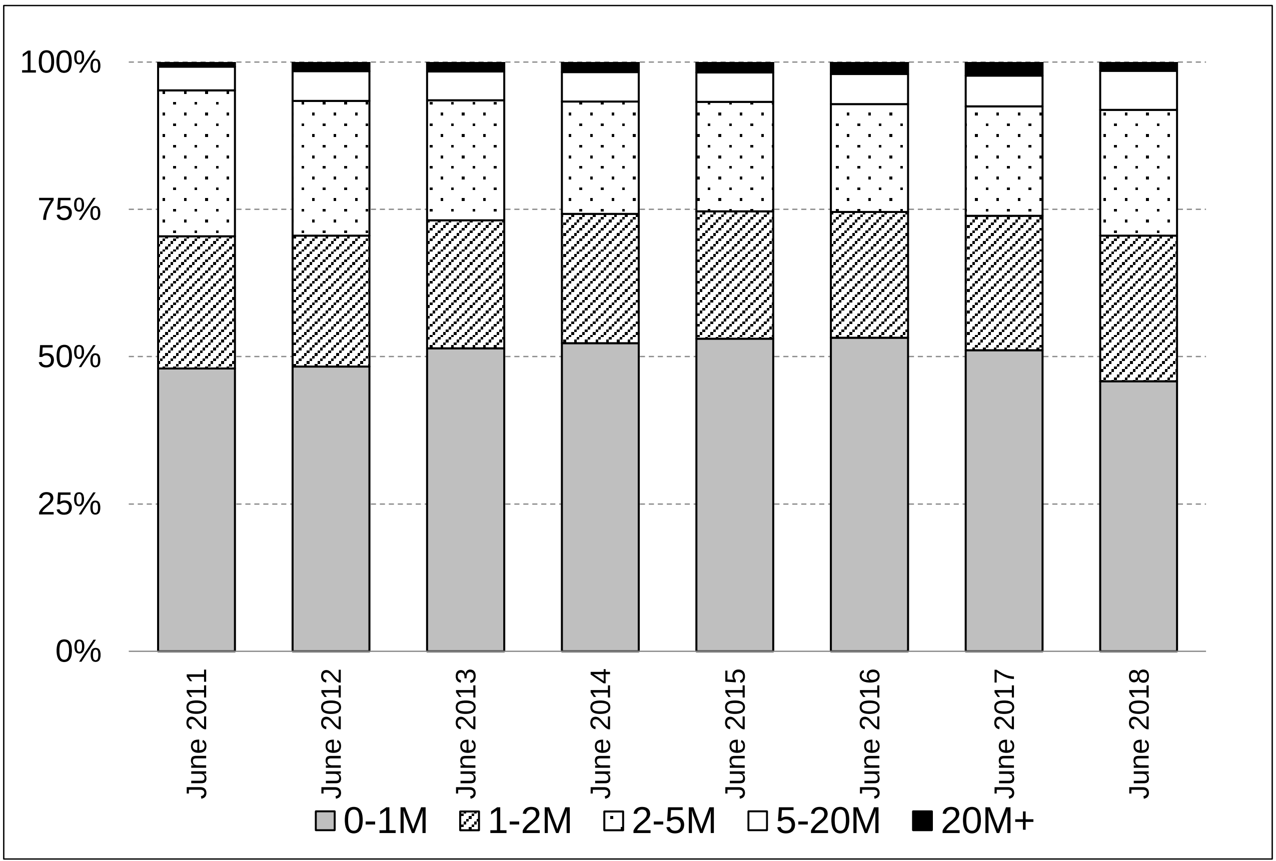
These annual turnover limits effectively cap the total value of contracts an eligible builder can make with customers in a year. From the VMIA’s perspective, the turnover limit is necessary to reduce the risk of a builder taking on more work than it can support financially and consequently becoming insolvent. For example, cash flow can be lumpy and builders may attempt to 'trade out of trouble' by taking on extra projects. This could be seen as risky by the VMIA, as it will be potentially liable for the cost of unfinished work if the builder becomes insolvent.

Figure 3.1 shows the share of eligible builders in each turnover band. The largest category, builders with turnover limits under $1 million, has 46 per cent of the total number of builders as at 30 June 2018. The second and third largest categories, builders with turnover limits of $1 million to $2 million and of $2 million to $5 million have 25 per cent and 21 per cent of the total number of builders respectively. While the smallest category, $20 million plus, has 1 per cent of the total number of builders.

The share of eligible builders in each turnover band for 30 June 2018 cannot be directly compared with the shares of previous years due to a break in the time-series.[11] This means the shares of eligible builders for the years up to 30 June 2017 are counted on a different basis to any year that follows.

[11] The break in time-series is for eligibility data only. It does not affect any other data in this report.

Figure 3.1 Eligible builders by turnover band ($)
Registered builders – June 2010 to June 2018



Note – The data for 30 June 2011 to 30 June 2017 is counted on a different basis to the data for 30 June 2018.

3.2. Recent increases in project certificate numbers

Project certificates are issued under four categories depending on the type of building work specified in the contract. The categories are: new dwellings, structural renovations, non-structural renovations and swimming pools.

Table 3.1 shows the relative contribution of each category over time to the total number of project certificates issued. Although the total number of certificates fell annually between 2010 and 2012, there have since been increases.

Table 3.1 Number of project certificates issued by type
Registered builders

Calendar 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	10,778	4,997	3,165	62,414
2011	40,241	10,263	6,706	2,046	59,256
2012	34,684	12,205	7,270	1,759	55,918
2013	36,658	13,091	5,121	4,185	59,055
2014	43,141	13,616	4,103	4,057	64,917
2015	47,126	14,297	3,435	4,389	69,247
2016	50,062	15,254	3,223	4,420	72,959
2017	53,598	16,753	4,266	3,774	78,391
2018 Jan-Jun	27,445	8,426	2,599	3,137	41,607

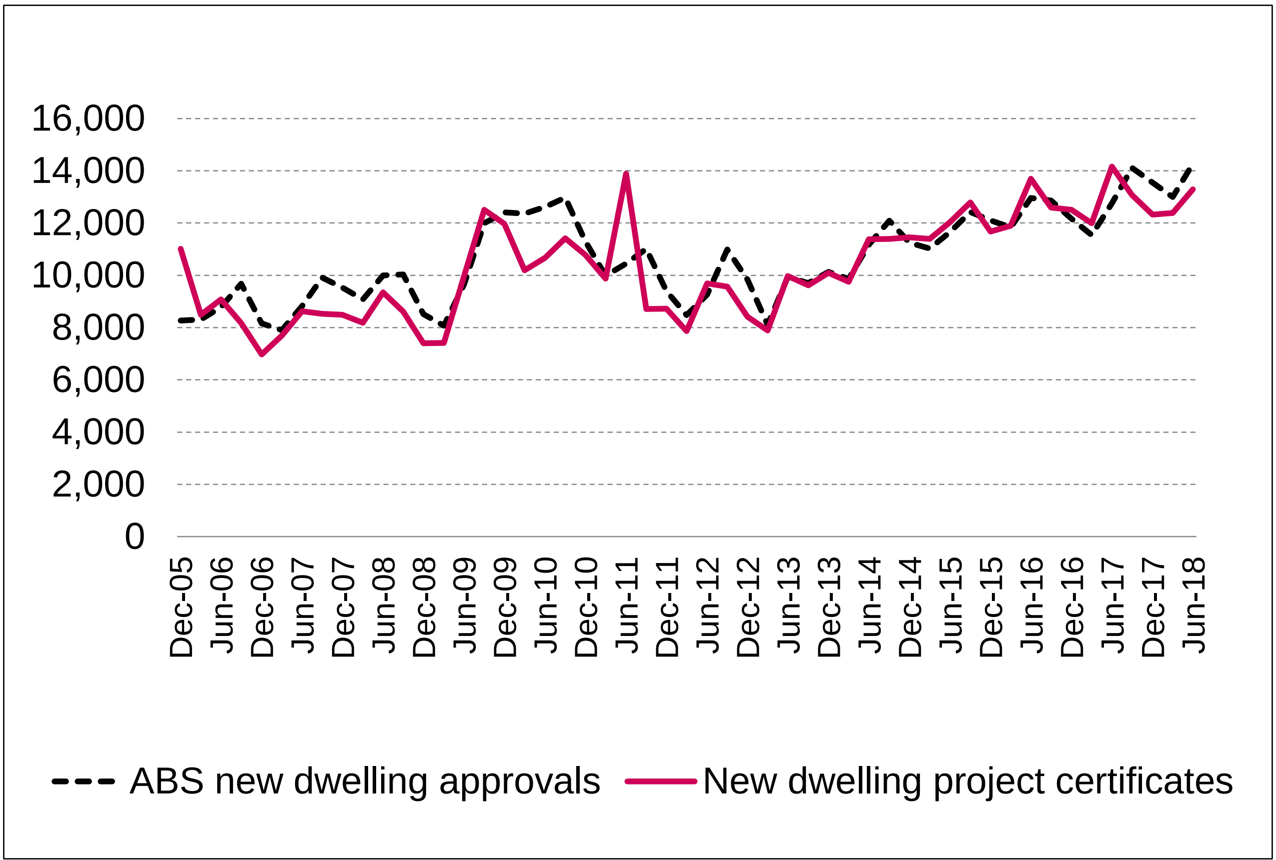
New dwelling project certificates

Most project certificates are issued for the construction of new dwellings. Around 68 per cent of certificates issued in 2017 were for new-dwelling construction.

Figure 3.2 compares the number of project certificates issued for new dwellings with the Australian Bureau of Statistics (ABS) quarterly data on building approvals. This comparison provides a check on whether builders are taking out insurance as required. The data series is not an exact match, because the ABS uses survey data and there are differences in the timing of when data is recorded.

The figure shows that the two data sets tracked closely until December 2009, when the withdrawal of insurers from the market may have led to delays in the processing of project certificates. This created a time lag between the issue of a building permit and the issue of a DBI certificate. In June 2011, there was a spike in certificates issued as high volume builders brought forward as many certificates as possible in advance of a premium increase on 1 July 2011. The number of project certificates has since stabilised and appears to track the ABS data reasonably closely.

Figure 3.2 Number of new dwelling approvals and project certificates in Victoria
Registered builders – December 2005 to June 2018



3.3. Recent average premium decreases

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. They calculate a premium for a specific project, taking into consideration the value of the work, the type of work and the builder's risk rating (as determined by the insurer).

Premiums may differ according to project type, builder risk rating and project size (value).[12] The total premium pool in any year is a combination of the premium rates being charged and the total amount of domestic construction that commences. Table 3.2 shows for each year since 2005: the

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12 For example, the VMIA publishes its premium schedule on its website 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).

total premium pool collected (premiums), the average premium of a project certificate, the total value of projects insured and the average project value.

Table 3.2 Total and average premiums
Registered builders – January 2005 to June 2018

Calendar year	Number of project certificates	Premiums ($m)[a]	Average premium of a project certificate	Value of project certificates ($m)	Average project value ($000)	Average premium per $1000 project value
2005	42,556	27.4	$644	6,839	161	$4.01
2006	47,337	28.3	$598	8,035	170	$3.52
2007	50,574	27.3	$540	8,779	174	$3.11
2008	49,946	25.2	$504	8,954	179	$2.81
2009	58,525	32.0	$546	10,718	183	$2.98
2010	62,414	39.7	$636	12,195	195	$3.25
2011	59,256	42.3	$714	12,059	204	$3.51
2012	55,918	44.9	$804	10,917	195	$4.12
2013	59,055	52.9	$896	11,609	197	$4.56
2014	64,917	65.9	$1,015	13,828	213	$4.76
2015	69,247	73.9	$1,067	15,750	227	$4.69
2016	72,959	79.5	$1,089	17,657	242	$4.50
2017	78,391	73.8	$941	19,731	252	$3.74
2018 Jan-Jun	41,607	34.3	$825	10,453	251	$3.28

[a] Excludes GST, stamp duty and brokerage

3.3.1. Average premium of a project certificate

Despite decreases in recent years, the average premium of a project certificate increased by 28 per cent (in nominal terms) between 2005 and 30 June 2018. This may in part be due to an increase in the average project value (56 per cent) and in part due to insurers' revisiting their assessment of the risk for DBI.

Figure 3.3 illustrates the quarterly changes of the average premium for a project certificate over the last 13 years. It shows the average premium decreasing in 2017 and 2018. This coincided with two new insurers entering the DBI market and the VMIA establishing a new system for selling DBI. Before 2017, the figure shows average premiums have often increased, although they decreased between 2005 and 2008, possibly due to competitive pressures and the newness of the DBI market at the time. Average premiums then rose between 2008 and 2010 and were volatile between June 2010 and December 2011. By this time, all but one of the competing insurers had stopped offering DBI and the VMIA was brought in by the government to maintain supply. In its first year, the VMIA adopted QBE's premium rates before later issuing its own premium schedules. This then saw more steady increases in average premiums from 2011 to 2016.

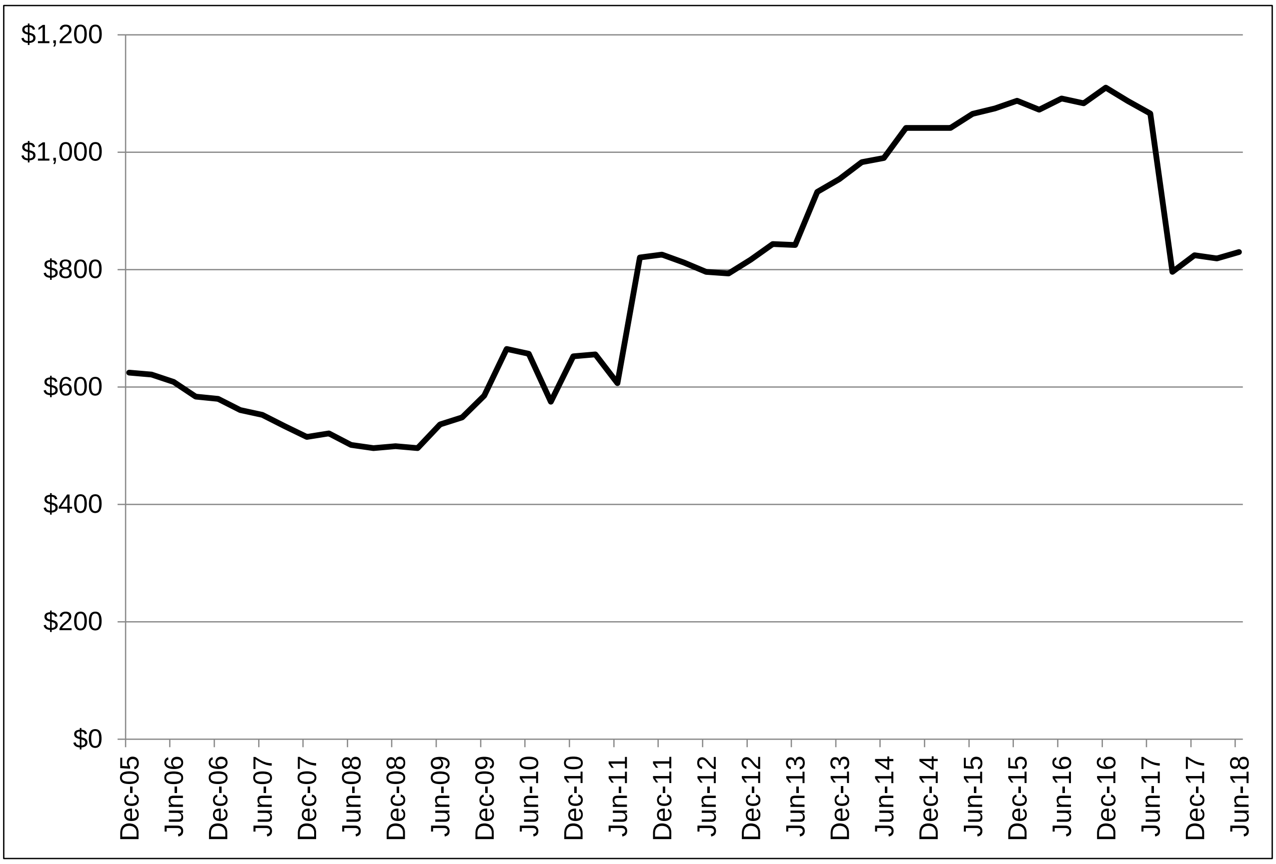
The VMIA's premiums are reviewed by the commission every two years. In our third and most recent DBI premium validation review, we concluded that (for the 1 July 2014 to 30 June 2016 period) the VMIA's:

- premiums were sufficient to cover its expenses, risks and long-term claims costs
- premiums were not set above the level required to cover its expenses and the risks of long-term claims costs
- underwriting standards conformed to commercial standards.

We will release our fourth DBI premium validation review (for the 1 July 2016 to 30 June 2018 period) in April 2019.

Figure 3.3 Average premium for a project certificate [a]

Registered builders



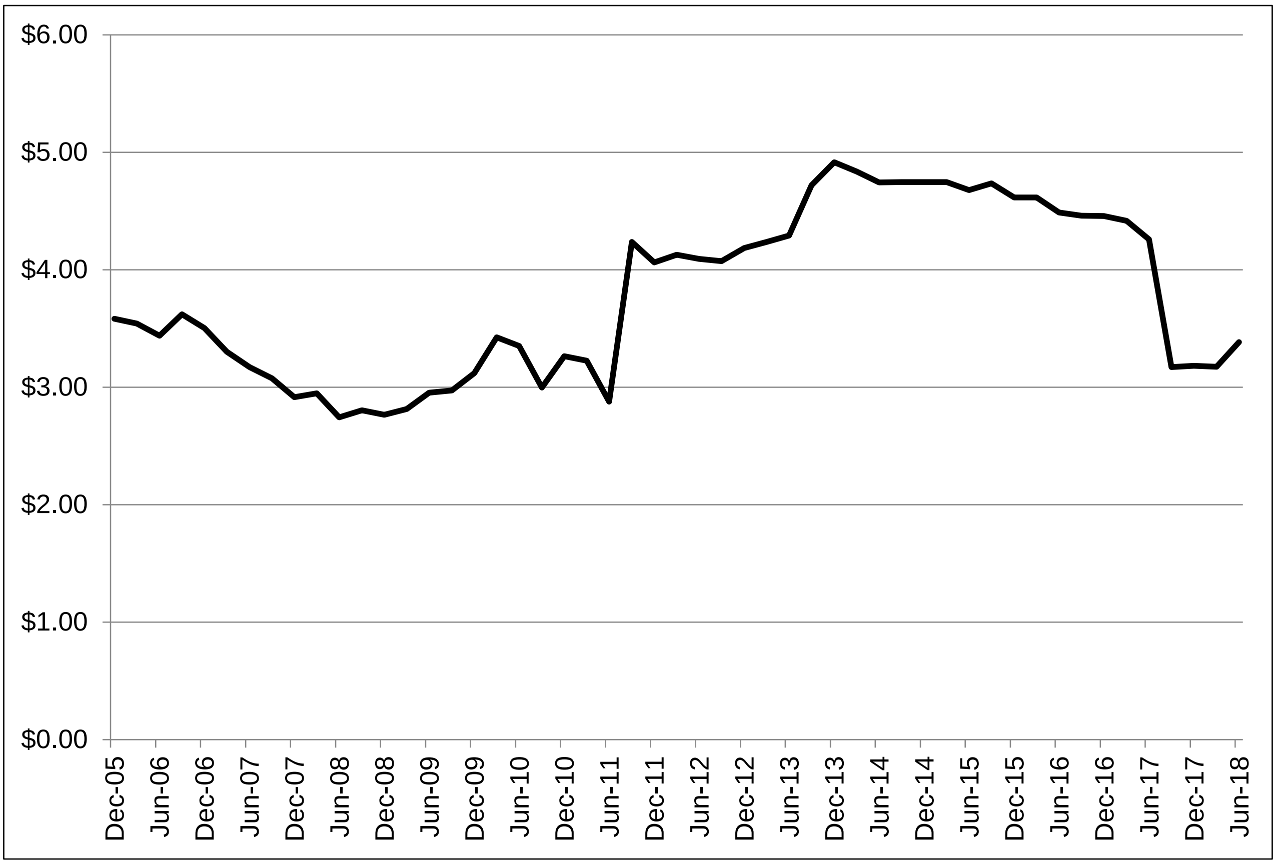
[a] Excludes GST, stamp duty and brokerage

3.3.2. Average premium per $1,000 of project value

Premiums can also be expressed per $1,000 of project value, which allows for a comparison of premiums on a set level of project value over time. Figure 3.4 shows the average premium rates per $1,000 of project value for the last 13 years. It shows recent decreases in 2017 and 2018, which coincided with two insurers entering the DBI market and the VMIA establishing a new system for selling DBI.

Figure 3.4 **Average premium per $1,000 of project value** [a]

Registered builders

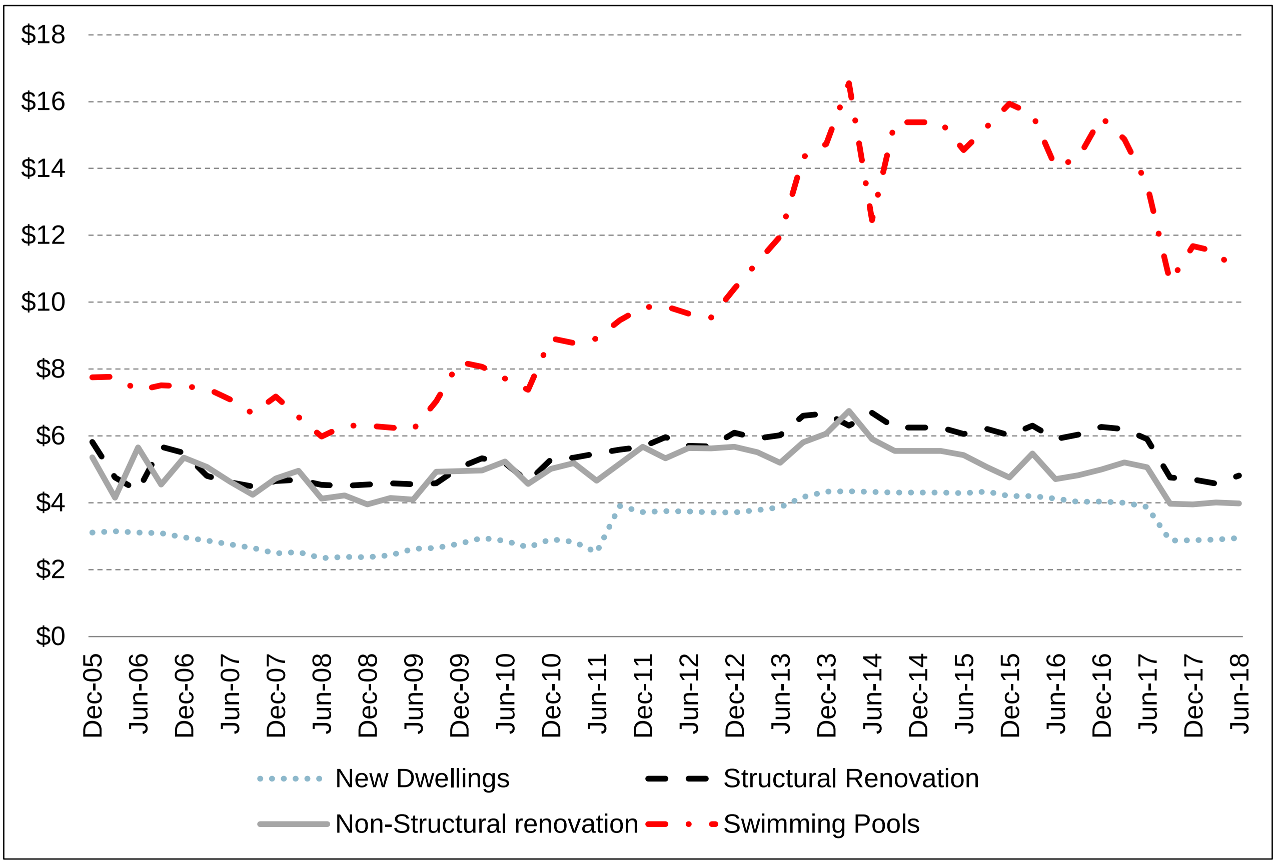


[a] Excludes GST, stamp duty and brokerage

The challenge for insurers is to set an efficient premium structure — that is, to match the premium paid for the project certificate with the risk to the insurer that is presented by the particular builder and project covered by the certificate. Historically, this has seen higher value projects generally presenting lower risk and therefore these projects have attracted lower premium rates. As such, high volume, high value categories of building (e.g. new dwellings) have always had the lowest premium rates. Swimming pools, which have a relatively low project value, have had the highest premium rates. This is shown in Figure 3.5, which provides a breakdown of the average premium rate per $1,000 of project value for each of the four different DBI project types over time.

Figure 3.5 Average premium per $1,000 of project value [a] – by type

Registered builders



[a] Excludes GST, stamp duty and brokerage

4. Project certificate claims

Key messages

Domestic building insurance (DBI) claims are relatively infrequent compared to the number of project certificates issued each year (around 1 in 100), with insurers having received 11,951 claims from 814,407 certificates issued since the scheme was introduced in 2002.

Builder insolvency remains by far the most common reason that claims on DBI are made and around half the claims received to date relate to a structural defect. The average cost of closed and finalised claims is around $33,000.

Claim turnaround times are an important indicator of scheme performance. Since the scheme began, the average time between receiving a notification and a claim being finalised is 422 days, or just under 14 months. However, there can be large variations between insurers.

Insurers deny claims on the basis of several criteria. The most common reasons for denying claims are the reported fault was not deemed a defect or because the builder was not insolvent.

This chapter provides a breakdown of the domestic building insurance (DBI) claims made against project certificates since 2002 by claim status, type, cause, frequency, costs, time period and reasons denied.

Note, this chapter's focus is on claims, not notifications. Where notifications are included in figures or tables, this is indicated. Claims are presented on a 'one claim to one dwelling' basis. Where a claim relates to a number of dwellings, this is presented as multiple claims.

Unless otherwise stated, the analysis in this chapter excludes Berkshire Hathaway Speciality Insurance (BHSI).

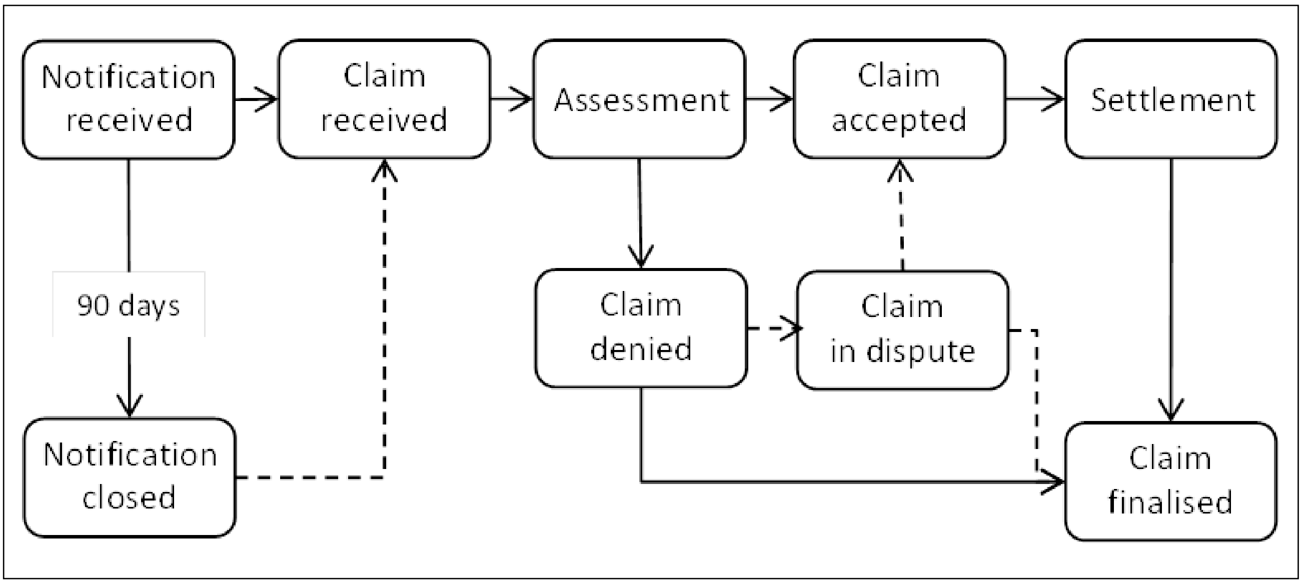
4.1. How are domestic building insurance claims made?

Claims under Victoria's DBI scheme can only be made under specific 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.[13]

Claims are relatively infrequent in relation to the number of project certificates issued, but each one may present a significant inconvenience for a customer who is unable to resolve an incomplete or defective home building project with their builder because of death, disappearance or insolvency.

When a customer notifies their insurer they would like to make a claim, the claim passes through multiple stages as it is processed by the insurer, as illustrated in Figure 4.1.

Figure 4.1 DBI claims process



Notifications

A certificate or 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 does not escalate into a claim until the certificate holder provides the minimum amount of information the insurer needs to process it. If this minimum amount of information is not received within 90 days, the notification is closed, but remains on file. It is possible for a notification to be re-opened at a later stage and then escalated into a claim.

[13] As noted earlier, on 1 July 2015, the Victorian Managed Insurance Authority added a fourth condition under which a homeowner can make a DBI claim – failure to comply with a Tribunal or Court Order. This is in addition to what is required in legislation. The 2015-16 year was the first year of data where this condition could have been observed.

Claims

In some cases, the required claims information is received immediately and a claim is opened without a notification period. Once a claim is opened (after the certificate holder passes on the required information to the insurer), the insurer is then able to complete its assessment and come to a decision about the liability of the claim.

In coming to a decision, the insurer may, among other things, investigate the builder to determine whether their situation meets one of the triggers for a claim and examine whether the claimed defect or non-completion 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 insurer accepts the claim, a settlement period begins in which the compensation is calculated and paid. It is not until the claim is fully settled with the claimant, that it is considered finalised and closed. If the claim is denied, the claimant has the opportunity to dispute the insurer's decision; otherwise, the claim is finalised and closed.

DBI is considered to be a type of long-tail insurance as claims can be made for up to two years after completion in relation to non-structural defects (for example, broken pipes), and for up to six years after completion in relation to structural defects. 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 time.

4.2. Most domestic building insurance claims are accepted

The status of a notification can be considered as open or closed. While a notification is open, it can be escalated into a claim. A notification is opened when a certificate holder notifies an insurer by providing very basic information of a fault at any time after a project certificate has been issued. It is closed if no information is passed on to the insurer within 90 days.

The status of a claim can also be considered to be open or closed. They also have a liability status: pending, accepted or denied. Even after a liability decision is made, a claim is still considered to be open until the claim is finalised and compensation is settled. Once this occurs, the claim is considered to be closed. No claim can therefore be categorised as closed while the liability decision is pending.

Table 4.1 shows the overall number of claims and notifications relating to registered builders since the introduction of the DBI scheme in 2002. Since the scheme began, insurers have received 11,951 claims and 2,373 notifications.

As at 30 June 2018, 87 per cent of claims (7,766 of 8,936) are closed/finalised and 98 per cent of notifications (2,317 of 2,373) are closed.

Table 4.1 Total claims and notifications by status

Registered builders – January 2002 to June 2018

	Open	Closed / finalised	Total
Claims			
Accepted [a]	992	7,766	8,758
Pending [b]	178	0	178
Total accepted or pending	**1,170**	**7,766**	**8,936**
Liability denied	54	2,961	3,015
Total claims	**1,224**	**10,727**	**11,951**
Notifications	56	2,317	2,373
GRAND TOTAL	**1,280**	**13,044**	**14,324**

[a] Includes deemed, full, and partially accepted claims. [b] Includes claims being assessed and claims in dispute

4.3. Most claims due to builder insolvency and structural defect

The cause of a claim is identified by its relevant trigger, that is, insolvency, death or disappearance.[14] The type of claim is specified by the type of work the claim relates to, that is, a failure to commence, failure to complete, structural defect or non-structural defect.

Table 4.2 provides a breakdown of all claims (open and closed, pending, accepted or not) by the reported cause and claim type. It shows that insolvency is by far the most common cause of a claim being made (at around 92.8 per cent). In terms of type of work, over half the claims received to date relate to a structural defect.

[14] As noted earlier, on 1 July 2015, the VMIA has added a fourth condition by which a homeowner can make a DBI claim — failure to comply with a Tribunal or Court Order. Data for these claims are included in the other/unspecified category.

Table 4.2 Claims received by type and cause

Registered builders – January 2002 to June 2018

Cause (→) Type (↓)	Insolvency	Death	Disappearance	Other / Unspecified [a]	Total	Type (%)
Failure to commence	254	4	6	0	**264**	2.2%
Failure to complete	2,785	35	123	3	**2,946**	24.7%
Structural defect	5,831	84	475	2	**6,392**	53.5%
Non-structural defect	2,130	33	87	4	**2,254**	18.9%
Not yet determined	89	0	6	0	**95**	0.8%
Total	**11,089**	**156**	**697**	**9**	**11,951**	**100.0%**
Cause (%)	**92.8%**	**1.3%**	**5.8%**	**0.1%**	**100.0%**	

Note – Excludes notifications.

[a] Includes claims by which a builder has failed to comply with a Tribunal or Court Order.

4.4. Claims are made infrequently

Claims can be made a number of years after the project certificate is issued. For the purposes of our analysis, we assume this can be up to seven years after issuance. After this, we assume the liability period of claims to be exhausted.

Table 4.3 compares the claims insurers have received (open and closed, pending, and accepted or not) in the corresponding project certificate issued year with the total number of project certificates issued in that year. In the table, years 2002 to 2011 have been shaded grey to indicate the years in which we assume the liability period to be exhausted. Years 2012 and later are still considered to be active for liability of claims.

For claims with exhausted liability, the table shows that on average between 2002 and 2011, around 1.8 per cent of project certificates ended up with claims, although there were spikes in claims on project certificates issued in 2005 and 2010.

For claims with liability still remaining (the non-shaded years), 2012 had the highest percentage of certificates generating claims, at 1.53 per cent. However, it will not be known how the percentage of certificates issued in these years compares with those issued before 2012, until their liability expires.

Table 4.3 Frequency of claims received over time
Registered builders – January 2002 to June 2018

Calendar year	Claims by certificate issue year	Project certificates issued	Percentage of claims to certificates (%)	Years of liability remaining [a]
2002	158	14,663	1.08	-
2003	447	36,935	1.21	-
2004	552	31,332	1.76	-
2005	955	42,556	2.24	-
2006	744	47,337	1.57	-
2007	1,042	50,574	2.06	-
2008	935	49,946	1.87	-
2009	955	58,525	1.63	-
2010	1,459	62,414	2.34	-
2011	1,256	59,256	2.12	-
2012	858	55,918	1.53	1
2013	627	59,055	1.06	2
2014	434	64,917	0.67	3
2015	755	69,247	1.09	4
2016	674	72,959	0.92	5
2017	99	78,391	0.13	6
2018 (Jan Jun)	1	41,607	-	7
Total	**11,951**	**814,407**	-	-

Note – Data revised since previous report. Includes all open and finalised claims. Excludes notification only claims.
[a] This is an assumed number of years of liability remaining.

4.5. What are insurers' claim costs?

The main measure of claim costs used in this report is net incurred costs. This is made up of several categories and represents the insurer's total liability at any given point in time (see Box 4.1).

Box 4.1 Calculating net incurred costs

	Item	Description
	$ 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, etc
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.
equals	**Net incurred costs**	Insurer's total liability at given point in time

When setting premium levels, the total net incurred costs are more significant to insurers than the total number of claims received, as it is claim costs (as measured by net incurred costs) that drive insurers' profitability levels. For example, while some claims might be accepted and finalised with no claim-related costs to the insurer, other claims may incur claim-related costs for investigation even if they are not accepted.

Table 4.4 shows claim costs (net incurred and average) at different stages of claim development: notification only, open and pending, open and decided, and closed and finalised.

Average costs are lower for finalised claims ($32,647) compared with open and decided claims ($39,626), where the insurer is estimating the cost of the outstanding liability. This could indicate either that actual costs tend to come in under the insurer's estimate, or that the costs are higher for more recent claims which are not yet finalised.

Table 4.4 Claim costs at different claim stages

Registered builders – January 2002 to June 2018

	Notifications		Claims			
	Notification only	Open and pending [a]	Open and decided	Closed and finalised – total	Closed and finalised – accepted	Closed and finalised – denied
Number of claims	2,317	178	1,046	10,727	7,766	2,961
Sum paid to claimant ($000)	0	372	24,398	320,550	318,945	1,605
(plus) Sum paid to third parties ($000)	79	415	6,160	39,243	36,233	3,010
(less) Sum of third party recoveries received ($000)	0	0	1,045	9,587	9,520	67
(plus) Sum of net outstanding ($000)	21	547	11,936	0	0	0
Sum of net incurred cost ($000)	**100**	**1,335**	**41,449**	**350,206**	**345,658**	**4,548**
Average cost per claim ($)	43	7,499	39,626	32,647	44,509	1,536

[a] Includes claims in dispute

Table 4.5 illustrates how the type of claim impacts the average cost of claims (closed and finalised). It shows failure to complete claims are the most costly type of claim. The average cost is around one and a half times greater than the next most costly type of claim, a structural defect.

Table 4.5 Average costs of claims (accepted-finalised) by type

Registered builders – January 2002 to June 2018

	Number of accepted-finalised claims	Net incurred costs ($000)	Average cost per claim ($)
Failure to commence	216	4,104	19,000
Failure to complete	2,284	141,581	61,988
Structural defect	3,856	158,865	41,199
Other (non-structural) defect	1,410	41,109	29,155
Total	**7,766**	**345,658**	44,509

The cost of a claim is influenced by many factors, some of which are outside the insurer's control. For example, the age of the property affected and the nature of the defect can greatly influence the cost of rectification. Over time, an insurer's ability to manage costs of investigation and repair will help to determine their profitability.

4.6. The average accepted claims turnaround time is 14 months

The assessment period (the time taken for the insurer to make a decision) may be a matter of days or months depending on the individual circumstances of the claim. An insurer can accept, partially accept, or deny liability (for a number of reasons). If an insurer accepts a claim, a settlement period begins in which compensation is calculated and paid. It is not until a claim is fully settled with the claimant, that it is considered finalised and closed. If a claim is denied or partially accepted, the claimant has the opportunity to dispute the insurer's decision; otherwise, the claim is finalised and closed if denied, or compensation is calculated and paid if partially accepted.

The time it takes for a claim to go through each stage of the claim process can 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, the average time between receiving a notification and a claim being finalised is 422 days, or just under 14 months.

Of the average 422 days, 361 occur between the liability being decided and the claim being finalised, the last stage of the claim process. The length of time it takes to finalise can be influenced by many factors, such as an insurer's approach to claims handling or whether a claimant wishes to contest the insurer's decision about the liability of the claim.

In contrast, the initial stage of the claim process, between when claims are received and the liability decision occurs, accounts for 60 days (or 14 per cent) of the total average time. This much shorter length of time is likely a result of DBI legislation — if an insurer has not made a liability decision within 90 days of minimum claim information being received the claim is deemed to be accepted.[15] There are circumstances in which this period can be extended with the agreement of the claimant but, in general, insurers aim to make a liability decision within this time frame.

4.7. Most claims denied due to fault not being deemed a defect

There are several reasons why an insurer may deny a claim. Most claims (around 64 per cent) are denied either because the fault reported was not deemed a defect, or because the builder was not insolvent. A breakdown of the different reasons claims are denied is shown in Table 4.6.

Table 4.6 Reasons for claim denied
Registered builders – January 2002 to June 2018

Reason	Number	Proportion (%)
Incorrect insurer	142	5.1
Out of time	253	9.2
Builder found	188	6.8
Builder not dead	8	0.3
Builder not insolvent	610	22.1
Not deemed a defect	1,151	41.7
No loss	184	6.7
Owner did not proceed	223	8.1
Total	**2,759**	**100**

15 Domestic Building Insurance Ministerial Order, section 29; Order made under sections 135, 137A and 137D of the *Building Act 1993*.

5. Owner-builder policies, premiums and claims

Key messages

Owner-builders who carry out building work (over $16,000) on their own property, require domestic building insurance (DBI) if they sell that home within six and a half years of completion.

The number of owner-builder policies has been declining since 2006, from almost 6,000 a year to less than 2,000 a year, although there was a small increase in 2017.

Owner-builders are considered a higher risk category than registered builders and have a higher rate of claims, even though the total number of claims is very small (just 192 since 2002).

The average cost of a closed and finalised claim is around $17,800.

The most common reason for claims against owner-builders is disappearance of the previous owner. 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 chapter provides a snap-shot of policy numbers, premiums and claims data on owner-builder domestic building insurance (DBI).

Note, the analysis in this chapter excludes Berkshire Hathaway Speciality Insurance (BHSI).

5.1. Which owner-builders require domestic building insurance?

An owner-builder is defined as someone who carries out building work on their own property. Owner-builders are generally not in the building industry but must obtain a 'certificate of consent' from the Victorian Building Authority[16] if their building work is valued at more than $16,000.

Owner-builders who sell a property within six and a half years of the completion of work, for which they have obtained a certificate of consent, must obtain domestic building insurance (DBI). They are required to provide the new owner with evidence of this DBI policy and a report on any building

[16] Certificates of consent prior to 1 September 2016 were obtained from the Building Practitioners Board. Their functions, powers and responsibilities have since been transferred to the Victorian Building Authority.

defects.[17] In this way, owner-builder DBI is quite distinct from the DBI purchased by a registered builder.

The insurance policy (which is similar to a project certificate issued to a registered builder) is for the benefit of the new owner and any subsequent new owners, in the event that the owner-builder dies, disappears or becomes insolvent, and the building work is defective.[18]

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

5.2. Owner-builder policy totals have increased

Table 5.1 shows how many DBI policies are issued to owner-builders each year, as well as the total value of policies held and the total premiums paid for them. In each case, the numbers have increased from 2016 to 2017. In particular, the value of DBI policies has increased by 55 per cent in 2017, from the previous year. There was also a relatively smaller gain of 5 per cent in the number of owner-builder policies issued. In the eleven years before 2017, the number of owner-builder policies had been declining from almost 6,000 a year in 2006, to less than 1,600 a year in 2016. Figure 5.1 provides a graphical representation of this trend, with the number of policies issued declining from a peak of over 1,100 in the September 2007 quarter to be around 450 per quarter over the last six years (despite a spike in the December 2013 quarter).

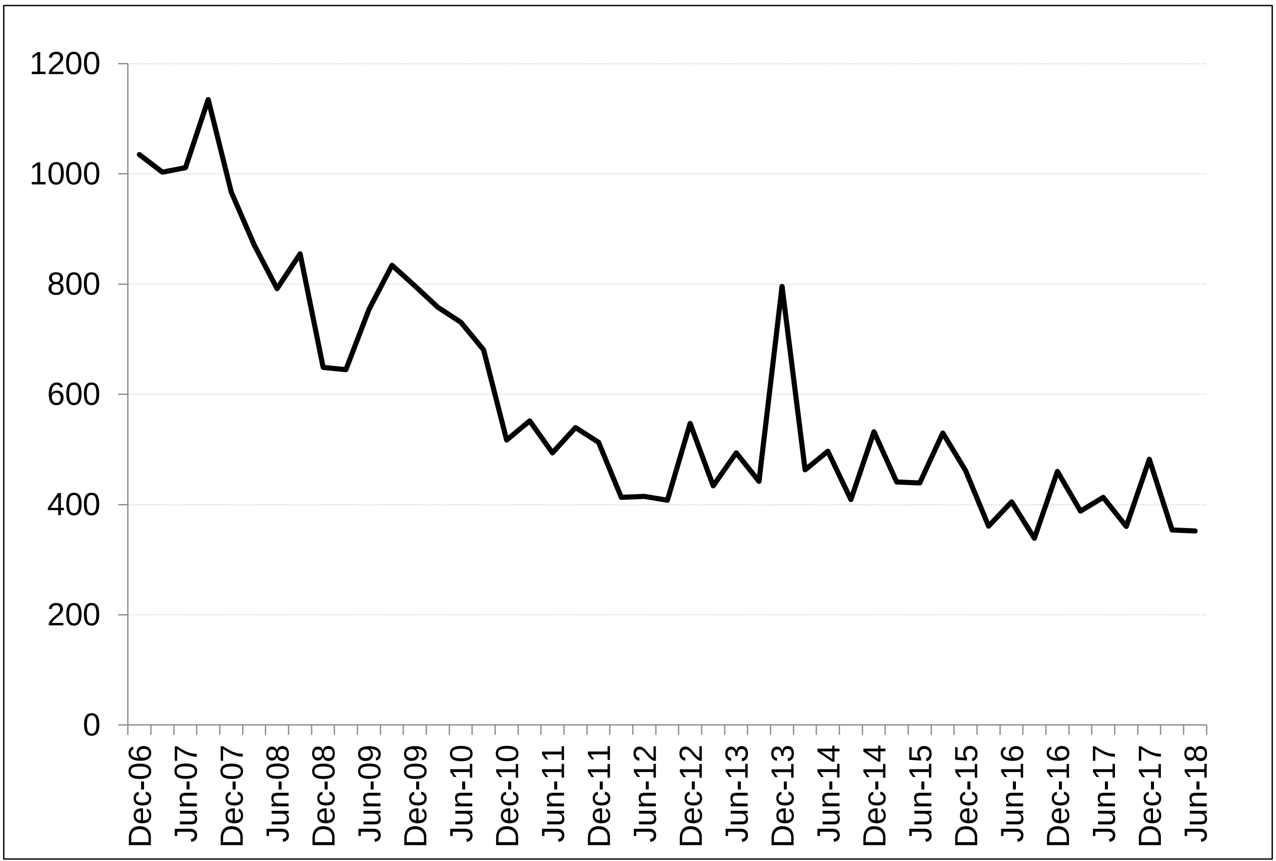
[17] The report must be prepared by a prescribed building practitioner.

[18] As noted earlier, on 1 July 2015, the VMIA added a fourth condition by which a homeowner can make a DBI claim — failure to comply with a Tribunal or Court Order.

Table 5.1 Owner-builder policy totals

Calendar year	Number of policies	Value of policies ($000)	Total premiums ($000)
2002	3,068	363,702	645
2003	3,370	405,389	744
2004	3,388	457,190	3,714
2005	4,645	694,034	4,983
2006	5,805	952,246	3,804
2007	4,116	674,972	3,285
2008	3,167	549,537	2,470
2009	3,030	492,269	2,301
2010	2,687	471,311	2,196
2011	2,099	373,092	1,992
2012	1,783	318,538	1,731
2013	2,166	383,343	2,022
2014	1,901	359,358	1,803
2015	1,872	350,733	1,801
2016	1,565	290,935	1,650
2017	1,643	451,980	2,270
2018 (Jan-Jun)	706	146,792	653

Figure 5.1 Number of policies issued by quarter
Owner-builders – September 2006 to June 2018



5.3. Premiums higher for owner-builders than for registered builders

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

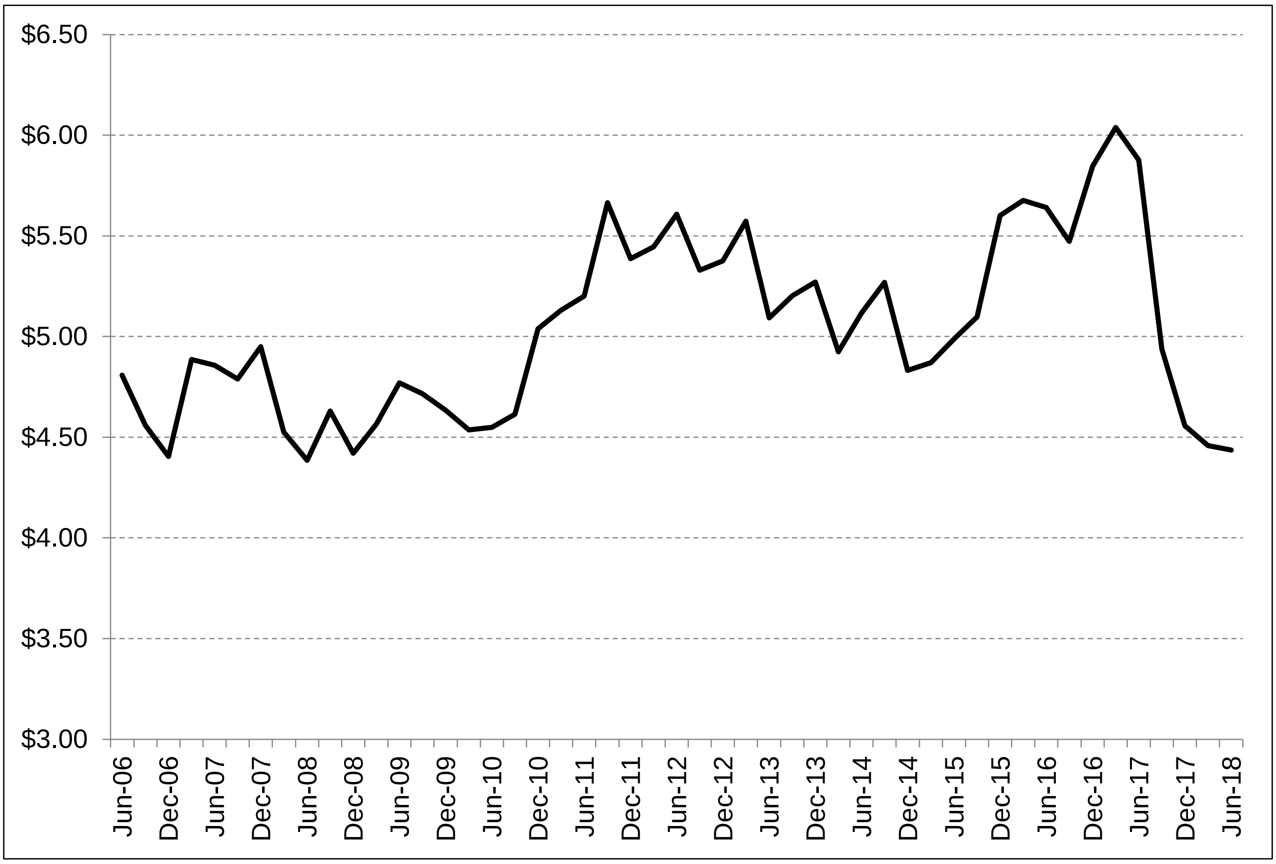
In comparison to registered builders, owner-builder policies cover structural and non-structural faults under the same rules as registered builder project certificates, but do not cover 'failure to commence' and 'failure to complete'. The liability period may be shorter because the policy is only taken out when the house is sold. Insurers also have more information to assess risk at the time of writing the policy because construction is typically complete and a defect report is available.

The difference in insurers' treatment of owner-builder risk (to registered builders) is shown by the difference between premiums. Premiums for owner-builders on average are $5.00 per $1,000 of project value. This is above the average of registered builders at approximately $3.80 per $1,000 of project value.

Figure 5.2 shows how the average premium per $1,000 of project value has changed over time. The rate has fallen in the last 12 months from a peak of just over $6.00 to around $4.50, which coincided with the VMIA establishing a new system for selling DBI. Before this, the rate was around $4.50 to $5.00 before 2010 and was around $5.00 to $5.50 from 2010 to 2017.

There has been some volatility in the owner-builder rate over the years. Due to the low number of policies issued and the project-specific factors used to determine the cost of each policy, the quarterly average rate can easily be affected by the type of properties that are insured.

Figure 5.2 Average premium per $1,000 of project value
Owner-builders – June 2006 to June 2018



5.4. What are the breakdowns for owner-builder claims?

Owner-builders are considered a higher risk category than registered builders and have a higher rate of claims even though the total number of claims is very small. As Table 5.2 shows, since 2002, 192 claims have been accepted. The ratio of accepted claims to denied claims is roughly 1:1, whereas the same comparison for registered builders is around 3:1. The higher proportion of claims denied for owner-builders could be attributable to the lack of centralised information about the location of owner-builders, which leads consumers to use a DBI claim as a first step in investigating any problems.

Table 5.2 Claim numbers by status
Owner-builders – January 2002 to June 2018

	Open	Closed	Total
Accepted [a]	10	182	192
Pending [b]	3	0	3
Total accepted or pending	**13**	**182**	**195**
Claims denied	2	255	257
Total claims	**15**	**437**	**452**
Notifications [c]	2	79	81
GRAND TOTAL	**17**	**516**	**533**

[a] Includes deemed, fully, and partially accepted claims. Excludes claims where cause not yet determined.
[b] Includes claims being assessed and claims in dispute.
[c] 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.

As Table 5.3 indicates, the most common reason for claims against owner-builders is disappearance of the previous owner. In the absence of a central licensing body, as exists for registered builders, it is more difficult for the new owners of a property to track down the original owner-builders to rectify any faults.

Table 5.3 Accepted claims by cause
Owner-builders – January 2002 to June 2018

Cause	Number	Proportion (%)
Insolvency	76	40
Death	5	3
Disappearance	111	58
Total	**192**	**100**

Note – Accepted claims only. Excludes claims pending a decision, claims denied and notifications. Also excludes claims where cause not yet determined.

Table 5.4 shows that 46 per cent of the 257 claims denied by insurers, were cases where the insurer was able to locate the original owner-builder. The other major reason for insurers denying owner-builder claims is due to the builder not being insolvent.

Table 5.4 Denied claims by reason

Owner-builders – January 2002 to June 2018

Reason	Number	Proportion (%)
Incorrect insurer	2	0.8
Out of time	28	10.9
Builder found	119	46.3
Builder not dead	2	0.8
Builder not insolvent	62	24.1
Not deemed a defect	37	14.4
No loss	0	0.0
Owner did not proceed	7	2.7
Total	**257**	**100**

Table 5.5 shows the average claim cost at different stages of claim development: notification only, open and pending, open and decided, and closed and finalised.

Average costs are much lower for finalised claims ($17,800) compared with open and decided claims ($84,100), where the insurer is estimating the cost of the outstanding liability. This could indicate either actual costs tend to come in under the insurer's estimate, or the costs are higher for more recent claims, which are not yet finalised.

Based on the 182 finalised claims accepted to date, the average cost of a claim on an owner-builder policy is $40,500.

Table 5.5 Claim costs at different claim stages

Owner-builders – January 2002 to June 2018

	Notifications	Claims				
	Notification only	Open and pending [a]	Open and decided	Closed and finalised – total	Closed and finalised – accepted	Closed and finalised – denied
Number of claims	100	3	13	437	182	255
Sum paid to claimant ($000)	0	0	618	5,825	5,690	135
(plus) Sum paid to third parties ($000)	10	4	276	2,530	2,264	266
(less) Sum of third party recoveries received ($000)	0	0	0	581	581	0
(plus) Sum of net outstanding ($000)	0	33	199	0	0	0
Sum of net incurred cost ($000)	**10**	**37**	**1,093**	**7,775**	**7,374**	**401**
Average cost per claim ($)	98	12,333	84,107	17,791	40,515	1,573

[a] Includes claims in dispute

Glossary

Term	Definition
Berkshire Hathaway Specialty Insurance (BHSI)	A private insurer that started providing DBI in 2018.
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	The three triggers for a claim under Victoria's DBI scheme. On 1 July 2015, the VMIA added a fourth trigger – failure to comply with a Tribunal or Court Order.
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).
Dwelling	A home as described in a project certificate or policy that can be owned individually.
Eligibility	Pre-approval from an insurer for a builder to purchase domestic building insurance for domestic building projects up to an approved turnover limit.
Investment returns	The revenue earned by an insurer from investing premium revenue.
Liability period	The period of time that an insurer is liable for claims on a project certificate/policy.
Long tail insurance	Insurance products where the full cost of claims is not known for a long time after the premium is charged.
New dwelling	One of four categories of domestic building insurance that refers to the building of a new home.
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.

Term	Definition
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 of the building work.
Premium	The charge for insurance coverage.
Private insurers	Independently trading insurance companies that previously competed in the DBI market. Generally they were 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 and policies issued in a given 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, and 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 Building Authority	A statutory authority that oversees the quality and standard of professional services in the building industry in Victoria (from 1 September 2016 it includes the powers and responsibilities of the former Building Practitioners Board).
Victorian Managed Insurance Authority (VMIA)	A statutory body providing DBI.

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