RESPONSE TO IPART DRAFT REPORT ON

Home Building Compensation Fund

16 Oct 2020

NON-CONFIDENTIAL

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INTRODUCTION

Risk Specialist Group (RSG) and a group of companies with which it has been discussing improvements to the current industry issues raised by the *IPART Review of the NSW Home Building Compensation Fund* is pleased to submit this commentary on the Draft Report released in September 2020 and issues raised at the Public Hearing held on 29 September 2020 – an industry event at which stakeholders were invite to comment or raise questions about the content of the initial Issues Paper and this Draft Report.

The Final Report is due to be submitted to the Minister in November 2020, and RSG would like to take up the opportunity to contribute feedback on the Draft Paper and also provide some corrections to statements in the Draft Report attributed to RSG, which we believe are incorrect or not reflective of the statements made in our response to the initial *IPART Review of the NSW Home Building Compensation Fund* issues paper.

This response to the IPART paper is structured in three parts:

- The first addresses IPART's brief, its recommendations as a result of the industry consultation process and Risk Specialist Group's responses to IPART's findings and recommendations
- Appendix A clarifies points made by RSG in its response to the Issues Paper, which it believes have been misrepresented in the Draft Report. RSG requests that these errata be corrected in the Final Report to be submitted to the Minister
- Appendix B recaps RSG's position from its response to the Issues Paper that wholesale change is required in the industry to remedy the current issues.
  After reading the Draft Report, RSG thinks that while some of all of the Draft Report recommendations may act as a 'band aid' to the industry for the short-term, they will not solve the greater, systemic issues currently leading to the poor performance of the fund, which is not meeting the needs of any group of stakeholders, as it:
    - Does not provide value for money to government or the NSW taxpayer, with a 2018-19 financial year loss of $1.95m
    - Is unnecessarily complex for builders to navigate and adhere to
    - Operates on a 'last resort' model which does not best serve consumers, who typically wait many months for an outcome from a claim on the fund.

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COMMENTARY ON DRAFT REPORT

Risk Specialist Group (RSG) is pleased to respond to the IPART Draft Report, issued following its industry consultation through the Issues Paper published earlier in 2020. RSG's response is structured in three parts:

- The first addresses IPART's brief, its recommendations as a result of the industry consultation process and Risk Specialist Group's responses to IPART's findings and recommendations
- Appendix A clarifies points made by RSG in its response to the Issues Paper, which it believes have been misrepresented in the Draft Report. RSG requests that these errata be corrected in the Final Report to be submitted to the Minister
- Appendix B recaps RSG's position from its response to the Issues Paper that wholesale change is required in the industry to remedy the current issues.
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    - Is unnecessarily complex for builders to navigate and adhere to
    - Operates on a 'last resort' model which does not best serve consumers, who typically wait many months for an outcome from a claim on the fund.

  Attachment 1 to Appendix B is a paper explaining a new government / private sector model for home building in NSW, which goes far beyond the IPART recommendations and offers a whole new approach to solve the many problems of the industry.

1. Methodology

RSG recognises that in issuing its Issues Paper and Draft Report, and conducting the public hearing on the Draft Report, it has met the obligations of its brief from the NSW Government, to 'review the effectiveness and efficiency in the home building compensation fund in protecting consumers who are currently covered under the scheme.'[1]

However, the facts that:

- so many previous reviews on home building compensation and related schemes have been carried out on this and precedent schemes, from the Gyles Royal Commission in 1992 onwards
- the privatisation of the market in 1997, an initiative aimed to introduce competition and improve conditions and pricing for homeowners, effectively failed with HIH's collapse in 2001, the exit of the remaining insurers in 2010 and the need for the NSW Government to again take charge of the sector
- the unsuccessful attempt from 2018 onwards to attract private insurers back to the market, leaving icare as the monopoly provider
- the building insurance and compensation schemes being fragmented between low- and high-rise (above three storey) buildings

demonstrate that the industry is demonstrably failing its key stakeholders, being home owners, builders, and the NSW government.

It is losing substantial amounts of money each year while:

[1] Draft Report, Section 2, page 8

- failing to adequately provision for risk in the industry
- forcing homeowners through an extended and expensive 'last resort' claim process
- setting unreasonably difficult and duplicative requirements for builders to enter the scheme, imposing significant burden on their businesses[2].

RSG has no issues with the methodology followed by IPART, but rather contends that the scope of its enquiry was too limited to be able to review the industry as a whole and provide recommendations about the whole-of-industry overhaul RSG believes is needed in order to provide a cost-effective and beneficial service to builders and homeowners, and demonstrate value for money to the Government of NSW and its taxpayers.

Currently there are almost $600 million of defective buildings in New South Wales and HBCF have declared a loss of $200 million for the last financial year and continue to increase premiums quarterly with the hope to remedy problem. RSG believes that increased premiums will not solve the systemic problems in the industry, and that the findings and recommendations of the IPART paper – due to its limited scope – will do nothing to address this major issue. Increased premiums are reflected in increased home prices, in an economy and major city (in the case of Sydney) where home ownership is already unaffordable to many.

As well as having what we regard as a suboptimal scope, the Draft Report does not present clear recommendations to overcome the issues it has identified within the industry and presented as its findings, or offer ways to implement them. RSG has developed – based on proven models internationally, including scheme introduced in South Africa 40+ years ago – and end-to-end solution to overhaul the scheme, involving key stakeholders including government, builders, industry associations, homeowners and insurers which it offers to industry as a model for discussion, optimisation if necessary and implementation. This model is presented as an Attachment to our report. If the Minister is supportive of further investigation of this model, this is a process that should be undertaken by all aspects of industry to understand the benefits to each party.

We note in addition that the issues investigation did not have scope to assess the fact that the HBCF model is different from the Strata Building Bond Scheme, when both sets of legislation relate to the defects in buildings. It is possible to operate a scheme where both types of buildings, and others including swimming pools etc, are covered by the one scheme, reducing confusion in the marketplace, inconsistencies between the schemes and duplicate administrative and other costs. This should be the subject of further investigation by IPART, or consideration in light of new models for the NSW market, such as that suggested by RSG (Attachment 1 to Appendix B of this response to the Draft Report).

2. Issues and Recommendations from Section 1.3

Table 1: Issues and recommendations from Section 1.3 of the Draft Recommendation Report

No.	Issue	Draft Report Recommendation	RSG's Response	Additional Commentary (if any)
	Monopoly Insurer *(Section 1.3 of the Draft Report)*			
	icare is the only home building compensation (HBC) in NSW.	Increase HBC providers by allowing non-insurer providers like fidelity funds to offer alternative	As private insurers left the market in the 1990s and have not been enticed back, neither	It is difficult to implement change within an established, monopoly

2 Comment regarding builders' opinions on burdens on their businesses quoted from the Draft Report, Section 2.1, page 11

	As a monopoly, it has little pressure to provide efficient products and quality services *(Section 1.3 of the Draft Report)*	indemnity products (this would require changes to the *Home Building Act 1989* to allow non-Australian Prudential Regulation Authority (APRA) regulated entities to enter the market. The Draft Report notes that market entry is still likely to be unappealing because of HBCF's consistent losses, and the likely increase in builder insolvencies due to the effects of COVID-19.	regulatory changes nor economic conditions are likely to encourage them back in the short term, meaning icare is likely to remain a monopoly provider.	organisation, where the smaller stakeholders who have most to gain or lose (builders and homeowners) have little influence over organisational or regulatory change. A greater scope to significantly change the current industry model is necessary. There are other industry models that have been proven to perform better than any scheme in Australia, including those implemented in Queensland and Victoria, the main compactors focused on by the IPART review. Again, refer to Attachment 1 to this response to the draft report to understand how the overall insurance model can be improved to provide solutions better than any currently implemented in Australia.
		Separate, cost-reflective construction and warranty period products, which would allow new entrants to offer construction-period cover.	This may not be appealing to homeowners as it would require them to take out and manage two policies: one for the construction period and one for the Defects Liability Period. The separation of construction and defects cover adds to the detraction of insurer competition as the construction period represents the better risk profile. It is unlikely that any insurer would offer defects cover if	

			given the choice which would lead to market failure as builders and consumers would be unable to access the cover that is most required. Like many insurance products that are known loss leaders, the concept of an insurance portfolio is to balance these exposures and use this client base to market more attractive and profitable classes of business. HBC is not a product that enables this balance and trade-off to occur given the complexity of gaining cover and making a claim, further leading to the unattractiveness of this product for insurers.	
	Regulatory Oversight *(Section 1.3 of Draft Report)*			
	icare is likely to remain the default provider in the short-to-medium term *(Section 1.3 of the Report)*	An independent regulator should determine icare's premium prices to replicate the outcomes of a competitive market, an approach consistent with the NSW Government's approach to regulating other monopoly service providers	RSG agrees with this proposal as a short-term measure, pending further reform to the industry.	Again, RSG notes that the scope of the IPART investigation and report was not broad enough to be effective in the wider industry reform we believe is needed to provide a solution that prevents a monopoly market, reduces duplication of effort in the NSW Government administering different schemes and which can stem the tide of losses year-on-year reported by IPART.

3. Findings from Section 1.6

Table 2 lists the findings throughout Chapters 2-9 of the Draft Report and RSG's responses to those on which it holds a position.

Table 2: Findings listed in Section 1.6 of the Draft Recommendation Report

No.	Draft Finding	RSG's Response
1.	Building issues can be costly and take a long time to resolve through the dispute resolution mechanisms that apply when a builder is still trading (ie, has not become insolvent, died or disappeared, or has had their licence suspended).	Agreed. This adds to the claims costs as builders remain unable to work while these issues are resolved, compounding the insolvency risk as matters are heard through NCAT and/or judgments are made that impact their solvency. The cost and length of time taken to follow the path through discussions with the builder, NCAT and ultimately icare are not in the best interests of homeowners, who face large costs and are unable to have building remedies applied until the process has reached its conclusion. A solution that provided independent inspections at key points as work proceeded, and which therefore compelled builders to remedy defective work before proceeding to the next stage, would be far more effective and reduce the calls on the pool of funding available for compensation. Further, builders could be required to deposit a percentage of the job's value into a retention fund, to be held until the completion of the defects warranty period, so that money for repair of defects is immediately available. If no claims are made against the builder in that time, the full value of the retention fund contribution, including interest, would be repaid to the builder. This scheme would protect: • Builders from bankruptcy while providing them with income against the funds held • Homeowners from lengthy and expensive proceedings to pursue their claims through NCAT and ultimately to icare.
2.	HBCF premiums in NSW are significantly higher than premiums for similar schemes in other states.	Premiums in NSW are higher because the current insurer runs a 'burning cost' model whereby premiums reflect aggregate exposure, unexpired risk liabilities and average claims cost. The level of cover in NSW is more than double that of any other regional scheme which plays out in the claims liability and resulting premium calculations to determine break-even levels.

No.	Draft Finding	RSG's Response
3.	We estimate that the average claim value in NSW is around 50% higher than claims made under similar schemes in Victoria and Queensland (after adjustments have been made for differences in coverage and building costs).	(Following the comment above.) In net terms, these higher claim values are explained by the amount of exposure retained by the insurer. For example, the Queensland scheme cedes 63% of premium received to reinsurers and the bulk of claims costs are met by reinsurers. By comparison, icare retains 100% of the premium (a similar dollar amount to Queensland), but without the benefit of reinsurance recoveries (or income from exchange commission), the net average claims costs is dramatically inflated. Further, the insurance cover in Queensland applies for contracts above $3,300 compared with NSW's $20,000, which dramatically changes the risk profile and average claims cost. In recent years, Queensland has had a disproportionately larger number of renovations that are covered under its scheme, but would not be covered by the NSW scheme. These low contract sum improvements accounted for 25% of claims during 2020, with an average claims cost of $5,200 (QBBC Annual Report 2020). In other words, the lower value at which home owners can make claims directly affects the numbers of claims made. The Queensland model is not necessarily one to be adopted wholesale by NSW, as it presents its own range of issues including the different risk profile in NSW which would need to be carefully modelled to see if it actually provided financial advantage given other facets of the NSW building industries. RSG recommends that IPART and the industry look more broadly than simply at the Queensland and Victorian models in the search for a solution that does not ultimately cost the NSW taxpayer millions of dollars per year, while protecting builders with a scheme that does not demand they over-capitalise their businesses, but instead offers them a way to invest money that may be needed for future claims, for which they will receive a future benefit in investment income, if the funds have not been drawn on for defect rectification.
4.	NSW has fewer claims than claims made under similar schemes in other states.	This is correct, and is a factor of the 'last resort' approach to insurance. Having fewer claims is not necessarily a positive measure, given the parameters of the scheme

No.	Draft Finding	RSG's Response
		make it difficult for homeowners to even reach the point of commencing a claim.
5.	There are regulatory barriers inhibiting entry for private providers. In particular, it is unlikely that fidelity funds that are not regulated by the Australian Prudential Regulation Authority (APRA) could offer HBC cover in NSW under the current drafting of the legislation.	Agreed, and this is well-evidenced by the failure to attract private providers to the market since 2018. Additionally, the post-COVID-19 economic situation is likely to increase builder bankruptcies, increasing risk to insurers and making market entry even less attractive.
6.	That the HBC licensing framework unnecessarily duplicates APRA's role in the prudential supervision of insurers, increasing costs of entry to the scheme for insurers.	RSG disagrees with this finding, suggesting instead that past dealings in this product and the resulting losses are the primary reason for the lack of competition in this market. It took the abolition of 'first resort' cover in 2002 to encourage private competition to initially enter the market. The majority of these providers had already left, or left the market around 2009 as a result of its non-viability. Vero (Suncorp), IAG (CGU and Lumley), and QBE have all previously withdrawn from the market on this basis, resulting in the current SIRA/icare scheme. There would be a significant reluctance for these major insurance groups to re-enter the marketplace under the current operating procedures.
7.	That the regulatory framework deters entry by unnecessarily restricting how private insurers and providers compete in the market.	Again, RSG disagrees with this finding as it believes the primary reason for lack of competition in the market is previous experience and fiscal decisions that the scheme was not viable.
8.	HBC is a 'long-tailed product', which means providers must hold capital to cover liabilities for up to 10 years, discouraging providers from entering the market.	This response follows those above. Insurers cover a number of long tail liability programs that require long-term capital (offset by long-term investment and discount rate adjustments). The aggregation of exposure in HBC is the material issue whereby the insurer must have sufficient capital to cover Probable Maximum Loss (PML) assumptions. Currently APRA and SIRA monitor the insurer's capital adequacy and financial capacity to meet the modelled exposure and likely costs from defined events such as: • Major builder insolvency

No.	Draft Finding	RSG's Response
		• Economic downturn • Pandemic etc. The greater the exposure, the greater the capital amount required. Long-tail products typically perform better on development and are comparatively cheaper than short-tail products, but this is the opposite situation for HBC. There are alternative models that remove the APRA or SIRA large capital funding requirements, instead retaining funds from builders, providing a pool of capital.

4. Recommendations from Section 1.6

Before addressing individual recommendations from the report, RSG offers some high-level commentary as context for its following feedback.

While we acknowledge the somewhat limited scope mandated for the review, and note that Section 2.3 of the Draft Report indicates that few responses were received from homeowners and consumer groups, we still believe that a shortcoming of the Draft Report is that there is little reference to critical issues such as the impact that the current scheme has on:

- Consumers, whose building costs are increased but under a regime where claiming is a 'last resort' when all other avenues of redress have failed
- Builders, who have to be financially assessed, are constrained by job limits etc and are put through laborious dispute processes in order to maintain their livelihoods
- icare itself, having to solely administer a scheme that no private insurer has been able to sustainably manage over the past 20 years. Despite the difficult conditions under which it works, icare is subject to constant scrutiny around costs, when it is:
  - Simply meeting a statutory requirement
  - Being compared with dissimilar programs (that is, no 'apples for apples' comparison).

The Draft Report makes several references to known 'first resort' schemes and fidelity schemes and attempts to address this in the recommendations around barriers to entry, but it is important to remember that the most recent first resort insurer in NSW was HIH, and it took significant reforms to get private insurers back into the market following its collapse.

What needs to be understood and agreed is whether the solution to the lack of private insurers in the market is an insurance product or a State-managed scheme. The critical component of insurance is being able to measure and evaluate the risk/exposure and mitigate risk through effective underwriting. The current scheme carries essentially three triggers for activation, which are a mix of insurance and statutory issues:

- Death or disappearance is equivalent to a life insurance product
- Insolvency, equivalent is a trade credit/surety issue
- License suspension, which is a statutory liability.

Each of these trigger events have elements of insurance products, but are not solely insurance products, adding complexity to the scheme.

The Queensland scheme, by comparison, relies solely on insurance practices. This is a benefit of separating statutory and insurance issues, but does not cover the complex statutory requirements that should be in place to complement insurance products in the HBC market.

Separating insurance issues from statutory issues is a key part of introducing a more effective and less complex HBC scheme to NSW. This is possible under a scheme that has a statutory body such as IPART managing those issues, and a group of insurers managing risk, underwriting, re-insurance to ensure they are not vulnerable. This makes risk management much simpler for non-State underwriters, simplifying the industry and having a flow-on effect of lower premiums. This eliminates the previous issue in the industry where icare's (and previous insurers') attempts to underwrite the primary exposure have been unsuccessful, because of inability to model, underwrite and manage the risks of triggers that include aspects of both statutory and insurance requirements.

A related issue is to ensure that industry bodies take accountability for educating and licensing builders, not only about technical proficiency but also about running a small-to-medium size business including cash flow not only for jobs in progress but for insurance against future defects liability claims. Mandatory industry-body certification alone has the potential to significantly reduce builder insolvency, further reducing the risk profile for insurers, again leading to reduced premiums.

Without substantial change, existing practices will continue. IPART is attempting to create competition in a highly unattractive marketplace. Non-insurer providers cannot meet requirements, and increase the risk of market failure if receiving claims their capital bases are unable to cover. Relaxing prudential rules, however, would further discourage competition from mainstream insurers.

While we applaud IPART's intentions, we believe they do not address the key issues with the current scheme and therefore efforts to encourage competition and market entry from private providers will ultimately prove unsuccessful.

We believe that this product is best administered as a state-based scheme that removes the insurance elements and focuses on holistically addressing the real causes of building disputes and building defects. The State can then work with the insurance industry to cover insurance requirements for HBC.

Table 3 lists the recommendations throughout Chapters 2-9 of the Draft Report and RSG's responses to them, where appropriate.

Table 3: Recommendations listed in Section 1.6 of the Draft Recommendation Report

No.	Draft Recommendation	RSG's Response
1.	That the NSW Government improve access and timeliness to dispute resolution processes, by ensuring Fair Trading and NCAT are sufficiently resourced and have the relevant expertise.	We agree, however feel that home building disputes should be centrally managed by specialists – including actions such as independent inspection at key stages of building, on-site mediation and early intervention – to ensure timely and accurate determinations.
2.	That Fair Trading develop a program of proactive investigations and audits of building work in the low rise residential sector, similar to the approach being taken by the Building Commissioner in relation to apartment buildings.	We agree, and note that the critical stage inspections for home building need to span not only the National Construction Code (formerly BCA) and plan compliance, but inspect for known common defect areas to prevent future defects.

No.	Draft Recommendation	RSG's Response
3.	Fair Trading and NCAT should collect information and publicly report on the number and type of complaints (including construction type, issue type, value of rectification and other costs), and the time taken to resolve them.	We agree that this is valuable information for the industry and public to have access to, but note that it does not resolve the key reasons for disputes or defects.
4.	The lodgement of a complaint or dispute with Fair Trading or NCAT for a specified defect within the warranty period preserve a claim for insurance in relation to that defect.	No comment. (Refer to our Attachment to Appendix B, which would avoid the involvement of NCAT before a claim could be initiated by instead involving independent inspectors, mediators, builders and homeowners in a mediation process as the first step towards resolving issues before a claim is raised.
5.	SIRA report on costs as part of its annual performance monitoring review so that icare's costs can be more easily tracked over time, and compared with costs of the schemes in other states.	Noting that the other States have a variety of material differences in cover basis, triggers and limits, comparison is not meaningful and could further distract from the real issues of the current NSW scheme.
6.	The use of brokers become voluntary under the scheme, to provide builders with more options on how they manage their HBCF obligations.	While financial assessments are clearly required, the broking costs must be born somewhere. Brokers facilitate large amounts of information exchange as well as assessing eligibility based on expertise, which is necessary for a smooth process. If icare or any other insurer brings this activity in house or requires digitisation of brokers' information channels, this would increase incurred cost which, as is noted above, must be borne somewhere. Other than a potential change in administrative process which may simplify builders' applications, it is difficult to see any benefit to implementing this recommendation.
7.	icare's premium calculator provide the estimated premium for each builder to help homeowners better manage their costs and understand the insolvency risk associated with different builders.	We do not believe this is appropriate as we understand the financial rating of the builder is a material factor in the premium charged, and this would just cause further confusion to homeowners and questions of their builder as to why they are not charging a certain price.

No.	Draft Recommendation	RSG's Response
8.	The NSW Government amends section104A of the *Home Building Act 1989* and associated Regulation to allow alternative indemnity providers to offer a discretionary (non-insurance) product.	The Government needs to decide as to the applicability of Insurance to this scheme. Reducing prudential standards to encourage non-insurance providers creates an unequal playing field and is anti-competitive in nature having different guidelines for participation for some insurers than others. If insurance products are being sold, alternative providers should be regulated to the extent that they have sufficient capital to meet PML and aggregated exposures in the event of builder collapse/economic downturn etc. This is a very broad topic which warrants more investigation than the scope of the initial Issues Paper or Draft Report has allowed for, and which potentially has implications across other industries.
9.	That SIRA simplifies its licence application process for insurers to recognise that APRA's prudential standards apply, removing the need for a duplicate assessment. This could reduce licence fees payable by insurers.	This recommendation is noted, although it only applies if competition exists.
10.	That the NSW Government: 49	
	– limits the application of sections 103BD to 103BG of the Home Building Act 1989 that regulate premium pricing to the default market incumbent, icare 49	Agreed.
	– removes the requirement for SIRA to approve private insurers and providers' eligibility and claims models, in favour of a market monitoring arrangement where SIRA reports on market participants' performance against high-level principles.	Agreed.
	This should be reviewed in five years or earlier if the market composition has changed considerably.	
11.	That the NSW Government requires icare to make available separate cost-reflective construction period and warranty period products so that a new entrant could provide construction period cover only.	This may not be appealing to homeowners as it would require them to take out and manage two policies: one for the construction period and one for the Defects Liability Period. The separation of construction and defects cover adds to the detraction of insurer competition as the construction period represents the better risk profile. It

No.	Draft Recommendation	RSG's Response
		is unlikely that any insurer would offer defects cover if given the choice which would lead to market failure as builders and consumers would be unable to access the cover that is most required. Like many insurance products that are known loss leaders, the concept of an insurance portfolio is to balance these exposures and use this client base to market more attractive and profitable classes of business. HBC is not a product that enables this balance and trade-off to occur given the complexity of gaining cover and making a claim, further leading to the unattractiveness of this product for insurers.
12.	An independent regulator determines icare's premiums for the HBCF to ensure they reflect efficient costs. SIRA's role, as the scheme regulator, could be expanded to provide it with determination powers. Alternatively, IPART, as the NSW pricing regulator, could be given the on-going role of determining icare's HBCF premiums.	RSG does not support this recommendation, and suggests that any consideration of icare's premiums be looked at in light of price adequacy, as the scheme does not currently break even, primarily due to prior years' performance. Were the market to become competitive, this recommendation would cease to be relevant.
13.	SIRA increases its regulatory oversight of icare by reviewing and determining icare's builder eligibility model and claims handling processes.	RSG does not support this recommendation, as it is counter to the view that regulation should be relaxed to encourage new entrants.
14.	SIRA establishes appropriate KPIs against which it can measure and publicly report on icare's performance in resolving eligibility issues and finalising claims in a timely manner.	RSG does not support this recommendation as it will not have any material positive outcome for either consumers or builders while the scheme operates under its existing form, but merely adds an additional layer of administration and potential sources of data for invalid comparison with data from schemes in other States.
15.	icare provides greater transparency in how it undertakes its eligibility assessments and how it determines individual builder loading/discounts used in risk-adjusted premiums	Agreed.
16.	icare: – Provides information in plain language in the Builder Eligibility/Change application form or the Builder Self Service Portal, why particular information is sought and	Agreed. Any clarity in communications that can be provided for builders, homeowners and other parties to aid understanding should be pursued.

No.	Draft Recommendation	RSG's Response
	how it would be used in determining a builder's eligibility. – Provides information in plain language on how the information provided by builders was used to determine their eligibility profile and their individual loading/discount, including any conditions of eligibility. – Makes clear any adjustments that have been made to consider any industry specific circumstances eg, the adjustment for a pool builder in determining their eligibility to account for 'sleeper pools'. – Periodically updates the work undertaken by the Data Analytics Centre in 2016, to examine whether the factors previously identified and currently used, continue to be significant in predicting builder insolvency, and if there is scope to reduce the amount of information sought without necessarily increasing risk.	
17.	icare reviews its dispute resolution processes to resolve eligibility issues in a more streamlined and timely manner	This is an outcome that would be welcome, but the recommendation does not supply sufficient detail about how this would be implemented to comment on whether or not the recommendation is valid.
18.	SIRA produces guidance for the building industry that addresses the following questions: – For contracts that require HBCF cover, whether items such as soft-scape landscape works and pool equipment can be excluded from HBC requirements – How to allow for variations in the cost of HBCF in contracts, if the exact contract price is not known at the time the contract is signed – Whether head contractors can require subcontractors to also purchase HBCF cover for subcontracted residential works exceeding $20,000 – Whether HBCF cover is required for alterations and renovations for multi-units above three storeys.	RSG does not have a particular view on this recommendation. In general, we support single sources of information, and clarity in expression, to reduce the risk that builders, homeowners and others find conflicting information or information that is hard to understand, particularly for lay people.

APPENDIX A: ERRATA

Some quotes or commentary in the Draft Report attributed to RSG are incorrect. These errors are listed in Table 4, and RSG requests that they be corrected in the Final Report to be submitted to the Minister.

Table 4: Corrections to Draft Report where Risk Specialist Group is quoted or attributed

Reference or Statement	Should be Corrected To…
Section 5.2, page 40: 'We received submissions on entry barriers from icare, SecureBuild, the Risk Specialist Group, HIA and others. We held follow up discussions with stakeholders to discuss their issues, …'	IPART did not hold follow up discussions with Risk Specialist Group regarding our comments on barriers to entry. The sentence quoted at left could be corrected to 'We held follow up discussions with some stakeholders…'
Section 6.4.1, page 61: 'The Risk Specialist Group stated: A multi-product model would allow insurers to focus on their preferred area of exposure. However, it would be unlikely to provide better value than existing products and add further administrative burden and cost.'	The Risk Specialist Group stated: A multi-product model is unlikely to provide better value than existing products, as it will add further administrative burden and cost, while limiting the value of cover to the extent that the insurer sees viability in the product.

APPENDIX B: RSG'S PROPOSAL TO ADDRESS MAJOR INDUSTRY RISKS

As indicated in its response to the initial Issues Paper published by IPART, RSG believes that a greater degree of change is required in the industry than the scope of the IPART review and subsequent recommendations permits.

This section summarises our current views, and serves as the lead-in to a government / private sector model that we believe could significantly change the current industry status, achieving better outcomes for all stakeholders from government to homeowner.

The Current Crisis in Home Building Compensation

The current crisis in Home Building Compensation is caused by the fact that, historically, administration costs and claims by homeowners have exceeded premium revenue. Private insurers have left the market due to its lack of financial viability and, even with quarterly premium rises, the Home Building Compensation Fund (HBCF) continues to lose money.

The cost of the remediation process once cases reach NCAT exacerbates the problem, as do the additional administrative costs of other agencies such as the Certifiers Board.

The Issues for Homeowners

For homeowners, home warranty insurance has long been criticised as being of little value, as not only does the cost of the insurance add to the contract value, but access to the funds in the event of a claim can often only be achieved following complex processes that necessitate the homeowner:

- Raising action through the consumer tribunal (and then only if the tribunal sides with the consumer and the builder fails to comply), or
- Seeking remedy from the builder through civil proceedings that trigger the insolvency of the builder.

Unlike any other general insurance product, this form of insurance pays out on a very small percentage of policies – a reflection of the complexity of triggering the policy.

The Difficulties for Builders

A builder's access to the product is equally difficult, with extensive information provision and financial review requirements – including requests for the injection of capital or the substantiation of an asset position that is considered reasonable and adequate in mitigating an insolvency risk.

Builders are subjected to annual insurance limits and job limits, often restricting them from taking on new work until existing jobs are verified as completed, which causes further frustration to homeowners who are unable to have their plans released from council and obtain a construction certificate prior to the builder resolving these insurance requirements.

The various legislation allocating responsibilities under home building regulation and insurance contracts contributes to some of these issues, causing confusion and increasing the costs of administering the scheme.

The Flaws in Current Guidelines

The guidelines issued by HBCF have a number of grey areas that builders / homeowners and Certifiers find difficult to interpret. Some definitions vary between councils and the HBCF guidelines, and there is no flexibility to resolve the variations.

Some major issues include the facts that:

- Pricing is not consistent with risk – for example, prior to August 2019 the insurance price of duplexes was almost three times the current price
- The definition and pricing of dual occupancy granny flats is inconsistent, causing confusion to Certifiers, builders and consumers
- Calculation of assumed turnover is unclear in the assessment process, confusing to builders and accountants
- The majority of financials are unaudited, leading to flawed risk assessments
- The delay in assessments causes undue stress to builders and delays in commencement of projects
- There is a lack of building industry knowledge and experience in the HBCF management arena
- The issue of certificates is not policed by HBCF, and fraudulently issued certificates create major additional legal and administration issues
- The industry bodies cannot properly focus on the issues of their members as they are non-profit capitalised, with the majority of income received in commission and fees.

The Demand for a New Approach

The fact that, over the past decade, the insurance landscape has changed to the degree that four major insurance groups in the Australian market have exited the schemes either as private insurance providers or risk-free service providers can itself be seen as market failure.

The polarising nature of the product means that insurers (including brokers) see the product as too difficult to manage and don't believe it provides sufficient ability to build their businesses. Knowing that previous insurers continue to incur losses from prior schemes is a further disincentive to attracting new market entrants.

A system that demonstrably disadvantages the primary stakeholders it not a system that works for anyone. The current system is unsustainable unless it:

- Is priced to a point of being unaffordable
- Continues to be cross-subsidised by the community.

Either case constitutes failure in a product intended to protect homeowners from the risks of engaging qualified builders.

To stem the losses, regain homeowner confidence and help protect builders from insolvency, a multi-factorial approach is required. It must:

- Address the of all of homeowners, builders and insurers
- Reduce defects, lowering calls on the fund – this requires a more rigorous and independent quality assurance process than is currently in place
- Build the amount of money available to the fund to stop the requirement for 'top ups' from public funds
- Provide additional oversight, and education where necessary, so that builders:
    - Correctly scope and quote work
    - Verify before obtaining insurance that they have sufficient working capital (not assets, which may not provide sufficient liquidity) to complete the project
- Attempt to attract private insurers back to the market, providing them with an acceptable risk level and profitability margin.

A Proposed End-to-End Solution to Benefit the NSW Government and Protect Builders and Homeowners

In Part 2 of its response to the initial Issues Paper, RSG provided a document outlining a new government / private sector model, an end-to-end solution that would benefit the NSW Government and protects builders and homeowners.

We now attach a slightly updated version of the paper explaining this model here, for review by the IPART Tribunal Members for this review and the IPART Committee. We would be very pleased to present this to the IPART Committee in order to further explain how a new model for NSW could address the issues addressed in the Issues Paper and Draft Report, and other issues which RSG and others have noted were not in the scope of the review.

Refer to Attachment 1: *A New Government / Private Sector Model for Home Building Compensation in NSW*.

A NEW GOVERNMENT / PRIVATE SECTOR MODEL FOR

Home Building Compensation in NSW

16 Oct 2020

NON-CONFIDENTIAL

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NSW Home Building Compensation in Crisis

Home Building Compensation in NSW is in crisis. IPART declares losses year-on-year and icare is a monopoly provider and has been for more than a decade since private insurers left the market.

Government is losing money.

Private insurers will not enter the market.

Builders find the process arduous and expensive.

Homeowners – the ultimate stakeholders to be protected provided by the insurance – see it as of little value because it adds to the ultimate cost of the contract and pursuing a claim can be time-intensive and costly as potential claims must go through NCAT before even reaching the stage that a claim may be raised.

The model is failing.

An End-to-End Solution that Benefits the NSW Government and Protects Builders and Homeowners

In response to this crisis in industry, Risk Specialist Group (RSG) has developed a new model that involves both government and private sectors, to substantially change the industry to make it profitable and of more benefit to all stakeholders. It is a model which has been effectively implemented previously in other parts of the world including South Africa more than four decades ago. This provides proof of its efficacy, and offers NSW the opportunity to bring its HBC to a level that better serves stakeholders and is profitable.

The model offers and end-to-end solution where responsibilities and risk are assigned to those parties best able to manage them, resulting in a cohesive industry solution that eliminates the shortcomings, expense and redundancy of the current scheme.

RSG pooled the collective knowledge a cross-disciplinary group of brokers, builders, Inspectors and others in the industry to tailor this model specifically to NSW's needs. However, we seek the opportunity to explore the concepts in more detail with members of the NSW HBC community knowing that the opportunity to work with government and a full range of stakeholders – including homeowners – will offer opportunities to co-design elements of the proposed scheme.

Rather than simply focusing on statutory requirements and insurance products, the scheme focuses on education, contract management, cash and progress payment management, critical stage inspections, mediation and margin retention. This is a Building Risk Management Model that:

- Offers significant cost savings to the NSW Government
- Provides benefits to builders, such as removing the need to provide a Home Warranty Certificate
- Removes the need for homeowners to pay premiums and provides them peace of mind about redress and quality of repairs to defective work, even if their builder goes out of business or is otherwise unavailable.

BENEFITS TO STATE GOVERNMENT

- Increased ability to attract private insurers back to the market, with a variety of complementary service providers to contribute to builders' success
- Reduced administration costs and losses
- Improved reputation from homeowners' confidence in a revised scheme

BENEFITS TO BUILDERS

- Improved access to formal business support and assistance with scoping, pricing and cash and workflow management, especially for small builders
- Reduced administrative burden for compliance
- Overhauled, less adversarial dispute resolution process

BENEFITS TO HOMEOWNERS

- Improved knowledge about builder's likely ongoing solvency
- Increased confidence in a quality build, from an independent quality assurance process
- Reduced need to seek remedy against defects, and an easier process to do so

How it Works

RSG's Building Risk Management Model will help reduce government expenditure on NCAT, Home Warranties and defect liability payments. We recommend that the program be established by government, in consultation with specialist advisors, and that the government retain responsibility (as it currently does) for financial aspects of the scheme.

The program is proposed to be delivered by:

- The NSW Government, in consultation with a specialist consultant such as RSG (this organisation would be selected by tender)
- Service providers selected from a pre-qualified panel of suppliers.

The Retention Fund

The Retention Fund is the cornerstone of funding for defect repair, including government funding currently provided through Home Warranties and NCAT when builders are no longer in business or otherwise unavailable when defects arise. The proposal is that each builder will lodge 5% of the value of each project into the Retention Fund before a Certificate of Commencement is issued (an alternative is a Performance Bond, described below).

Full details of the Retention Fund would be worked out as part of reviewing, refining and implementing the proposed model, but the following scenario is provided to demonstrate how investment and returns may work.

- In 2019, approximately 65,000 building projects were undertaken in NSW, each with an estimated contract value of $300,000. A 5% deposit into the Retention Fund therefore indicates an annual investment of approximately $975m. For the purposes of this scenario, we assume these figures will not change substantially, and annual inflows will continue to be approximately $975m and held in the Fund for approximately 6-10 years.

- Once established, the Fund would be able to access suitable investment exposures with the required diversification. The Fund would be invested as a common pool, although each contract's tranche would be separately identified. Given the need to access capital from the fund as needed for remediation, the Fund would be managed relatively conservatively to avoid large amounts of volatility. In general terms, the Fund would be managed under a defensive allocation rather than moderate, balanced or more aggressive. Whether the Fund is managed actively or passively may also significantly affect the returns achieved.

RSG has had a leading Funds Manager perform some very early modelling, under a general model the Funds Manager uses internally for early modelling of various portfolio options for its institutional clients. It is based on the Fund Manager's assumptions which it believes are reasonable and based on sound theoretical principles, but the performance outcomes cannot be guaranteed given the Fund is still at the conceptual stage, and market performance during the period the Fund is active cannot be predicted. The modelling results are complex, and are available on request. They focus on exposure across a range of investment sectors and risk categories (defensive, moderate and balanced).

Modelling could be further explored during consultation with government and others, considering current market conditions (particularly considering the effects of COVID-19) and the state of the building industry at the time the Model is likely to be introduced.

It is also important to note that this model works both for buildings under three-storeys high and buildings of three-storeys or more. As these are currently covered by different legislation and managed by different government departments, leading to wasteful duplicate administrative and other costs, there is a further Government saving in consolidating the two schemes.

Major Components of the Model During Construction

Major components of the model during construction include:

- **Industry groups** interested in being involved in **builder's coaching and certification**, to ensure builders have both technical proficiency and knowledge of running small-to-medium size enterprises – including critical cash flow management – to ensure builders are qualified for the jobs they undertake.

  Additional support in the form of branding, marketing, hiring, tax advice and other activities can be organised by introduction to agencies specialising in these fees.

- An **audit** will ensure the builder has the capacity to undertake the project, and recommend if bank finance should be arranged.

  Support to obtain bank financing can be arranged, again through banks who are familiar and qualified to serve as sources of finance under the scheme.

- **Insurance brokers** will ensure that appropriate insurance policies are in place.
- An **independent builder's reviewer** (which again could be someone from an industry group) reviews all documentation to ensure that it is robust, accurate and project-ready.
- The **builder** transfers 5% of the project value to the Retention Fund or obtains an equivalent amount in a Performance Bond and lodges it with the Government.
- A **Funds Manager** will invest the funds over a 6-10 years period (the period of liability) and an annual return (interest only) will be paid to the builder.
- A **Construction Certificate** (CC) will be issued by the Certifier after a Certificate of Compliance has been issued by the insurance broker.

- **Staged certifications** will be undertaken by the Certifier as per the *Building and Development Certifier Regulation*. Building inspections and certifications will be carried out at agreed points, and any additional or remedial work instituted and reinspected.
- Contractually, **periodic reviews will be conducted against the builder's business**, following APRA's *Prudential Standard CPS 231 Outsourcing* including Business Continuity Planning (BCP), compliance, privacy, quality assurance and adherence to critical service standards and contract obligations.
- A **lockup building inspection** will be undertaken by an independent building consultant appointed by the Certifier.
- **Pre-final inspection** will be undertaken by the independent building consultant.
- The **Final Occupational Certificate** will be issued by the Certifier subject to the completion of the pre-final inspection.
- At the conclusion of each project, the insurance broker will provide **operational reporting** on distributors, customer satisfaction and contract performance to the **Minister for Better Regulation and Innovation**.

Major Components of the Model During the Six Year Warranty Period

If any defects are discovered during the six year warranty period, a **Mediator** will be appointed and will coordinate a meeting amongst the homeowner, builder, Certifier and building consultant to agree the requirements for resolution of the defects.

A **Project Manager** will be appointed by the Mediator to oversee the remedy of defects and – if the original builder is unavailable– a builder will be appointed to conduct or complete the work.

If the defective work is carried out by:

- The original builder (last resort cover), this cost is to be borne by the original builder and funds for this builder cannot be drawn from its Retention Fund contribution or Performance Bond
- A different builder, work is paid for from the Retention Fund or Performance Bond, underwritten by the NSW Government in the event of any shortfall.

  If the original builder goes bankrupt, disappears or dies, the Retention Fund contribution or Performance Bond will be used to rectify defects or complete repairs.

Builders in the program will be invited to participate in, and benefit from, the ongoing **Builders and Developers Forum**, run by industry groups, which will:

- Keep builders updated about industry developments including changes in legislation and their effects
- Offer a variety of Continuing Professional Development (CPD) opportunities.

The Model is illustrated with flowcharts and additional information on the pages that follow.

Case Study 1: Jane’s $350,000 Family Home

This case study illustrating the RSG model is based on a contract value of $350,000.00 for the construction of a single-storey dwelling with minor defects within a 6-year period.

Jane decides she would like to build a family home. She appoints an architect to draw up plans and submits a Development Application (DA) to her local council for approval. Once council has approved her DA, she decides to get quotes from several builders.

Jane turns to Google to find a local builder who is licensed and has a proven track record along with great customer reviews. She comes across Harry’s Luxury Homes and goes through his website. She is impressed with Harry’s brand and visual appeal of the website, so she dives further into his projects and reviews. Harry seems like a top bloke, so she chooses him as one of her preferred builders to get a quote from and engages in conversation.

After meeting with Jane, Harry’s Luxury Homes would like to quote on Jane’s requirements. Harry has already been working with a Builder’s Coach who has helped him set up all areas of his business for success. He has also undertaken several training courses with the HIA. Harry is confident that he will not be underquoting himself and submits a quote to Jane.

Jane reviews all the quotes she’s received and decides to meet with a couple of her preferred builders. After further discussions, Jane decides to go with Harry’s Luxury Homes. Harry prepares a standard HIA contract which is signed between Harry and Jane.

The contract is sent to RSG and an auditor appointed to go through Harry’s Luxury Homes financials, insurance and licensing. The audit shows that Harry’s company already has capital equivalent to 5% of the contract value. It also shows that Harry has the required insurance policies in place (ie. Public Liability, Worker’s Compensation) and that he is a licensed builder. Harry is notified that his eligibility to build Jane’s home is approved and he issues Jane with an invoice for 10% deposit.

Jane transfers $35,000 to Harry so that the project can commence. Harry transfers 5% of the contract value ($17,500) via RSG into a Government-backed and managed Retention Fund. RSG deducts 20% ($3,500) of the Retention Fund deposit to cover the cost of management and administration fees meaning that Harry has $14,000 deposited in the Retention Fund.

Harry is happy knowing that if there are no defect claims over the next six years, he will get back his $14,000. He also loves the fact that he will be receiving a dividend of approximately 5% annually (on average) of all the monies he has deposited into the Retention Fund.

Jane is happy knowing that she does not have to pay for Home Warranty Insurance and that she is dealing with a quality builder managed by a professional organisation like RSG.

After the deposit has been made, RSG cross-checks all documents, appoints a Certifier and issues Harry and the Certifier with a Certificate of Compliance. The Certifier issues Harry’s Luxury Homes a Construction Certificate (CC) and Harry proceeds with the construction of Jane’s home.

Over the term of the contract several inspections are carried out. Any minor defects that arise during the construction phase are addressed and reinspected before Harry continues with the next stage of the project and so on, with the inspections carried out at critical stages.

After six months, Harry is ready for the final inspection to be carried out by an RSG-authorised Inspector. The inspection passes and an Occupier’s Certificate is issued to Jane as the homeowner.

After two years there are minor defect with Jane’s home. Jane reaches out to Harry to inform him that there is a water leak in one of the bathrooms and a one of the cornices has cracked. Harry

Case Study 1: Jane's $350,000 Family Home

goes on-site to look and deems that it is not his fault that the waterproofing failed, however that he will fix the cracked cornice. Harry fixes the cornice but refuses to fix the waterproofing issue. Jane contacts RSG, which appoints a Mediator for Jane's case. The Mediator organises a meeting with all parties including Jane the homeowner, Harry the builder, the Certifier, the Inspector and Project Manager.

Harry continues to refuse to rectify the waterproofing issue stating that the subcontractor he used is out of business and that he should not have to cover the cost of repairs. The Mediator sees differently and gives Harry the option of complying or having his license cancelled And Retention Fund money forfeited so that it can be used to fund the rectification work by another builder. Harry agrees to fix the issue.

After six years has passed, Harry is refunded his $14,000 Retention Fund deposit. Over that same period Harry has made over $8,000 in interest payments from the Fund.

Case Study 2: Mark's $500,000 2-Storey Dwelling

This case study illustrating the RSG model is based on a project value of $500,000.00 for the construction of a two-storey dwelling with major defects and the builder going bankrupt within a 6-year period.

Mark decides he would like to build a family home. He appoints an architect to draw up plans and submits a DA to his local council for approval. Once council has approved his DA, he decides to get several quotes from various builders.

Mark turns to Google to find a local builder that is licensed and has a proven track record along with great customer reviews. He comes across Unique Homes and goes through their website. Mark is impressed with Unique Home's brand and visual appeal of the website, so he decides to look further into their projects and reviews. Apart from a couple negative reviews, Unique Homes seems like a reputable company, so he chooses them as one of his preferred builders to get a quote from.

After meeting with Mark, Phil the managing director from Unique Homes would like to quote on Mark's requirements. Phil has already been working with a Builder's Coach who has helped him set up all areas of his business for success. He has also undertaken several training courses with the Master Builders' Association (MBA) to help address some issues in the past that left negative reviews. Phil is confident that he will not be underquoting himself and submits a quote to Mark.

Mark reviews all the quotes he has received and decides to meet with a couple of his preferred builders. After further discussions, Mark decides to go with Unique Homes. Phil prepares a standard MBA contract which is signed between himself on behalf of Unique Homes and Mark.

The contract is sent to RSG and an auditor appointed to go through Unique Homes financials, insurance, and licensing. The audit shows that Unique Homes does not have the required capital which equivalent to 5% of the contract value. However, it does show that Unique Homes has the required insurance policies in place (ie. Public Liability, Worker's Compensation) and that Phil is a licensed builder. RSG arranges for Phil to speak to one of the lenders on its panel of verified service providers. The bank approves additional working capital for Phil which is equivalent to 5% of the contract value. Phil is notified that his eligibility to build Mark's home is approved and he issues Mark with an invoice for 10% deposit.

Mark transfers $50,000 to Unique Homes so that the project can commence. Phil transfers 5% of the contract value ($25,000) via RSG into a Government-backed and managed Retention Fund.

Case Study 2: Mark's $500,000 2-Storey Dwelling

RSG deducts 20% ($5,000) of the Retention Fund deposit to cover the cost of management and administration fees, meaning that Phil has $20,000 deposited into the Retention Fund.

Phil is happy knowing that if there are no defect claims over the next six years, he will get back his $20,000. He also loves the fact that he will be receiving a dividend of approximately 5% annually (on average) of all the monies he has deposited into the Retention Fund.

Mark is happy knowing that he does not have to pay for Home Warranty Insurance and that he is dealing with a quality builder managed by a professional organisation like Risk Specialist Group.

After the deposit has been made, RSG cross-checks all documents, appoints a Certifier and issues Phil and the Certifier with a Certificate of Compliance. The Certifier issues Unique Homes a Construction Certificate (CC) and Phil proceeds with the construction of Mark's home.

Over the term of the contract several inspections are carried out. Minor defects discovered during these inspections are remedied and reinspected before Phil proceeds to the next stage of the work, and so on with the inspections carried out at critical stages

After eight months, Phil is ready for the final inspection to be carried out by an RSG-authorised Inspector. The inspection passes and an OC is issued to Mark the homeowner.

Over the next four years, Unique Homes completes another 20 homes with an average contract value of $350,000 each. As a result, Unique Homes has deposited a total of $280,000 into the Retention Fund over a four-year period. During this period, their Retention Fund money has earned another $36,000 in interest which has been paid out to the builder over the course of the four years. In the fifth year, the owners of Unique Homes fall on hard times and have no choice but to liquidate the company. The company is wound down with the Retention Money of $280,000 remaining in the fund should any claims arise.

In the sixth year, Mark's façade starts to show some major cracks and corrosion is evident on the sides of the slab. Mark reaches out to Phil from Unique Homes to inform him of the issues. Phil lets Mark know that the company has been liquidated so he can't help him out. Mark contacts RSG who appoints a Mediator for Mark's case. The Mediator organises a meeting with all parties involved in the construction of Mark's home, including Mark the homeowner, the Certifier, the Inspector and appoints a Project Manager to find out how the issue happened. The Project Manager arranges for an on-site inspection of Mark's home then reverts to the Mediator. The Mediator approves works to be carried out to fix Mark's home.

The Mediator instructs the Project Manager to get a few quotes from builders to rectify the issue. After receiving three quotes from a panel of RSG-approved service providers, the Project Manager awards the job to Jim's Building Services. The defective work will cost $340,000 to fix. RSG authorises the use of Unique Homes' Retention Fund deposit to be used for the rectification works. Unique Homes still had $280,000 in the Retention Fund, meaning that the NSW Government would need to fund the $60,000 difference.

Jim's Building Services completes the job which is inspected by both Mark the homeowner and an RSG-appointed Certifier. Instructions are sent to RSG confirming the satisfactory completion of the defective work. Jim's Building Services issues an invoice to RSG and RSG instructs the Retention Fund Manager to covert $280,000 worth of stock under the Unique Homes account into cash. Once settled, RSG pays Jim's Building Services invoice and the Unique Homes' Retention Fund account is closed.

Now and Then

As a comparison between the current scheme and the proposed Risk Management Model, Table 1 compares the existing and proposed schemes.

Table 1: Comparison of current scheme versus proposed scheme

Home Warranty Industry Overview

Description	Current Model	RSG Model
Industry Bodies conducts training and assessments	✗	✓
Home Warranty Insurance	✓ (2%-6% of contract value)	✗ (Replaced by 5% of contract value in Retention fund)
Builder coaching and management	✗	✓
Retention fund (5% of contract value)	✗	✓
Certification and inspection (Certification on staged basis and independent building inspection at lock-up and final stages)	✗	✓
Builders ROI via retention fund	✗	✓
Mediation process involving all parties	✗	✓
Model covers high rise	✗	✓
Annual fund/premium pool*	$129 million*	$975 million

*As per page13 of iCare annual report 2018-2019. RSG Retention annual fund is based on 65,000 projects annually with an average value of $300,000 x 5% contract value deposit.

Step-by-Step

The Risk Management Model steps are summarised in *Figure 1*, with more detail provided in *Figure 2*.

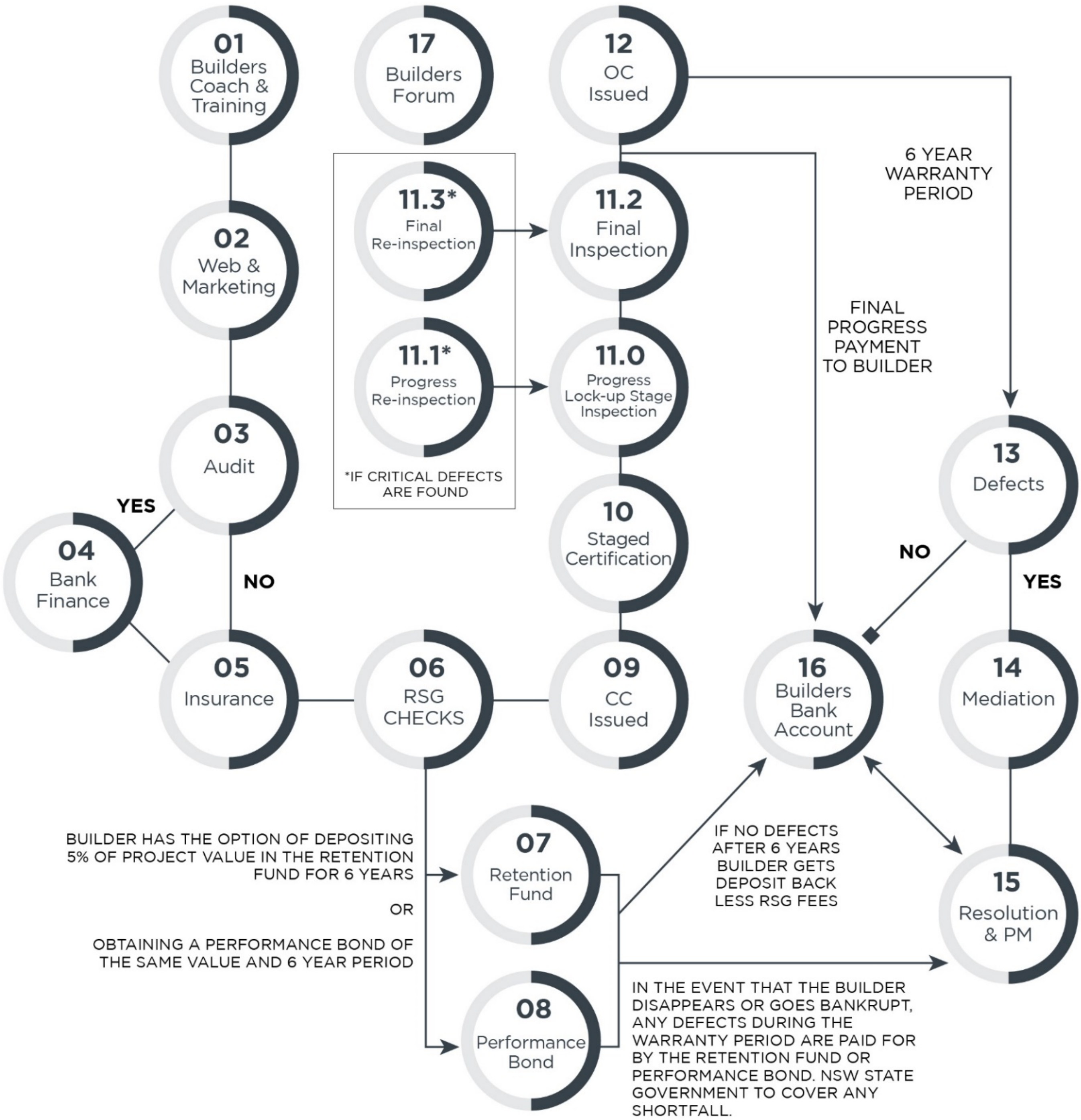

Figure 1: Summary and illustration of the proposed model

HOW IT WORKS

01
Builders Coach & Certification

The RSG Risk Management Program starts with RSG appointing a coach to help guide the builder throughout the entire process and organising key pre-project services. This includes ensuring builders are qualified for the jobs they are undertaking.

Industry groups offer ongoing training and support.

02
Branding, Web & Marketing

If the builder needs corporate or project-based branding, web and marketing, that work will commence early.

A professional look and the right marketing mix (print, digital, signage etc) will maximise exposure to the builder's target market, contribute to consumer confidence and sell the benefits of a specific project if it is speculative rather than commissioned.

03 / 04
Audit

The audit phase looks at the company structure and financial standing of the builder. If everything is in order, they proceed to step 5, if not, then a bank is involved to facilitate the required capital and cash flow requirements.

05
Insurance

An insurance broker checks and arranges all required insurance policies.

06
RSG Checks

All previous documents will be reviewed to ensure everything is in place for project commencement.

The builder transfers 5% of the contract value to the retention fund or obtains a performance bond. If everything else is in order, RSG issues the builder/certifier with a certificate initiating the start of the project.

07 / 08
Retention Fund & Performance Bond

A funds manager will invest the funds over a 6-10 years period (the period of liability) and an annual return (interest only) will be paid to the builder.
The amount contributed to the Retention Fund for each project (that is, 5% of the contract value) will be returned to the builder at the completion of the period of liability.

As an alternative, the builder can obtain a Performance Bond of 5% of the project value and lodge it with the Government.

09 / 10 / 11
CC & Staged Certifications with Quality Check

DA Construction Certificate (CC) will be issued by the Certifier after a Certificate of Compliance has been issued by RSG.

Staged certifications will be undertaken by the Certifier. Building inspections and certifications will be carried out at agreed points, and any additional or remedial work instituted and reinspected. A lockup building inspection will be undertaken by an independent building consultant appointed by the Certifier. Pre-final inspection will be undertaken by the independent building consultant before the Certifier issues the final occupational certificate to the owner/builder.

12 / 13 / 14
OC, Defects & Mediation

Once an OC is issued, the warranty period comes into effect. If any defects come to surface over the 6 year period, then mediation is facilitated by a solicitor. If not, the builder receives their retention money back (less RSG fees).

15 / 16
Resolution / Builders Bank Acc

As part of any agreement reached through mediation for defects, a project manager is appointed to ensure the repairs are carried out properly by the builder. If the builder disappears or goes bankrupt, then the repairs are funded by the retention money or performance bond. Any shortfall is funded by the NSW State Government.

17
Builders Forum

Ongoing CPD based events.

Figure 2: Building Risk Management Model: How it Works

Roadmap to Implementation

RSG recommends that this program be established by the office of the Minister for Better Regulation and Innovation, with RSG appointed as a service provider to help set overall strategy and implement the program, or the appointed service provider appointment can be made by tender. For the purposes of this paper, we use RSG as the service provider.

Once operational, the program will require a panel of preferred distributors for each role in the model. As part of strategy and implementation, RSG would work with the Minister's Office and the NSW Government's procurement agency to set the criteria and selection process for suppliers in line with those for pre-qualification and selection of panellists on other government panels.

The NSW Government has an opportunity to implement this model in NSW and then license or otherwise monetise its implementation across Australia and globally, reaping a reward on its Intellectual Property.

Timeline for implementation

A timeline for implementation of the program could be developed as part of a tendering process. The timeline will be affected by COVID-19 and the State's economic recovery including stimulation initiatives in the building sector.

While the program will take some time to implement, rapid commencement would help prevent a new range of building projects subject to the same issues government and industry are intending to solve in seeking improvements the current model.

Risk Specialist Group and Other Organisations

This section describes the organisations, and types of organisation, that would be involved in the establishment, implementation and ongoing governance and management of this model.

Risk Specialist Group

Risk Specialist Group is currently a business name registered by Insurance Specialist Group Pty Ltd. Should the model in this paper be adopted, Risk Specialist Group will be established as an independent Proprietary Limited Company, governed by a non-executive Board of Directors and managed by an Executive Management Team of seasoned industry professionals, with experience spanning all sectors in the model.

RSG recommends that the NSW conduct a tender to appoint the professional services and advisory organisation. RSG would tender for this position.

The selected professional services and advisory organisation would be the agency contracting with government to establish, implement and (if required), oversee the Building Risk Management Program.

A pricing model can be determined as part of an implementation roadmap, based on the conditions under which the model is adopted, and subject to further verification given industry sector pricing at the time the scheme is introduced. It would be validated as part of benchmarking tenders.

Retention Fund and Performance Bond Manager

As an alternative to a deposit to the Retention Fund, a builder can instead choose to buy a Performance Bond of an amount required for the deposit plus the operational fees.

Note that the Retention Fund and Performance Bond Manager is envisaged as being a NSW Government appointment, as the Government has financial independence from any agencies involved and the ability to underwrite any shortfall in the Retention Fund or Performance Bonds. RSG is currently in discussion with a major Australian wealth management and investment organisation with the balance sheet required to support the Model that it can introduce to government as appropriate.

Consultation During the Preparation of this Model

In developing the proposed model, RSG has consulted with a range of respected industry organisations, each of which would be qualified to be a panellist within its area of expertise. All organisations are committed to improving the current process in a cost-effective way that benefits government, builders and homeowners.

This consultation has allowed RSG to test that the model it is proposing is robust and achievable, and ensure the model includes solutions or recommendations to issues raised by each industry organisation as it has considered how the revised model would work.

Summary of Benefits

A radical overhaul of the HBC model in NSW is needed, and the model proposed by RSG aims to address the major issues of the current scheme, resulting in:

- Financial solvency for the scheme
- Upskilled builders with better business management and quality workmanship
- Happier homeowners with higher quality builds and easier forms of redress in the event of defects.