



## About the National Insurance Brokers Association

The National Insurance Brokers Association (NIBA) is the peak representative body for general insurance intermediaries in Australia.

NIBA represents over 450 member firms and 15,000 individual intermediaries including multi-national broker firms, broker networks, large Australian-owned insurance broking firms and small to medium-sized broker businesses.

Brokers place almost half of all general insurance premiums in Australia. In the 2019/20 insurance brokers placed over \$25 billion in premiums and directly contributed \$2.6 billion in gross value added (GVA) to the Australian economy.

Insurance brokers perform a number of valuable services for their clients including;

- Helping clients to understand, manage and minimise their risk exposure
- Identifying and arranging appropriate insurance or other risk-financing mechanisms in either domestic or international markets
- Acting as the clients advocate if an insured event occurs

In performing these duties, insurance brokers act as advocates for their client and have statutory, common law and professional obligations to act in the best interests of their client at all times.

Insurance brokers represent the interests of the purchasers of insurance, the policyholders, and not those of insurance companies. Consequently, comments made by NIBA and its members are made on behalf of its members and the public that purchases insurance, not on behalf of insurance companies.

## Introduction

The National Insurance Brokers Association welcomes the opportunity to provide these comments in response to the Independent Pricing and Regulatory Tribunal draft report into the Review of the Effectiveness and Efficiency of the NSW Home Building Compensation Fund (HBCF).

NIBA is concerned that the eighteen draft recommendations outlined in the report do little to address the systemic issues that have long plagued the HBCF. In particular, NIBA notes that the recommendations do not address the underlying risk profile of the fund or the uncertainty surrounding the long-term economic viability of icare HBCF.



At its simplest level, insurance is the principle that the claims of the few are spread across the policies of the many. Traditionally premiums are set at a level that allows the insurer to cover the costs of claims, the administration of the fund and a return on the capital invested in the business (although historically this has not the case for the HBCF). For most cases, premiums by large are a reflection of the total cost of claims. Issues arise when the costs of claims increases to levels deemed unsustainable by the insurer. When this occurs, the insurers' response is to either reduce the level of cover being provided, increase premiums, or withdraw from the market.

The most effective way to reduce premiums and encourage new entrants to the market is to decrease the number and costs of claims via effective risk management and mitigation. In its original submission, NIBA identified that illegal phoenix activity was increasing the overall risk profile of the pool. NIBA outlined a number of opportunities for icare to leverage data analytics tools and enhanced information collection during the builder eligibility process to identify builders that engage in this activity and exclude them from being eligible to obtain insurance. As icare is a monopoly provider, unethical builders will not be able to meet their obligations to hold home building insurance and will soon be forced out of the market.

As the risk profile and the cost of claims fall, the economics may begin to look more attractive to private insurers and encourage private insurers or alternative risk financiers to re-enter the market. However, due to the long-tail nature of the product, any changes to improve the risk profile of the fund will not influence premiums or the cost of claims for a number of years. Given that the high risk of the market was one of the main reasons cited for the exodus of private insurers, NIBA does not envisage private insurers re-entering the market until these issues are addressed.

Any review of the efficiency of the HBCF cannot ignore the continuing decrease in the performance of the scheme. Icare's financial statements paint a concerning picture for the future of the fund. Due to historically low premium rates for most of the funds' operation, the HBCF reported a \$636 million deficit for the 2018-19 financial year, an increase of \$200 million from the previous year.

HBCF continues to receive significant taxpayer funding relating to reimbursement of losses arising from historic underpricing of premiums. In July 2019 HBCF received \$12.2 million from the Crown in respect of realised losses in the 2017/18 financial year. According to their financial report, HBCF expects to receive funding from the NSW State Government post 1<sup>st</sup> July 2021 (when premiums for all property classes will reach break-even levels) until all losses incurred prior to the establishment of full cost recovery premium rates are recovered.



## **NIBA comments on draft recommendations**

*Recommendation 6: The use of brokers become voluntary under the scheme, to provide builders with more options on how they manage their HBCF obligations.*

It is NIBA's view that this draft recommendation demonstrates a lack of understanding on the part of the tribunal as to the important role of insurance brokers (distributors) within the home building insurance market.

Despite the lack of consensus among states as to which model of home building insurance is most effective, every state and territory (with the exception of Queensland, which operates a first resort scheme) has seen the value of retaining distributors in one form or another. This includes states such as Victoria, who operate under a similar model to NSW.

Distributors provide valuable services to both icare and their clients. If the current system was replaced, these responsibilities would have to be borne by another party. Currently, icare hbcf does not have the capacity to manage a portfolio of thousands of HBFC eligible contractors and would need a significant investment of government capital to do so. This would increase the administration costs of the scheme, raising premiums and negating any savings that had been achieved.

Despite being deeply ingrained in the HBCF process, distributors remain independent advocates for their clients. Brokers have a statutory and common law duty to act in the best interests of their client, insurer agents (such as those employed by icare) do not have these same obligations. If icare were to assume the functions of distributors, it would create a moral hazard where icare would not be able to independently act in the interest of builders due them also being the insurance provider.

### **Value of distributors to icare**

icare outsources a significant amount of the administration of the HBCF process to distributors. HBCF currently has 23 authorised broker distributors who distribute HBCF insurance and provide services on the terms set out in a Direct Distribution Deed. Distributors have a higher level of contractual liability to icare as opposed to normal broker functions, taking on broader responsibilities as well as associated liabilities. These responsibilities are outlined below.



- **Distribution services;** including preparing eligibility applications, ensuring builders meet all conditions of eligibility, advocate on behalf of builder clients, submitting and binding/issuing policies for all project applications received from builders.
- **Communicating with builders;** communicating icare HBCF requirements and decisions, assisting icare in obtaining information, minimising unnecessary disruption to projects due for commencement and identifying such concerns to icare or its appointed agents, Reviewing and analysing mandatory information collected and highlighting any weaknesses to the builder, monitoring, managing and reporting ongoing risk.
- **Facilitating payment of premiums;** collecting premiums on behalf of icare, including pursuing builders for payment dishonours.
- **Managing disputes;** explaining and facilitating access by a Builder to icare HBCF 's complaints and dispute resolution process, responding to requests by icare HBCF in relation to enquiries received from homeowners, developers, SIRA, Fair Trading, Councils and Private Certifiers or other bodies regarding the issue, cancellation, change etc.
- **Builder eligibility reviews;** notifying builders of upcoming reviews including scheduled periodic eligibility reviews, Completing a builder eligibility assessment, facilitating the submission of all required documentation, ensuring that all timeframes are adhered to and avoid the builder incurring a premium loading for non-compliance with review requirements, communicating agent requests for supplementary information to builders in support of an eligibility review.
- **Operational Management with Builders and icare hbcf;** responding to general enquiries from builders regarding HBCF insurance cover, responding to requests by icare hbcf for information in relation to an application and/or the issue of a Certificate of Insurance (COI) e.g. complaints, adverse information etc., monitoring a builder's utilisation of their open job limits in order to facilitate timely submission of any required BPC application so that the builder can obtain HBCF cover for future projects, responding to requests by icare hbcf for information in relation to the risk management of builders, notifying icare hbcf of information received likely to impact on the risk presented by a builder to icare hbcf.
- **Issuing of certificates of insurance;** processing applications for HBCF Insurance cover taking into consideration any special conditions imposed on the builder, Facilitating the submission of applications for projects and assessing submissions for completeness and accuracy ensuring where submissions are bound/issued by the distributor that COI are issued to builders within service standards having regard to the legislative requirements and timeframes in relation to the provision by builders and developers of the certificates (including to homeowners and off-the-plan purchasers) processing applications for cancellation of certificates and changed policy transactions, notifying icare hbcf of any

information received of alleged fraudulent policies/ certificates of Insurance having been provided to a third party within 48 hours.

## **Value of distributors to clients**

Distributors play a vital role in helping builders navigate the HBCF process. HBCF insurance is an incredibly specialised product, this is evidenced by the small number of brokers approved by icare as distributors. To be effective in their role, distributors require knowledge of the HBCF eligibility Manual, The Building Act 1989 (NSW), the Claims and Insurance Management System manual, the Builder Eligibility Assessment tool, HBCF underwriting guidelines, accounting and financials of the client, the development application and planning approvals process in addition to knowledge of the NSW home building compensation scheme. It is the view of NIBA that builders do not possess the expertise to navigate this process themselves

Distributors also provide a boot-leather saving to their clients. HBCF insurance is not a 'set-and-forget' product, distributors are engaging with their clients on an almost daily basis to ensure that they are meeting their requirements under the terms of the COE. Distributors are constantly aware of their clients' OPEN limits and work with them to ensure that they can focus on growing and running their business smoothly. The nature of HBCF insurance means that distributors are invested in the success of their clients.

In addition to the responsibilities already outlined in this submission, distributors provide a number of other services to their clients including;

- Managing the appeals process and escalation
- NSW Fair Trading related licensing issues and advice
- Legal issues where advice is sort around The Building Act and the associated Insurance perimeters
- Training of stakeholders including clients and accountants
- Changes to builder profile and pipeline addressed through mid-term reviews
- Recommendations on other Insurance products when reviewing both policy issuance and eligibilities
- Arranging and attending client meetings with their stakeholders.

NIBA members have reported that the issuing of COI in line with the certificate of eligibility agreement is one of the most important roles distributors undertake on behalf of icare. As previously remarked in the draft report the HBCF process is incredibly complicated, in part because of the volume and breadth of information distributors and their clients are required to provide. The application process requires the



collation of information from the building contract, tripartite agreements, proof of ownership and funding and in some cases development applications. Due to the potential liabilities incurred by the distributor if an error is made, this process is often completed by senior staff members who possess tertiary qualifications in economics or business.

### **Broker remuneration**

Despite the value distributors provide to clients and icare, they do not receive a commission for this service. This is because unlike traditional insurers, icare does not pay commissions on its products. Instead, distributors have adopted a fee-for-service model, which is negotiated between the broker and the client.

NIBA members have reported an increase in the movement of builders between distributors over the past few years, as clients seek better terms, service or lower premiums. As icare is the monopoly provider, distributors are unable to compete on price terms without reducing their fees. This competition has already resulted in a considerable reduction of fees across most broker distributors, below the 15% stated in the draft report. Icare is able to measure the movement of builders between distributors through letters of appointment, which would provide some insight into the competitiveness of the market.

NIBA is aware that icare is currently undertaking a tender process to establish a new HBCF distributor panel. It is NIBA's view that this process should be delayed until IPART have completed their report and government has issued a response so that distributors can be certain of the environment within which they will operate.

NIBA understands that icare intends to reduce the number of distributors from the current 23. NIBA opposes any such reduction. The ability to provide HBC insurance should be determined by the experience and capabilities of brokers, not arbitrary limits set by icare. In NIBA's view, these limits will do nothing but decrease competition and limit choice for contractors. NIBA is concerned that the tender requirements will create unnecessary barriers to entry for this type of activity.

NIBA understands that pricing models will be a key focus of the new tender process and that icare intends to publish distributors maximum fees. NIBA's very firm view is that the distributor is engaged by the builder client, is responsible and accountable to the client, and negotiates the remuneration arrangements with the client in a competitive market environment. It is not necessary or desirable for icare to be intervening in these arrangements.