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SENATE

STANDING COMMITTEE ON ECONOMICS

Reference: Australia's mandatory last resort home warranty insurance scheme

THURSDAY, 10 APRIL 2008

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SENATE STANDING COMMITTEE ON

ECONOMICS

Thursday, 10 April 2008

Members: Senator Hurley *(Chair)*, Senator Eggleston *(Deputy Chair)*, Senators Mark Bishop, Bushby, Joyce, McEwen, Murray and Webber

Participating members: Senators Abetz, Adams, Allison, Barnett, Bartlett, Bernardi, Birmingham, Boswell, Boyce, Brandis, Bob Brown, Carol Brown, George Campbell, Chapman, Colbeck, Coonan, Cormann, Crossin, Ellison, Fielding, Fierravanti-Wells, Fifield, Fisher, Forshaw, Heffernan, Hogg, Humphries, Hutchins, Johnston, Kemp, Kirk, Lightfoot, Lundy, Ian Macdonald, Sandy Macdonald, McGauran, McLucas, Marshall, Mason, Milne, Minchin, Moore, Murray, Nash, Nettle, O'Brien, Parry, Patterson, Payne, Polley, Robert Ray, Ronaldson, Scullion, Siewert, Stephens, Sterle, Stott Despoja, Troeth, Trood, Watson and Wortley

Senators in attendance: Senators Eggleston, Hurley, Marshall, Milne and Murray

Terms of reference for the inquiry:

To inquire into and report on:

Australia's mandatory Last Resort Home Warranty Insurance scheme, including:

a. the appropriateness and effectiveness of the current mandatory privatised Last Resort Builders Warranty Insurance scheme in providing appropriate consumer protection and industry management;

b. the reasons for and consequences of the ministerial decisions relating to the removal of consumer protection provisions in respect of Corporations Regulation 7.1.12(2);

c. the ramifications for the future supply of this insurance product following the draft recommendations from the Productivity Commission report released in December 2007;

d. any potential reforms and their costs and benefits which may lead to appropriate consumer and builder protection and improved housing affordability; and

e. any related matters.

WITNESSES

Committee met at 2.38 pm

DWYER, Mr Phillip John, National President, Builders Collective of Australia Inc.

JOSEPH, Mr Russell, Member, Builders Collective of Australia Inc.

CHAIR (Senator Hurley)—I welcome committee members and those attending. The committee has authorised the recording, broadcasting and rebroadcasting of these proceedings in accordance with the rules in the order of the Senate of 23 August 1990 concerning the broadcasting of committee proceedings. I put on record that committee witnesses are protected by parliamentary privilege with respect to their submissions and evidence. Any act which may disadvantage a witness on account of their evidence is a breach of privilege. While the committee prefer to hear evidence in public, we may agree to take evidence confidentially. The committee may still publish or present confidential evidence to the Senate at a later date. We would consult the witnesses concerned before doing this. The Senate can also order publication of confidential evidence. Do you have any comments to make on the capacity in which you appear?

Mr Joseph—I am a member of the Builders Collective and I also work with policy.

CHAIR—If you wish, you can make a short opening statement before we go to questions. Would you like to make a statement, Mr Dwyer?

Mr Dwyer—Certainly. We may share the statement, if that is alright.

CHAIR—Certainly.

Mr Dwyer—Thank you. Initially, I will give you a small amount of background. I have been 30 years in the building industry, and I was a member of HIA from 1988 until three years ago. I have apprenticed two sons into the industry. Our buildings have been used as the perfect criteria for introduction of planning codes such as VicCode 2. I am showing you the front of the magazine *Housing*, an HIA publication. We have been major industry award winners, both with HIA and MBA.

When HIH collapsed, I tried to unify the industry and get the two associations to present a united front. I found that was not possible. The Builders Collective came out of that. The collective was formed and we proceeded to try and gain reform for what we termed the 'crisis' of the industry through the HIH collapse. Also at that time we met with APRA, ASIC and various people. I have here a prospectus for a proposed mutual to provide consumer protection. I have the Western Australian one, the New South Wales one and the Victorian one. We were encouraged to proceed with that at that time. We spend over $200,000 on setting this proposed mutual that would be owned by builders throughout Australia to provide consumer protection to the building industry on a first-resort basis. That proceeded until Royal & Sun Alliance put a lot of pressure on the Western Australian government and the support for it was withdrawn, so all that money was wasted.

After that, we went to Queensland and researched the Queensland model of insurance. We spend four days up there altogether. We were the guests of the Queensland Building Services

Authority. We were most impressed with their scheme. We looked at overseas models and a lot of various areas. The Queensland model—and this is from back in 2003, when were up there researching it—is a holistic regime that covers industry management and consumer protection, everything on a first-resort basis. It is very similar to what we used to have in Victoria and New South Wales under the Housing Guarantee Fund. We have promoted that model ever since for appropriate consumer protection for Australian consumers of the building industry, and also for responsible industry management for the builders of the industry. Those were the sorts of things we did originally. I will hand over to Russell and he will go through the first part of our quick presentation.

Mr Joseph—I have been a registered domestic builder for 20 years and a commercial builder for over 20 years. I have been a member of the HIA for nearly that period of time; however, I have resigned from the HIA as of today in order to present evidence to this inquiry. I have been the chairman of the peninsula branch of the HIA, representing 800-odd HIA members in Melbourne, for the last four or five years, and it was not possible for me to speak on behalf of the Builders Collective and to this issue while remaining in that position. I have given undertakings in the past to the HIA because they were not happy with my position on this matter. So I was in the position where I needed to resign from all of those roles today.

I am very happy to be here and I thank you for this inquiry. We propose to speak for about 20 minutes. We will alternate on a few issues. We will run through the four main points which are in the motion so that the questions do not double up. We just want to cover the main points, if that would be acceptable, Chair.

CHAIR—Yes. Go ahead, Mr Joseph.

Mr Joseph—Thank you. I want to talk to the first point, which was the appropriateness and effectiveness of the scheme. We have always held that it is not appropriate and not effective, and the evidence—or lack of evidence—that has been provided in the public domain over the last few years has proven exactly that position. The Australian Consumers Association has been the major consumer voice from a disparate group of consumers who are not really united. It has described this insurance as 'junk insurance' and has said that it 'makes a mockery of consumer protection' and that it is 'cover you cannot rely on'. These are statements that are on the record from the Australian Consumers Association over the last few years. The problem that we have with this is that as builders we are selling a product which is absolutely worthless to our clients, and it is costing a lot of money.

There has been no evidence submitted to date that can be independently verified by anybody that there have been any substantial number of claims made on this brand of insurance. We are talking specifically here about last-resort, mandatory, privatised builders warranty insurance, which came into effect in June 2002. We have never, ever seen the statistics on exactly how many claims have been settled on these policies from that date to now. In fact, if we use the Tasmanian example, the Tasmanian government decided last week to finally dump this product completely. That was on the basis of the fact that they could not get a straight answer from the insurance industry on those simple fundamentals. The claims-to-premium ratio has never quite been there. We know for a fact that in Tasmania—and it was published by the minister at the time—there was one claim, or possibly two claims, that had been settled in Tasmania in that time. We were instrumental in that one single claim down there by putting pressure on the

insurance company involved. We knew who it was and, once that pressure was there and there was a threat of a national media exposure, all of a sudden the claim was settled.

The information about claims on this product—again, I am talking about the appropriateness and effectiveness of it—was also corroborated by a couple of senior claims managers from the large insurance companies who have since left and whom we have spoken to. These people have said that there have been very few claims nationally. The information that they had has been corroborated now, two or three years later, particularly by the Tasmanian government.

The profits that this product generates for the insurance industry in particular and even for the trade associations—the HIA and the MBA—are enormous. We have seen this as HIA members; we were complaining about this for a long time and not really getting anywhere. I stayed with that to try and implement some change from within, but it was just not happening. The profits of this have been exposed in some recent submissions that you may have seen, related to an owner-builder policy in Tasmania. There were incredible 60 or 70 per cent commissions on these policies which go back to various associations and agents.

The other issue of appropriateness relates to the builder guarantees and indemnities. In August 2001 most of us were registered through HIA in HIA Insurance Services. They were the major provider that was left at the time. We were all asked to fill in deeds of indemnity, which we had to do; otherwise we could not get insurance, and without insurance we cannot work. So we filled out deeds of indemnity, and these deeds of indemnity have started to come home to roost for a few builders, who have been pursued by the insurers to repay claims. Some of these builders do not even know what the claim was about; the insurer just says, 'No, we paid a claim; you have to pay us,' and that is it. The builders are being bankrupted and sent to the wall.

On the bank guarantees, we have various pieces of evidence about the value of these bank guarantees and how they operate and work. These are guarantees that individuals such as us in business have to put up to insurance companies in order to allow us to work. They are designed so that there if there is ever a claim and the insurer pays out then they have a bank guarantee that they can pull the money straight back out. So we wonder about the appropriateness of it; if we are insuring ourselves anyway, via our own deeds of indemnity and bank guarantees, why do we have insurance in the first place? It does make a bit of a mockery of it.

I will leave that there. Again, perhaps you could save your questions for when we have finished our presentation; then we will not double up. Phil will talk about corporations regulation 7.1.12.

Mr Dwyer—It has taken a long time to work out how this came into place. It would appear that the change to the corporations regulations was put into effect in 2001. I will be handing to the committee a bundle of documents that will provide every bit of documentary evidence to support what I have to say now. Basically, we had the HIH collapse in March 2001 and the 9/11 disaster, and this started coming into effect at that time. The infamous 10-point plan was conceived and devised by Royal & Sun Alliance and HIA. HIA, you must remember, was the only broker for this insurance. The only way you could obtain this insurance in Australia was by being a member of HIA, and you were given an insurance certificate from Royal & Sun Alliance, now Vero. The 10-point plan—of which I have a copy for you here—put in motion a change to the corporations regulation to allow this to come into play. That was on 15 October

2001. On 4 October Joe Hockey and John Watkins announced the Percy Allan inquiry to suppress the dissent or crisis that was going on over that period of time, to say, 'We're dealing with the matter.' The Percy Allan inquiry was commissioned by the Ministerial Council on Consumer Affairs.

Senator Helen Coonan was responsible for this area, as was Minister Hockey. Both of them went through this process but, at that time, Helen Coonan was doing a building project on her own home in Woollahra—the $650,000 or so renovation. She had a falling out with her builder—the builder is named in the documents I have for the committee—which was reported in the *Sydney Morning Herald* in December 2001. The Labor Party was going to take them to task in the new year because parliament rose at that time. The builder was instructed by the Housing Industry Association to go to ground, and he will never be pursued for the $200,000 payout that was made to Senator Coonan. This is a very serious issue, as far as we are concerned. A full $200,000 was paid out. With this warranty insurance, on a building contract, the insurance pays only 20 per cent of the contract value. No-one had ever got a $200,000 payout—but Senator Coonan got one. We are concerned about that.

This whole regime is underpinned by the corporations regulation that was changed and came into effect on 19 March 2002. Again, I have here that documentation and a letter from ASIC. The letter from ASIC came about in September last year only after we put a lot of pressure on ASIC, demanding that they do something about this situation because builders were going to the wall and consumers were being trashed to the extent that they were losing life savings. Together with the FinCorp Action Group and the Westpoint Investors Group, we put a lot of pressure on ASIC to try to get some answers. We got our answers, with the change to the corporations regulation on 30 September last year.

That is how we have been able to put all this together. All this documentary evidence is compelling. It is very hard to dispute any of it. I can provide the inquiry with the name of the builder concerned and the instructions he got from HIA. He has never been pursued through recovery, yet other builders have had bank guarantees accessed and so on. The insurance industry, particularly Vero, say, 'We have hardly any bank guarantees,' but I can assure you that I can provide the data that shows that Reward Insurance, the other minor player in this whole equation, had eight per cent of the market. They currently hold 393 bank guarantees from builders, representing $39.8 million. When you take the bank guarantees that HIH had, Vero Insurance had—or Royal & Sun Alliance, as it was known then—and Reward Insurance had, which only held eight per cent and had 393 of them, it becomes a very serious matter. I can give you the name of every builder who has provided those bank guarantees. All this money comes out of the building industry and adds additional costs to everything.

Moving forward, the infamous 10-point plan also had a segment in it about warranty insurance, because we still had the project builders, estate builders, complaining about not being able to access warranty insurance. Therefore, the state governments of New South Wales and Victoria elected to underwrite the big builders for any event above $10 million. Consequently, if there is a failure of a large builder, the state government or the taxpayer, not the insurance industry, will be picking up the tab. It is all very well for state governments to say, 'We don't want any part of warranty insurance and we will abrogate our responsibilities to the insurers.' They are still underwriting any major event. Then we had the other, larger, builders that were building high-rise and so on. They got excluded from the need for warranty, so those consumers

became different from the consumers that live on the ground. Why I do not know. They did not need warranty. That is what makes a farce of this whole circumstance.

While all this was taking place, Senator Coonan was being paid her $200,000. We do not know why she got that. Perhaps the insurance industry decided that that was a good way to demonstrate to her that it was all working very well and to allow the corporations regulation to come into effect. Basically, what the corporations regulation has done is to turn it into what they call a wholesale product. There is no regulatory control by any authority over this builders warranty insurance. That is why builders can have demands placed on them. They can wait 12 months to get insurance. In my case I was without insurance for two years. I never had a claim against me; I never had any problems at all. There were many others like that. There were builders going to the wall everywhere. While all this was taking place, we had the Percy Allan inquiry still proceeding, but it was only a smokescreen. It was never going to be considered because, although the report of the Percy Allan inquiry was released in June 2002, the 10-point plan was put into effect and implemented on 1 July 2002.

What we are saying, I guess, is that the federal government are what underpins this whole regime, not the states. Yet the federal government have brushed it aside in every instance that we have approached anyone from the federal government, saying, 'It is a state issue; we have nothing to do with it.' They have everything to do with it because it is underpinned by the federal government and the change to the corporations regulation. We are vitally concerned about that aspect of this failed builders warranty insurance that is serving no-one that it is meant to serve. The management of our industry is somewhat of a disgrace. Unfortunately, there is a certain element out there that does impact on consumers. So we obviously need a consumer protection regime, but not one like this.

Others will have us believe that only one per cent of building permits have a problem. That is incorrect. A lot of our information will be based on Victoria, where we can access the accurate figures. The Building Commission in Victoria has told the Productivity Commission that six per cent of permits issued require external assistance to resolve disputes and so on. Since 2002 that is some 30-odd thousand consumers that have required external assistance from lawyers, tribunals and so on.

The tribunal in Victoria has got to the stage where it is now more expensive than the Supreme Court. With barristers, QCs, lawyers and so on, people go in there and they do not come out the other end. That is why we do not hear from the consumers other than the ones that have gone through the system after five, six or seven years, have finally come out and have got nothing else to lose by opening up and telling people.

There would not be a week that goes by that I do not share the despair and hopelessness of these people throughout the nation. It can be in any state except Queensland. I never hear from anyone in Queensland, but in every other state there are people that are suffering under this regime, when they believe that they have consumer protection in the form of this product that is called warranty insurance. The very name itself implies that it is going to protect them.

That also compromises our tendering system and so on, because people believe they are protected, so they will take the cheapest quote rather than do their homework on a builder. They think, 'I'm protected by warranty insurance.' They are not. You can go on, Russell.

Mr Joseph—As a result of this change of the regulations, the ramifications are clearly that ASIC, APRA and the ACCC are not able to effectively manage the consumer protection of this. Builders cannot access any consumer protection provisions. Everyone is sort of shut out of it. As a result, it does affect the future supply, which is the next point we were going to talk about.

I will just give you a quick update on Tasmania. They moved a few weeks ago to slowly disband this product over the next 18 months and put in another regime of adjudication et cetera. But, as of last week, they have decided to just dump it straight out—to lose it completely. There were many comments made by the then Attorney-General, but fundamentally it had not worked. It provided no value for Tasmanian consumers. The comments against it at the time in the government press release were quite strident.

Initially when it was introduced into Tasmania the then Attorney-General, Judy Jackson, was on the record in *Hansard*—and I think Phil has a copy there—as saying that the government was held to ransom by the insurers to implement it. She repeated that term 'held to ransom' twice. We met with the government officials at the time, who described exactly the meeting when they were held to ransom and they were given an ultimatum that they either implement this insurance or else, basically. This is the history that is there. Again I say there is a *Hansard* to back it up.

Now that it has been dumped, I think it is very significant to demonstrate that, for the future supply of this product, the community confidence in it has clearly been destroyed. At the moment it is still mandatory. I think it is a very important point to understand that all around Australia, except in Queensland, this product is still mandatory. You must buy it in order to get a building permit and to do a legal building project.

One government in Australia has been brave enough to say: 'No, it does not work. It is basically a fraud. It is ineffective. It has no value to consumers.' The other state governments are still forcing people to buy it, and community confidence in this product is going to be very severely affected as a result. We met with senior officials from the Office of Fair Trading recently and asked them the same question about how the community reacts to this in terms of government—'They're forcing me to buy a product which is worthless; I cannot make a claim; I've got to virtually bankrupt myself just to go through the litigation process'—and is that going to be a problem for government down the track? It was a very, very difficult question for them to answer, understandably.

That is one concern that we have, because if you have got a large number of disaffected consumers in the states who have been forced to buy a product which is now known to be ineffective and of no value then that raises very, very serious questions about the future supply of this product around Australia. I think that is something that needs to be addressed. That is it on that point. Our next point is the potential reforms and the cost benefits of those reforms. Phil will speak briefly on those.

Mr Dwyer—I have been very involved with Tasmania. Tasmania at this stage—

CHAIR—Sorry; we are just a little mindful of the time, so if you could—

Mr Dwyer—Yes, I know; I will not be long. Tasmania at this stage have decided not to have any insurance at all because that will provide better consumer protection for consumers.

Basically, what they are doing is having a very simple contract with good information for both the consumer and the builder. Variations, which is one of the biggest areas of dispute in the building industry, must be signed off on before they are carried out. There will be an adjudicator from consumer affairs to determine defects on behalf of either the builder or the consumer. They will move forward along those lines with a simple contract which will be mandatory. They are going to go down that path without any insurance at all. Their argument is simply: even if a builder dies or becomes insolvent, it takes years to access that insurance—if they can in fact access it. The experience seems to be that they cannot anyway, so they are far better off doing nothing.

They would prefer to have the Queensland model. They would even like Queensland to provide that insurance for them. There are reasons for that and I think there are three people who are sitting behind me who are more qualified to speak about that. The Queensland system, which we have been advocating all the way through, is what we would like to see for industry management. Unfortunately, we have got trade associations that take government legislation and convince governments to adopt legislation that gives them a money stream. In Queensland they also have trade associations, but they do not have any role to play in the consumer protection regime or the industry management. Again, the people behind me will explain that more fully.

In Queensland the roles of the trade associations are also the complete reverse of what they are in the other states. In Queensland we have a Master Builders association that has in excess of 10,000 members. They support the QBSA regime very strongly as an appropriate regime for consumer protection and industry management, whereas HIA only have under 3,000 members and they have been endeavouring to undermine that scheme constantly over past years. Even as late as earlier this week in Tasmania, a member of parliament was told that the Queensland scheme was at risk of financial failure. Again, there are three people behind me here who will refute that, because their balance sheet increased by $21 million in 2007.

You can provide first-resort insurance effectively and without excessive cost—contrary to what others would have us believe. Again, it is far better for those who administer the Queensland scheme to express themselves rather than for me do it, except to say that we have been a constant supporter of it from day one and we remain the same way today. As a secondary situation, we would be far better off just having what Tasmania have done and relying on the statutory warranties under the Building Act, which cannot be got at because warranty insurance is in the way. But, if we were able to just get rid of warranty insurance and just have the statutory building acts that consumer affairs can act on, we would afford far better consumer protection to our consumers in the building industry right now.

Mr Joseph—Should we leave it there?

Mr Dwyer—I think so, because we are going to hear about the Queensland model very soon. I think we would like to hear from the committee with regard to questions and so on and fill in the gaps that we have missed, if that is okay.

CHAIR—Yes, thank you, gentlemen; that is very helpful. Are there any questions?

Senator MILNE—Mr Joseph, you said in the beginning that you had resigned from the HIA in order to be able to give evidence here today.

Mr Joseph—Yes.

Senator MILNE—You said that that was because you had given undertakings in the past or whatever. Can you explain to me why it would have been a problem for you to come here today and say what you have said? What were those undertakings? Can you explain to me why you have had to resign? It seems drastic to have to do that.

CHAIR—Gentlemen, just before you answer can I remind you once again, as I said in the opening remarks, that you can at any time request confidentiality in any part of your evidence.

Mr Joseph—I understand and I appreciate that. I do not think I will need to. About a year ago I wrote a letter to the *Financial Review* containing a sentence saying that I was sick and tired of the HIA saying that there was nothing wrong with warranty insurance—and I was, and I still am. As a result of that and as a result of my associations with Phil Dwyer and other community activists I was held to account at a disciplinary meeting of the HIA for bringing the HIA into disrepute and all this sort of thing. Lawyers had flown down from Canberra, and the tone of the meeting, to try to determine whether or not I should remain a member of the HIA, was fairly legalistic. I was asked, if I wanted to stay, to give undertakings. I have a copy of those here. One of them was to refrain from making any public statements which may be prejudicial to or likely to bring into disrepute the Housing Industry Association Ltd. As this is a Senate inquiry into last-resort builders warranty insurance, it was unlikely that I was going to be able to comply with that undertaking while still remaining a member. I felt that rather than compromise myself and have unending litigation hanging over my head for the next 15 years I would rather just cut the ties and move on.

Senator MILNE—I must say I am a bit shocked at what sounds to be a fairly heavy-handed response to a letter to the editor complaining about a product and not so much about the association itself. In your view, how does the HIA benefit from this disproportionately such that it would be worth taking that trouble to make sure people do not criticise it?

Mr Joseph—To be honest, I do not know. I know that they have made a lot of money out of builders warranty insurance. That is a fact. I do not know how much. We complained within the HIA very loudly five or six years ago. We felt that the issue of the money was very important but it was being pushed under the carpet. We had serious concerns. We were having a lot of trouble accessing insurance. We were in crisis. We felt that our complaints were largely falling on deaf ears. I believed that right would rule and kept persevering. I think I have realised over the last couple of years that I was really just wasting my time. People really did not want to listen, they did not want to know. I have publicly raised the issue of builders warranty insurance in the HIA; everyone knows my position. I have made presentations to the AGM in Victoria on it. I have been professional about it. But everyone just keeps telling me: 'Don't worry about it. It is not an issue, it is not a problem.' In our experience, from the consumer detriment that this product is causing as well as the builder detriment, I know that it is a problem and it will continue to be a problem. That was probably the main point that I made at the HIA AGM a couple of years ago: we need to be the leaders in fixing this problem, because the consumer detriment is going to rear up and bite us. I think most of the senators here have some idea of the sort of consumer detriment that has been caused by this, and the longer that it goes on the worse it is going to get. To be honest I just got tired of waving a flag and no-one taking any notice. In order to be here, I think these were potential legal issues that I really needed to address.

Senator MILNE—I have another question, which relates to this regulation that was introduced to change it to a wholesale product. You did not say what the rationale was for making it a wholesale product, yet clearly that removed it from any oversight. What was the rationale that was put forward to make it a wholesale product?

Mr Dwyer—None. There is no benefit. There is no rationale at all for it other than to give the opportunity to the insurer to demand bank guarantees, deeds of indemnity and even power of attorney—it even goes to that extent. Even very recently, in the week preceding Easter, three builders contacted me. One in New South Wales had a $100,000 bank guarantee accessed and the $100,000 taken. The first he knew of it was when the bank advised him how he was going to manage the repayment of it. Another one up on the North Coast of New South Wales had a similar type of thing—if he did not pay $85,000 to Vero Insurance they were going to access his bank guarantee. A third one in Gippsland was told that, if he did not carry out or undertake to do certain works of seven years ago, they would access the assets that he had signed over to them.

The rationale behind it can only be for the insurer to be able to take the action that they did and approach it in the way they did and make builders the underwriters, because builders cannot be underwriters of insurance; they must have APRA approval to be a reinsurer of insurance. I will be giving you a judgement from Western Australia of six months ago, when a builder was attacked by Vero. The summary judgement was overturned and in the opinion of Judge Eaton the obtaining of deeds of indemnity and guarantees by Vero insurance under reinsurance was illegal and unenforceable and the matter was a triable issue. The judgement is only 14 pages. It is quite simple and straightforward. It is my belief that it was Royal & Sun Alliance that wanted this corporations regulation change because it meant that they could have builders underwrite, they could obtain bank guarantees, they could obtain deeds of indemnity et cetera. So, while we pay very large premiums for this insurance, we are underwriting it as well. That has been our problem right from day one. We could never understand the probity issues surrounding this because we never knew about that corporations regulation until 30 September last year, and that is what put the jigsaw together.

Senator MILNE—So you are effectively saying that it is double dipping from the insurance companies.

Mr Dwyer—Absolutely.

Senator MILNE—They are offering an insurance product for which the builder is paying a premium and then forcing these bank guarantees and deeds of indemnity that you have talked about to recover the money from the builders. There is another thing I do not understand from what you are saying. If it is last resort and it is only paid if the builder disappears, dies or becomes insolvent, how can they access these other deeds and take money from your account if you have not disappeared, died or become insolvent?

Mr Dwyer—Before July 2002 it was first resort. All these claims, accessing of bank guarantees and so on relate to claims prior to last resort.

Mr Joseph—But the builder has still provided a deed of indemnity, which we had to do in 2001 anyway to keep building.

Mr Dwyer—So all it has done is to give the insurer, through the change of that regulation, open slather to access those assets. I mentioned bank guarantees just with Reward Insurance. It is an enormous amount of money—an enormous impost on the building industry. There are the costs of all of this: the costs of maintaining it, the accountancy fees and so on. While the insurers say, 'Well, you know, we're doing a great job and so on and so forth financially managing builders,' they are really not at all. It makes no difference, because they are not talking about builders who have got ability or anything like that; they are only looking at a balance sheet et cetera and having this sway over builders.

Russell was talking about signing guarantees that he is not going to do anything or say anything against HIA. The same sway is held by insurers and the trade associations when people kick up. There are any number of people who have been kicked out of trade associations and so on and so forth by the threat of losing their eligibility, because, getting it right into perspective, a builder cannot work in Victoria, New South Wales or Tasmania without insurance eligibility. For every job over $12,000 they must have this insurance eligibility to get registered in the first instance. That is what triggers the registration. That is the primary thing that starts the whole process—the insurance eligibility first and foremost. You cannot pay for your registration or obtain the registration without that letter of eligibility. That letter of eligibility determines your annual turnover, irrespective of whatever you might have done in the past, and also states what size of project you can build, irrespective of what you have done in the past. You get that letter of eligibility; you suddenly get your registration. Then, as a separate issue, on a project-by-project basis you can obtain this insurance certificate that you have to have before you can get a building permit.

Many builders will not accept this and will not condone that sort of conduct, so they work illegally for owner-builders. To talk about some current figures, let us talk about 2005, when Consumer Affairs Victoria put in a submission to the VCEC inquiry in Victoria—which had a predetermined outcome, but we will not bother going there. CAV said that more than half of the builders in Victoria were working outside compliance. Those are their figures. Tasmania says more than half are working outside compliance. In New South Wales, if we take accurate figures from December 2007, of the 34,000 registered builders—I will not worry about the hundreds—in New South Wales only 14,000 have insurance eligibility. This is a major issue because that instantly creates an anticompetitive environment, because the people who are working without the insurance and without the compliance costs and issues can be a lot more competitive than the builders who decide to be within compliance. Simply, we have these classes of building going on. All those ones working outside compliance afford no consumer protection at all, because in most instances there is no registered builder so there is no-one to have a go at.

Mr Joseph—I think you answered the question.

Mr Dwyer—Right.

Senator MILNE—Do we know how many builders are not building at all and just give up the trade rather than work illegally or pay this money? Have we got any idea?

Mr Dwyer—I have not got the exact figures, but it is a substantial number. Also, a lot of them maintain or try to maintain a registration but are not working in the industry until such time as things change. So it is very hard to find figures.

Mr Joseph—I will jump back to your question, Senator Milne, on the double-dipping issue with these guarantees. If you think of compulsory motor vehicle insurance, it would be like the insurance companies saying to every car driver, 'You need to give us a bank guarantee just in case you have an accident, so that if we have to pay a claim then we can just grab it.' It is exactly the same. There would be an outcry if that were ever suggested, but that is exactly what we have got.

Senator MARSHALL—I want to cover two issues just briefly. One is the consumer cost to the industry that you were just talking about, which inevitably gets passed on to the consumer. I have been reading with some interest some of the submissions made to the Productivity Commission and also some of the transcripts about these matters. In the submission from Kim Booth, MP, from the Tasmanian parliament, there was an attached policy schedule—I want to know if this is a common cost—where the value of the building work insured under the scheme was $48,000, and the total premium and charges were $1,651.60, which seems like an extraordinarily high percentage for insurance that does not seem to actually give warranty to the building work. It simply gives warranty against the builder becoming insolvent. The submission indicates that it includes agents' fees of $918.80. On my brief calculation, about 60 per cent of the total fee is agents' fees. All of that is being paid for by the builder to work legally and it is simply being passed on to the consumer, no doubt, where it is not actually offering the consumer any protection, as you have said. Is that common, or is this one out of the box?

Mr Dwyer—That is common. I have a copy of a *Hansard* here—again it happens to be from Tasmania—where a Liberal member of parliament suffered the same thing, and it refers to $900 commission as well. That is to the trade association; the one you are referring to is to the Master Builders Association.

Mr Joseph—We have got rate cards from the major insurers—which we can provide—which show the retail price for the product that builders have to pay. There are a lot of figures touted by the insurance industry to show how cheap it is. It is just untrue. The rate cards that we have are the actual rate cards given to category 3 builders, which are 97 per cent of the building industry, and that is a fairly typical figure for an owner-builder permit or for a registered builder permit.

Senator MARSHALL—I do not want to put words into your mouth, but to me the tone of your submission is that this insurance exists mainly for the benefit of those receiving the commissions as opposed to providing any consumer protection. You did indicate in your submission that you have been continually threatened and various methods have been used by different organisations to suppress your views. I wonder whether you could briefly explain the way that has happened.

Mr Dwyer—That is most certainly the case. That has been fairly constant over a number of years, since about 2003. The first incidence of this was when the executive director of HIA in Melbourne, a chap by the name of John Gaffney, basically defamed me to a number of people at a Building Advisory Council meeting—which was pretty ordinary. He had to apologise in writing for that. That was followed very soon by HIA deciding that I was not an appropriate member, so they cancelled my membership. They were the only organisation able to provide warranty insurance at that time, so that denied me insurance; so I had no income for a couple of years because of that circumstance.

Going on a little further, over 2004, Vero Insurance, through Minter Ellison, bombarded me with extremely legal letters and so on, culminating in demands to withdraw submissions from government inquiries and so on. It was not until the now opposition leader in Victoria dealt with that in parliament that that activity ceased. That was followed almost immediately by Dr Silberberg of HIA taking me through the Human Rights Commission process for racial vilification—not for words I had spoken but for words that somebody had put on an internet blog or our discussion forum on our website. As a result, I was in the federal court in the ACT. I won that case, with costs.

I am still subject to a defamation case brought on by Christopher Lamont, who was a senior executive of HIA, over a private letter I wrote to the then Prime Minister. He was chief of staff to former Minister Bailey, whom I was making representations to on behalf of the small business builders of the nation. So it has not stopped over all of these years, and why I ever put my head above the parapet I will never know. Anyway, it is still there for the moment. So it has been constant. But I am not the only one who has suffered. Many other builders have spoken out and so on. They have been kicked out of HIA just to quieten them. It has been very ordinary, all the way through. While we have two trade associations in the one industry, both of them are very much opposed in policy and so on. Even if you just take their simple contracts, the two contracts are entirely different. You can have a dozen interpretations of them. From that point of view, that is why Tasmania is changing.

Senator MILNE—Can I clarify something I did not understand in your answer. Are you saying that, effectively, the Housing Industry Association has the power to determine who can and who cannot work in the building industry by virtue of their control over access to this insurance product?

Mr Dwyer—That is the way it was. The ACCC, through a complaint from me in 2004, did change that in August 2004 and the market was opened up. But, prior to that, those were the circumstances. The only place to get access to insurance was through being a member of HIA through HIA Insurance Services to Vero Insurance or Royal & SunAlliance.

Senator MILNE—Since 2004, are they still able to exercise power that effectively prevents people from being able to access this insurance or, since the market was opened up has their power, to some extent, been undermined?

Mr Dwyer—Their power has been undermined, because there are other providers. But the product still remains exactly the same. It still does not provide any benefit and the cost is still the same.

Mr Joseph—One of the documents that Phil will present is a graph which graphs the income of the HIA over this period. When privatised last-resort insurance came into effect, the income graph was at quite a steep angle. It flattened out when competition started to come, which was after the 2004 date. It may be coincidence, but we think not.

CHAIR—How many insurers are now in the market in competition with Vero?

Mr Dwyer—Currently, there are four others in the market.

Senator MILNE—Do we know how many claims they have paid out? They say they have paid out a lot. You say they have paid out hardly any.

Mr Dwyer—That is where you get the inconsistency. Yes, they have paid out on first-resort claims but not on last-resort claims. The only data that has been put out was put out by the Office of Fair Trading in June last year. We have had that assessed by the Institute of Actuaries, and Daniel Smith, who did that assessment, said that he cannot decipher any accurate information from it, suffice to say that the insurance industry is doing very well, thank you very much. He wrote a paper in 2005 on builders warranty insurance, and I think it would be appropriate if I provided that to the inquiry.

Senator MILNE—If you could provide that information it would be very useful.

Mr Dwyer—I can most certainly do that.

Senator EGGLESTON—I would like to ask a quick question about Tasmania. You said that they had no insurance scheme but were going to a contract law based arrangement. What exactly are we talking about there? Is it a simple matter of liability for breach of contract or for negligence et cetera?

Mr Dwyer—The building act provides statutory warranties for up to 10 years. Basically, what they want to do is to have a mandatory contract that is very simple and provides very basic but informative information to both the builder and the consumer to manage that contract and to manage variations to the contract. That is where the biggest number of disputes are.

Senator EGGLESTON—You mentioned that.

Mr Dwyer—If something goes wrong, Consumer Affairs can act under the building act and those statutory warranties, which will afford consumers a lot better protection than they have under the last-resort scheme.

Senator EGGLESTON—How would you compare that to the Queensland scheme? You are going back to a contract arrangement.

Mr Dwyer—Yes. It is a poor cousin. Russell just said it is a poor cousin to it.

Mr Joseph—The Tasmanian government were not able to implement a system like the Queensland system on their own, we understand, because the market is just too small. It was not really going to work, so they decided that there was no value in the current scheme and they may as well provide their own system, which will have a better benefit. Phil mentioned before that part of the reason was also to help bring more of the building industry back into compliance. Because people cannot or will not get builders warranty insurance—because they do not want to put their house on the line just to get eligibility—they have ditched it all together, just to try and bring these people back into compliance. So there are a few strings to this.

Senator EGGLESTON—There are some advantages there, though, aren't there?

Mr Joseph—Yes.

Senator MURRAY—Gentlemen, it seems to me that there are two separate classes who need protection. One is builders and one is consumers. I am not convinced that you always need the same system for both. Just dealing with builders only, it seems to me that they need protection from unreasonable and vexatious consumers, because those ratbags do exist. They need the ability to be assisted when remedies are required as a result of honest mistakes. Some years later there may be substance about which they knew nothing, that sort of thing. Thirdly, there is the area which is self-evident: someone dies or has become insolvent and the estate needs to be protected or assisted in some way. I would see assistance in those areas as not really falling under the definition of 'insurance'. I would see it as a different mechanism, such as lawyers provide through a pool of money which is available for those purposes. Is there any state where, for builders only, there is a different scheme which is not covered by warranty or insurance of that kind? All the talk here, by the way, is about Queensland, Tasmania, New South Wales and Victoria. I have not heard Western Australia or South Australia mentioned so far.

Mr Joseph—They are similar to Victoria or New South Wales. The insurance does not protect the builder. That needs to be absolutely understood.

Senator MURRAY—It does not?

Mr Joseph—This insurance does not protect the builder. It is not designed for the builder in any way, shape or form. The protections for the builder are limited. Most builders will join HIA or MBA because they think that if they got into some trouble there would be some protection there, but unfortunately that does not really exist.

Senator MURRAY—It may be my impression, as someone who is not experienced in these matters, but in your discussion it seems to me that the two concepts are mixed up all the time. I wonder if it would not assist any future scheme if those two areas were completely separated. Let me ask the question, then, with reference to consumers. Builders who are dishonest deserve everything that happens to them, and consumers who are ratbags deserve the same. But I am concerned about consumers who have genuine cases of grievance which may arise as a result of a ratbag builder or a builder who has made an honest mistake and needs to remedy it. It seems to me the consumer is well catered for in most states by the tribunals—at least conceptually.

Mr Dwyer—Yes.

Senator MURRAY—My instinct is that there should not be an insurance scheme for them, that their remedy should be through forms of dispute resolution mechanisms, small-claims courts and, if necessary, large courts.

Mr Dwyer—That is something that we have worked on with Tasmania. We consider that the contract between the builder and the consumer is a very important document and it needs to be respected. It derives every cent of income for the Australian building industry. It is the engine-driver of the Australian economy. That is what we measure the economy on. So we consider it to be very important. We want that contract to have adjudication by Consumer Affairs based on, hopefully, a book of tolerances as to what is good building, bad building or whatever, so that we end up making binding rulings against a builder, consumer or whatever the case might be. They can then go to a court or a tribunal, by paying a fee and so on. We believe that the licensing

should also be linked. The licensing must be there. It cannot be in isolation somewhere else. That is where we have the problem now.

Senator MURRAY—What you are outlining is a classic dispute resolution mechanism, and I accept that. At the heart of my uninformed kind of impression of all of this, based on what I read, hear and see, is the sense that 'insurance' is a misnomer, that the word should be taken out of the lexicon altogether and should disappear, and builders' needs—namely, that the remedial work has to be paid for from somewhere—have to be differently constituted. Is that right?

Mr Joseph—That is correct. Again, the gentleman behind us from QBSA will explain how they do this, but that is exactly what they achieve. While I respect how you put that builders have different needs—that is exactly true—we are so interrelated with the building contracts that we sign, it is important to have a scheme, system or plan that is holistic, an umbrella over the whole industry, because one detrimental area in this will affect areas all the way around. We are interlinked through these contracts in every aspect of the building industry.

We support what has happened in Queensland and how they operate up there as it is a scheme that covers the whole industry. It is a holistic scheme. I do not know whether going back to having the builders tribunal on one side and the consumers tribunal on the other side would be as effective as bringing it all under one umbrella with the related builder issues of security and payment.

Senator MURRAY—I am not suggesting that, and neither am I trying to use this forum to design a new system—because there are better people than me to do that. What I am suggesting is that there are two entirely different needs. One is to provide money, which is the builders area, for remediation or whatever reason—a bloke has died; an honest mistake; or a ratbag builder—and the other is to provide a dispute resolution mechanism. I am concerned that, as long as we look at this matter as an insurance matter, we are being led up the path.

Mr Joseph—It is an insurance matter at the moment, and that is what we would absolutely like to change. This insurance has been brought out of proper scrutiny as a wholesale product by this regulation, and it is probably the only insurance product in Australia which is not subject to normal consumer protection provisions—which is absurd, considering it is supposed to be consumer protection insurance. Even from the federal government's perspective, if that protection of this product were removed and exposed to normal market forces, it would probably collapse overnight anyway.

CHAIR—Yes, it would seem to me—and I have some personal experience of this—that the very idea that there is some insurance there in the contract might give some consumers a false sense of security that there is something that they can fall back onto, whereas you point out that that is often not the case.

Mr Joseph—Absolutely. Tony Robinson, when he was a backbencher a few years ago, complained in parliament to his own consumer affairs minister on behalf of constituents whose builder had gone broke and had gone into voluntary administration, but they could not make a claim on their insurance, because technically they were not insolvent. He was ropeable at the time. He is now consumer affairs minister in Victoria, and we are looking for some decent

changes. But this is what happens. It is a technical issue of insolvency. People cannot access it. It is a very difficult product to access.

Mr Dwyer—The majority of builders do not have a problem. It is only the few that we do have a problem with, and that might be, as Senator Murray said, a consumer who creates that situation. But it is only a small percentage of all the permits. When we issue something like 85,000 permits in Victoria a year, six per cent is not a huge amount. The good builders have nothing to fear with any ADR process that comes in. But with the Queensland model that we keep referring to, insurance is only one small part. It is only one cog in the whole wheel. It is an industry management model that we are very interested in. We would be far better off without insurance; I do not think there is any doubt about that. The Queensland model takes into consideration security of payments and all that type of thing too, because we have a terrible problem in the Australian building industry where consumers will hold back the final payment. And the final payment might be $50,000 or $100,000—we are talking such large numbers. That can send a builder broke anyway if there is no cash flow.

Senator MARSHALL—The misconception that I see out there is that people actually believe that this is a warranty for their building product or the building that is being built. But it is not at all. It is really a warranty that the builder will continue to exist—

Mr Dwyer—Correct.

Senator MARSHALL—but it actually does not provide any consumer protection for defects or the nature of the building whatsoever, does it?

Mr Dwyer—Absolutely none. Zero.

CHAIR—Thank you very much, Mr Dwyer and Mr Joseph, for attending and assisting the committee.

[3.50 pm]

JENNINGS, Mr Ian, General Manager, Queensland Building Services Authority

McCOSKER, Mrs Mandy Fiona, Executive Manager Insurance, Queensland Building Services Authority

WRIGHT, Mr Colin Charles, Deputy General Manager, Queensland Building Services Authority

CHAIR—Welcome. I remind committee witnesses that they are protected by parliamentary privilege with respect to their submissions and evidence. Any act which may disadvantage a witness on account of their evidence is a breach of privilege. While the committee prefers to hear the evidence in public, we may agree to take evidence confidentially. The committee may still publish or present confidential evidence to the Senate at a later date. We would consult the witnesses concerned before doing this. The Senate can also order publication of confidential evidence. Would you like to give a short opening statement before we begin?

Mr Jennings—Yes. Before I get started there are a couple of myths that I would like to dismiss about the Queensland scheme, which have been out in the market for a number of years. I have led the BSA for seven years. Home warranty in Queensland has been in its existing form through a statutory scheme for 28 years. The BSA has regulated the market since 1992 and before that it was regulated through the Builders Registration Board. The first myth, which has been out in the market, is that the BSA is going broke. I have got a copy of our annual report which is actually publicly available on our website and is distributed throughout the industry. We had an equity position of $4.2 million in 2002. We had an equity position through the BSA at the end of 30 June 2007 of $57.2 million. Our insurance fund has assets of $211 million and liabilities of $171 million. Most of those liabilities relate to future claim provisioning. If the scheme went broke tomorrow—which I can assure this committee it will not—we would be able to fund every one of the claims that come through the door for many years to come for their full liability for 6½ years after construction. The scheme is a not-for-profit scheme. It is about servicing the Queensland industry and is well supported by the Queensland government.

The second myth is the conflict of interest between the regulator and insurer. There have been a number of inquiries and I have fronted those inquiries about this conflict of interest. Those conflicts relate to the suggestion that the BSA could use its insurance scheme to resolve a licensing problem, that the BSA could delay taking action against a builder to avoid costs to the insurance scheme and that the BSA could unfairly use its licensing powers to avoid paying an insurance claim. Through the national competition policy review in 2005, KPMG issued a report, which I have a copy of here today for the information of the committee. It alludes to these conflicts and dismisses them by saying that the scheme run in Queensland is beneficial in integrating the model between insurance and regulating the industry through the licensing framework.

The third myth is that we are subsidised by the government. The scheme is fully self-funded. It is funded through its general fund. We have two funds—a general fund, which is funded through a licensing registration system and which provides a lot of benefits to the community through education, compliance and awareness. We do a number of roadshows throughout the state for consumers and contractors. I have some literature here for the committee if you are interested. We also run an insurance fund, which is fully self-funded through the premiums, funded to the extent that it has provisioning for the liabilities.

The fourth myth is that the BSA does not reserve its claims. The BSA board, myself and the government ensure that we comply with APRA requirements. It is one of our policy principles that we comply with APRA. We have an actuary, which allows for the provisioning, and we provision for all liabilities and have done so since I have been at the BSA, seven years. It is a critical element that the government places upon us. It requires us to comply with APRA. We do not need to, but we ensure we do from a policy perspective from the board.

We have reinsurers. We have three lead reinsurers which we have a very close relationship with, those being Munich Re, Suncorp-Metway and Swiss Re. They take 75 per cent of the liabilities and 75 per cent of the income. We take 25 per cent. So we are part of the process. It is critical that we are part of the model. They recognise that, so we are actually working for them and working for us. It is a critical issue that we have that confidence from our reinsurers, and we meet with them constantly—to the extent that Mandy and Col will be with them next week, talking about our next renewal. We usually have renewal policies with our reinsurers. We place them for two to three years. We run them on a 75 per cent profit, 75 per cent loss ratio as a goal. If it goes over that, we renegotiate with the reinsurers.

So we have some very stern financial principles behind the scheme and behind the organisation. The myths of ‘subsidised’ and ‘conflict of interest’—they are not true. To the extent that we are publicly out there with our annual report and our data, it is totally different to the private schemes. Our financial position is out in the public domain.

I heard earlier some questioning about the integrated model. The success of the scheme is the integration. Our system is critical. It has roughly five elements, which I think is in our submission. The first element is the licensing regime, which is about bringing integrity into the system. There are some technical requirements for the builders—they have to have at least a certificate III to a certificate IV and up to an advanced diploma to get a particular class of the licence. There are managerial requirements—they have to understand the GST, cash flow and business principles. That is one of the elements of the model under that licensing arrangement. They must meet financial requirements on an annual basis. That is critical for them to get insurance. On an annual basis, they are providing us with their financial data and ultimately we are monitoring them through our compliance mechanisms, on an ongoing basis, to ensure that that they are continuing to meet those financial requirements. They are also required to have two to four years experience in the building industry for the class of licence which they are being granted.

The other element that is critical is the issue of information and advice to consumers and contractors. The building industry is a very complex industry. I have been in it for about 15 to 16 years, with seven years at the BSA. It is a contract based industry and it is very complex. It is vital to make sure, because of the imbalance of information to the consumer, that there is data

out there for the consumer, to address that imbalance. Very few consumers understand the building game—the technical elements and the contractual relationships. So there is an imbalance in favour of the builder. The builders understand the industry because they are part of the industry, from a technical and a contractual perspective. So it is vital to make sure that there is that awareness out there in the community. For consumers we run shows like 'Journey through the building process' throughout Queensland. We also run super shows educating the industry on defects—subsidence, waterproofing problems, termite problems—to try and address some of the defects that occur, as well as dealing with such things as supervision, other elements of contractual management and our Domestic Building Contracts Act.

The other element under the system is the issue of contractual legislation. This involves understanding such things as contractual provisions; providing information statements to consumers warning them about what is occurring within the industry so that they understand the elements of a contractual perspective; having such things as progress payments specified under legislation—matters such as whether there are four stages or five stages—and making sure that ultimately they are paying in accordance with those stages for the construction phase; and outlawing cost-plus contracts. It is vital to ensure that you protect both the consumer and the contractor.

There are a number of different types of contracts in Queensland; both associations and the BSA sell them. The BSA's contract is a fairly equal, balanced contract. The contracts from most of the associations do favour the builder, and you can understand that because builders are their members. Most of the members use that contract, which ultimately does not favour the consumer. So you need to have a system in place to make sure that you are addressing some of those contractual issues.

The fourth element is compliance. Ultimately you need to be out there doing proactive compliance from a financial audit perspective and a prosecution perspective. We run a system in Queensland called the demerit points system, very similar to the drivers licence system, where a builder gets two points for particular offences. Once they get up to 30 points, they lose their licence. That data is visually available on our website through a search. There is data sitting on the website telling people about the offences. The good builders have nothing on them and the bad builders will have a record, which allows the consumers to check in order to determine which contractor they should use. So we have this demerit points system.

We also have bans. We have the toughest regime, including life bans and five-year bans. On 8 February this year, I removed the licence of one of the biggest builders in the Queensland residential sector. I did not take a backward step in doing that. We had been monitoring that builder for 18 months on certain issues. I had personally met with him about five times on particular issues and what we were doing with his business. We were monitoring and watching, but we did not take a backward step when we had to move. We knew when we had to move and we moved. I will explain later how the system has worked for the consumer with the removal of the licence from that builder.

We have a dispute resolution service. There are two parties to a building contract: a builder and a consumer. It is a contractual relationship. Most contractual relationships, when you get a dispute, should go to court. It is a legal process. Through our dispute resolution process we have a system where a consumer needs to, first of all, talk to the builder about the problem. If the

builder fails to rectify the defect, the consumer can then notify us. We will then have an on-site inspection with the builder and the consumer. If the building does not comply with the Australian standards and the Building Code of Australia, the builder will be told by my inspector—who is a qualified builder—to rectify the defect. He will be given a period of time to rectify that defect, normally 21 days. If he does not rectify the defect within that period, we will formally issue a direction to the builder. That direction will become public on the website and be publicly known to any consumer who uses the builder in the future. Once the direction is given, he is given a period of time to comply with the direction, which is normally about 28 days. If he does not comply with the direction, it will then default to the home warranty scheme to be fixed. We will then recover the cost of fixing the defect from the builder if he still exists.

So it is a system that gives an opportunity to the builder to fix defects. If he does not fix the defects, we then take action against the builder through public warnings about his history and also through the recovery of the cost of fixing the defect. It is a system that is integrated and that works. It gives an opportunity to resolve it on-site between the consumer and the builder through the building inspector, and if it is unresolved it will ultimately go to the home warranty insurance scheme. It is a regime that has been in place for a long period of time and that works very well. However, it is a regime that needs to be improved. It is under constant review. You cannot just sit there, put the system in place and say it is going to continue to work. The system has changed constantly in my seven years, to fix some of the loopholes that do occur.

At the moment, we are looking at whether we should have one standard contract in Queensland. I had an hour-long meeting with my minister this morning, looking at some of the concerns in the industry. The government in Queensland is willing to improve the system and constantly looks at how we can reform it to improve it and make it better. It needs that improvement to make sure that we address some of the things that go on in the industry.

Most consumers in the community insure their houses with building insurance and contents insurance, and most consumers insure their cars. To insure a $400,000 house it costs roughly $1,500 annually. We have builders warranty insurance and building insurance because an individual is building the biggest asset in their life; it is the biggest investment they make. The average house in Queensland costs about $250,000. It costs about $1,900 to insure a house for 6½ years—that is, $300 a year—against major structural defects such as water penetration and subsidence, which is movement in the house. These are major problems. If they occur and the builder defaults and does not fix them, the warranty scheme will fix them. It is a scheme which I think is very affordable and very reasonable for insuring the biggest asset in a consumer's life.

Building warranty insurance also insures against noncompletion. In Queensland, if a builder dies or if I suspend or cancel his licence, the warranty insurance immediately cuts in and the home is completed. The home is completed for the contract value, not 20 per cent of the contract value. It is a scheme which provides a benefit from a noncompletion perspective, from a defect perspective and also from a subsidence perspective. In Queensland we provide no-fault subsidence protection to the builder. If the builder complies with our building policy and, for example, digs two bore holes on the site when he does soil tests—there are a number of guidelines he has to comply with—we will provide a warranty of $200,000 if that house moves. We force him to comply with standards in relation to movement. If he complies with the Australian standard in our policy, he will get no-fault subsidence cover for $200,000 if the house moves. So it is a system that does assist the builder through that mechanism.

The warranty also assists the consumer, if the house moves. Most of the major problems that occur are structural problems, and the builder ultimately does go broke because they are a big fix; it costs money to do a subsidence rectification. There are many homes that have cost $200,000 for me to fix. We do take action against engineers if there is a problem with the engineering design in a home. We look not just at the builder but also at the engineer and the consultants to determine whether we can recover against poor professionalism or negligence by an engineer. So the cover provides that benefit to the builder, which is an excellent product which all builders in Queensland highly support.

Queensland Master Builders thoroughly supports our scheme and has done so for a number of years. Over the years I have had concerns, as mentioned earlier, with the Housing Industry Association, and they continue to occur. From my perspective, in relation to the warranty scheme the HIA does make money out of the commissions. In Queensland we are a not-for-profit organisation. It is about serving the industry, reforming the industry, improving the industry and ultimately providing protection to the consumer from a warranty perspective and also from a dispute resolution perspective.

A building dispute does require a technical person. I heard talk earlier about Fair Trading getting involved in an issue. For every dispute, we have a qualified builder on site to compare it with the Australian standard in the building code. If it does not comply, we ultimately direct the builder to fix it. It is a system that has served Queensland very well, and the government is highly supportive of it.

I will give you a quick example of what occurred on 8 February. Real Property Constructions Pty Ltd had 233 homes on the go. It was almost the biggest collapse in Queensland's history. We have been monitoring Real Property Constructions for about 18 months. Real Property Constructions was turning over roughly $60 million worth of work. We had a number of systems in place. They had gone through an audit. I had staff at the business looking at the management system. I had an insolvency practitioner looking at the business and providing advice. I knew very well what date the company would become insolvent.

I really was not concerned about the consumers. I knew they had protection under the home warranty insurance scheme. Publicly, I have been criticised in the media, which I understand occurs. Consumers were saying: 'Why didn't you warn us? We went with this fella. There were no public warnings. You came out with a public warning on 8 February, which ultimately led to him going into liquidation.' We did not have data on his history. There were conditions placed upon that contractor in September; there was a condition of 'no new work'. We convinced him to downsize, to get rid of his sales staff, to close his sales office and to do all sorts of things to reduce his overheads. We had a number of conversations with the director of this company. He had previously gone broke and he had been banned for five years and he came back. We were in constant contact with this individual.

On 8 February I received data. I was meant to meet with the director of the company. I told him that he should inject $1 million to $1.5 million into the company or else I would immediately suspend his licence. He did not front up to the meeting. Within half an hour I had suspended his licence. I have since learnt that, two days beforehand, he was talking to a liquidator and was going to place the company into liquidation. As soon as I did that, he placed the company into liquidation. On Saturday and Sunday I had 26 staff ring every one of the 233

consumers. We said: 'We have a warranty scheme and we'll be able to finish your home. Would you like an appointment to see one of our staff?'

This builder was building homes on the Sunshine Coast, in Hervey Bay, in Brisbane and on the Gold Coast. We set up a number of teams in my regional offices for consumers to meet with my staff to help them lodge a home warranty insurance claim. There is no private insurer in Australia who would ring a consumer and ask them to lodge a claim. We rang everyone. Some of the consumers were from New South Wales and some of them were from Western Australia. This company was involved with a number of wealth creation companies and investment companies, which ultimately led to his collapse. We rang the consumers and they were surprised they were getting a phone call asking them to lodge a claim. We have processed 105 claims for that particular contractor as of today. We are in the process of finishing those homes. This would happen in no other state.

So you had a regulator, who was very concerned, monitoring someone. I thought he would continue and the business would continue. I wish it had. I was encouraging him to do certain things but, eventually, we worked out he was insolvent and moved. In doing that, we knew we had the home warranty scheme. The suppliers were protected. Most suppliers these days take out credit insurance. They protect their own backyard. The ones who owed me were the trade contractors and the subcontractors. I am currently working with the liquidator and funding an action with them to find out where the money has gone, to see what action I can take against the director, the auditor and the accountant who have been involved in this company to try to recover some money for the creditors. No regulator in Australia does that, except in Queensland. I cannot understand why others cannot do it.

I have benefited the consumer, I have benefited the creditors and I have helped the suppliers following this collapse. It was a major collapse in Queensland, the biggest in its history. We have come away from it with no problems. It does work. We have assistance, but it is an integrated model. It is heavily reliant upon the home warranty insurance product. We need it; it is part of the model. We have huge support from our reinsurers. They are the lead reinsurers in the world. They support the model, they are constantly in our office doing audits on the system to ensure that we are complying with our requirements and they are happy. So it works. We have the system in place; it is just a case of ensuring that we comply with it.

CHAIR—Mr Wright, I invite you to make an opening statement.

Mr Wright—I was engaged by the Queensland government 28 years ago to manage their first home warranty insurance scheme and I have been involved ever since then. I came from the private insurance sector. I had 15 years experience in that sector. That was probably one of the essential elements of kicking off the scheme and getting the scheme to where it is today. Mandy, who is our current Executive Manager Insurance, also came from the private sector with extensive insurance experience. In my time with BSA, and its predecessor, I have realised that there is a great difference between consumer protection and home warranty insurances provided by the private sector. The private sector is in business to make a profit. The consumer protection that BSA offers is about real consumer protection. We analyse the claims, we talk to the people, we get to feel their heartache, we get to understand where they are suffering and we get to model our insurance product. Without being too extreme in its benefits, it helps those people through the financial stress and worry that they have with a home in the first six years of its life, so they

have some stability and confidence that this product that they are buying will be the bricks and mortar that they expect it to be.

As you would know, most people buy houses by extending themselves to the full extent of their financial capability. It is all very well to say that there are tribunals, courts and other bodies you can go to for resolution of disputes but, invariably, all of these bodies require that you have legal representation because you are up against somebody else, who has money, who has legal representation. The average consumer cannot afford to do that, and the average consumer cannot present their case in a tribunal, nor can they afford to wait six or 12 months for a decision. They are renting a home; they are suffering financially. They are paying a loan off on a house they cannot move into, so they are being hit in numerous directions financially. The BSA's insurance product is designed to help an owner, as soon as they can terminate a contract with a contractor, show that the contractor has defaulted. So, if the contractor walks away from the job and therefore does not proceed with the work, the consumer can take action to terminate. They can come to the BSA to lodge a claim. They do not have to wait for him to die or become insolvent.

Our lead insurance company has an actuary in New South Wales. I will tell you this story, because I think it is so relevant, about a very intelligent man who was extending his house. He had a contractor who got into financial difficulty and just stopped work. The man had to move out of his house so it could be extended, so he is now living in rented premises. He cannot claim on the warranty insurance because this builder is not in bankruptcy or liquidation; he has just downed tools. He has now teamed up with another consumer, who also had a job underway with this same contractor. They have joined forces to take this contractor through the courts to, hopefully, gain a judgement so that they can then proceed with that judgement to bankrupt the builder. Only if they bankrupt the builder can they access home warranty insurance. Had this man been in Queensland, he could have terminated his contract, come to us and we would have finished his renovation and paid his rent until the house was finished.

So, again, there is a difference between consumer protection insurance and insurance for profit. Our model has continually evolved. The policy conditions that we have at the moment were the eighth edition. That is eight times in the last 14 years that we have seen a need to change, improve and modify our policy conditions to suit the market that we are dealing with. But it only works as an adjunct to the total model that Ian has spoken about. It needs contracts, contract law, education and information for consumers. It is a total model. When it goes in isolation it becomes a product that then gets—pardon the word—bastardised and it turns into something that is there for profit rather than real consumer benefit.

Senator MARSHALL—I commend you on the obvious passion you have for your product. Did I hear you right, Mr Jennings, in saying that, at the point where a consumer and a builder cannot resolve their differences and you are notified, whatever happens you effectively cannot go longer than two months before problems begin to be rectified?

Mr Jennings—It depends on the dispute. I have been involved in many types of disputes, from nutgrass to a scratch in a bath to a house falling down a hill. They are complex. The system in theory is that within two months the dispute should be solved. That is how it works: 21 days, 28 days—fine—then to insurance. Normally to go out to tender you are looking at one month to six weeks for the insurance process, so it may take a while. But in theory with a general dispute there is mainly a two-month period in which to have it solved.

Senator MARSHALL—Your insurance genuinely covers the building, the actual product?

Mr Jennings—Yes. It talks about minor defects and structural defects—category 1 and category 2. Minor defects need to be notified to us within six months of completion of the construction. They are like paint brandishes or a scratch or something like that. We have jurisdiction for six years and 3 months after construction. A major defect would be a water penetration issue, a movement problem in a house—those sorts of issues.

Senator MARSHALL—You gave us some figures about the rough cost of that insurance for building a house. I think you said it would be roughly $1,000 for a $250,000 investment over the 6½ years that it is covered for. Can you give me a ballpark figure as to what it would cost for a building value of $48,000?

Mr Jennings—That is $374.40.

Senator MARSHALL—As opposed to the home warranty insurance that we are looking at at the moment of $1,651.60, of which $918 goes in commission somewhere.

Mr Jennings—Yes. Our premium charts are publicly displayed on our website. All builders know what they are. When they are pricing a job they know what they are going to pay, so they are putting it in the contract price. The system works. They ring up our phone pay system and pay the premium over the phone. Ultimately what then occurs is that the certifier checks to see that the premium has been paid. We then send out the policy book to the owner of the property, the consumer, which gives them their policy conditions. So it is instantaneous that they get cover if they have met the financial requirements.

Senator MARSHALL—Mr Wright, you made a comparison with home warranty insurance and people needing to force builders into liquidation to get it. Even when that happens, home warranty insurance only allows you to claim 20 per cent?

Mr Wright—Twenty per cent of the contract value. That is the privatised model.

Senator MARSHALL—So after the process of having to legally force someone into liquidation or bankruptcy, that then enables you to claim, but only up to 20 per cent of the contract value.

Mr Wright—Say you have legal fees, your building work has deteriorated and building costs have escalated. We do not limit our cover to a percentage of the contract price. We provide a $200,000 benefit for noncompletion and within that is a $5,000 benefit that people can access for rent assistance.

CHAIR—Do you ask any builders for bank guarantees as part of your process?

Mr Jennings—No.

Mr Wright—But we prequalify them through the financial requirements for licensing. We are doing that at the licensing stage. They actually meet financial requirements, we then set their turnover limits and then, provided they stay within those turnover limits, they can just pick the

phone up and take out the insurance over the phone using a credit card or a bank account to pay. So there is no limitation on their activity. As Ian pointed out, they know the premium and they can put the premium in the contract. We believe that in other models builders have to guess the premium because they are contracting beforehand, so we imagine they would overinflate and then they would wait until the insurer actually processes it and gives them the real premium.

Senator MILNE—I want to follow up the question from Senator Hurley. Witnesses, I think you were here earlier when we were hearing from the Builders Collective of Australia in relation to this last-resort insurance. I refer to this business of requiring people to put up bank guarantees, indemnities and so on in addition to the insurance. Is it your view that I as well as the Builders Collective of Australia were right in saying that this is just double dipping? You already do it as part of a due diligence process to establish that the person is a fit and proper person and is financially able to carry out whatever they are doing. What is your view on that aspect of this particular product we are examining?

Mr Wright—It is very restrictive on their cash flow. Our system looks at their assets to determine what reasonable turnover they can achieve with those assets. When you then put in further requirements such as bank guarantees, you are draining those assets with premiums. The problem that we hear from the other states is that they hold those bank guarantees for the full 6½ years of the life of that insurance product, so you get an accumulation of bank guarantees to the point that it absolutely stifles a builder's development.

Senator MURRAY—The simple definition of insurance is that when an event for which you are insured against occurs there is an automatic payment within the set period under the set terms. Your evidence is that is what you provide. There is a similarity between your scheme and HIA's in the broader sense in that in both cases the reinsurance, the backing of the underwriting, is by private insurers—for-profit organisations. I think you named three: Munch Reinsurance, Swiss Re and Suncorp-Metway. Those three are all subject to APRA's oversight and regulation, which, as I should put on the record, has been upgraded recently so it is much more stringent—and it will be even more stringent from 1 July. My notes say that the BSA voluntarily complies with APRA's insurance industry requirements. Does that mean you are not subject to APRA's regulation? If it does mean that, can you tell us why that is so?

Mr Jennings—Under the legislation there is a provision that regulates that we comply with standards and principles within the industry. That does not prescribe APRA. There is a provision under our act that we need to comply with standards. The act prescribes that but it does not actually name APRA. That is the requirement for the insurance industry, so the board has this policy that ultimately we are required to meet the APRA requirements. So the act has a provision in it—

Senator MURRAY—Sorry to interrupt, but let me go back a bit so that I understand it. Is it because you are established by legislation and you are under the aegis of the Queensland government that you would not automatically apply to APRA? Is that because you are an exception?

Mr Jennings—Ours is a statutory scheme, but what has occurred is this. Through national competition a provision was made under the act to say that we need to comply with industry standards, and then it goes to the regulation. Nothing has been prescribed in the regulation at this

stage to say that we have got to meet APRA's standards, but the board has it as a philosophy to meet APRA's standards. Being a statutory authority and a government entity, you are not subject to those requirements.

Senator MURRAY—Mr Jennings, I do not want to anticipate what the committee report will look like and what a recommendation might be, but let us hypothesise. If the committee were to suggest that your scheme was an attractive one to be considered for other states or perhaps nationally, would you suggest that an important component of it would always be that the authority or the scheme should be subject to APRA oversight?

Mr Jennings—Yes, I would say that it is important that they comply with APRA. All the states should be. If they are running a statutory scheme, they should comply with APRA.

Mr Wright—Could I just add that our scheme would not live and survive in isolation from the regulatory framework that it works within. It is just one part of the total framework.

Senator EGGLESTON—I am very impressed with your scheme—I must say that. I think it is very good and certainly looks after consumers as they should be looked after.

Senator MARSHALL—Unique to Queensland, Senator?

Mr Jennings—*Choice* magazine said they would move to Queensland.

Senator EGGLESTON—I think I read somewhere here in the paper that you put forward that you operate as a general insurer in the same way. Have you always had the funds to meet your obligations, or at times have you needed support from the Queensland government?

Mr Jennings—The insurance scheme has always been profitable. The other aim of the business, being our general fund which regulates the building industry, has always had its ups and downs. We run two businesses really: an insurance business and the regulatory environment. The regulatory environment is probably the one that has come under pressure, and it is the one that continues to come under pressure, in managing it correctly. I suppose it comes down to the number of participants in the industry from a funding perspective and what licensing fees I can charge versus what services you provide. I believe that, in getting a licence, you have to add value to the community as well, so I have to add value to the contractors by their paying their licence fee. The insurance scheme has always been profitable. It is the general fund that has had the problems over the years, to the extent that, in the times of the National Party government, when Joan Sheldon was the Treasurer, the general fund did receive some money, $1.45 million. But it supported the general fund, not the insurance scheme.

Senator EGGLESTON—I have another quick question, if I may, because time is getting on. You would have heard the last witnesses refer to the ACCC and the consequences of them becoming involved. Would you like to see the ACCC given a role in this area, supervising this kind of insurance?

Mr Jennings—I am a firm believer that there needs to be accountability, honesty and integrity out there. In our system, it being a statutory scheme, I am accountable to the Queensland parliament. I sit in front of our estimates hearings. I table our annual report. I am questioned by

the government and the opposition. So we are accountable to the Queensland community for our scheme. I think that it should occur in a private system as well, and the regulators in that environment should then hold them accountable and make sure that there is integrity and honesty put on the table. So I am very supportive of APRA and the ACCC.

Senator MILNE—I just have a quick question. When we were just discussing Tasmania with the Builders Collective and asked why Tasmania has not gone to the Queensland model, the answer was that there is probably not critical mass. I am just trying to sit here thinking through how you could apply this model as a national model so that the small states like Tasmania—where there just are not enough people to make this a reasonable business—could benefit from it. Could you just speculate on that for a moment.

Mr Jennings—Yes, I could. The Tasmanian government actually came to us and visited us a number of times, and they have copied our model. They have done a number of submissions. They have come to our office constantly to look at how it is being run. They actually approached us about running it for them. I have a statutory scheme, accountable to the government under state legislation. I am a firm believer that you need state legislation to regulate the integrated model. You need the integrated model. You cannot just say, 'BSA, please come and run the Home Warranty Scheme.' I would say, 'I need the whole model down there for it to be successful.' It needs the whole model. A national scheme would work, but it is the whole model.

Each state is run differently, from a licensing perspective. We are the only state that has financial requirements, that places financial requirements on our licensees—because they leave it to the insurer to look at the financial requirements. That gives me compliance intelligence, because every time they are paying insurance I now know whether they are exceeding their annual allowable turnover. That then allows me to go in and have a look at that business. That is how it works. It is integrated, because you are getting the intelligence, you are getting the data, and you know instantly when there is a problem—rather than under the other states. They have got the insurance. They are doing the financial stuff. The insurers are not telling the regulators. All they say is, 'We're not going to give you insurance,' so the regulators then do not move on the individuals that may have financial trouble in the industry. It needs the integrated model for it to be successful, but it is the whole model, and then it would work nationally.

Senator MILNE—Yes, it could work nationally.

CHAIR—I just have a question going back to your premiums and the flat rate that you charge. Is there any suggestion—speaking of people who have different records—that having a flat rate might subsidise people who are behaving poorly, and how do you operate that?

Mr Wright—National competition was probably the first time that we publicly started to come under pressure about why we do not offer no-claim bonuses. It is simply that it is default insurance. We are not paying insurance against builders who are currently licensed—or, if they are licensed, they are not going to be licensed for long. The main hits on the insurance scheme are when a builder goes broke or is about to go broke. So, because the claims are being paid at the stage of a builder's demise, it is all those people who are currently in the system who are sharing the profits. You cannot give bonuses to those in the system—and, because you control their size of operation through the financial requirements, you are creating a level playing field in their licensing regime, so therefore you charge a level premium. You cannot pick out of them

and say, 'This one's a good one and this one's a bad one.' You have done that through the licensing network.

Mr Jennings—Can I just expand upon that. We have a licensing fee differential, so ultimately, if you have got a bad performer out there, they pay a higher licence fee. So, for every direction they get issued, they pay an additional $75 on their next licence fee. So what you are doing is that you have an insurance scheme and premiums that are set, but you then hit the industry—because I have more licensees that just do not do the residential sector. They move from the residential sector into the commercial sector. You might have a rogue builder in the residential sector. A week later, he might be building in the commercial sector. So we tackle the system through the licensing system, and there is a licensing fee differential, so your bad licensees will pay a higher licence fee and your good ones pay a lesser licence fee. That system is really through the licensing system rather than through the insurance scheme.

Senator MURRAY—Mr Jennings, are you familiar with the term 'phoenix company'?

Mr Jennings—Yes, I am very familiar with it.

Senator MURRAY—Then you will probably anticipate what I am going to ask you. As you know, the phoenix company problem has been a particular problem in the building industry, although it is in other sectors as well, and the Australian tax office and ASIC have taken a considerable interest in that area—and indeed it has influenced the recent changes to insolvency law. Do you know whether your system has reduced the incidence of phoenix operation in the building industry in Queensland? If you could detail it in particularity rather than anecdotally, that would be helpful—or provide the information later to the committee.

Mr Jennings—With the Better Building Industry reforms that occurred in Queensland in October 1999 came the introduction of the antiphoenix provision. This is a five-year ban. If a director goes into liquidation, insolvency or administration, they are banned from the industry for five years. They cannot be a person of influence in a building company, they cannot be a director of a building company and they cannot hold a licence for five years. That was one of the reforms. In 2003 a further reform was made whereby, if they come back after five years and another event occurs, they will go for life. Real Property Constructions, which I spoke about earlier, is a good example of that. The director of this company had gone into liquidation. He was banned for five years and then he came back. He actually came back a month before we were aware that he was again a director of the company. They are required to tell us. That is one example of someone who came back a month early from his five-year ban. We looked at him constantly while he was banned to determine whether he was a person of influence in that company—it is very hard to get data on this—and whether his partner was running the business. We believe that he was but we found it very difficult—

Senator MURRAY—When you say 'partner', do you mean in a domestic or a business sense?

Mr Jennings—Both.

Senator MURRAY—That is often the early signal.

Mr Jennings—Yes. It was very difficult to prove that he was a person of influence. The antiphoenix provision has restricted these companies because their directors are banned for five years. They have a right to natural justice. They can go off to the tribunal and become a permitted individual on the basis that they took all reasonable steps to prevent the company going into administration and liquidation. It is very hard to get data on it because, ultimately, they are banned. It is a matter of whether there is a shadow person behind the person—puppet—running the company. We have some compliance investigations going on in relation to that, where data has been provided to us. We have 72,000 licensees in Queensland and 20,000 of them are builders. I would probably say that, of those builders, there would be about one per cent or half a per cent—it is very low because of the provision. We do have some investigations of individuals on the go at the moment.

Senator MURRAY—Half a per cent of what? Half a per cent of phoenix companies?

Mr Jennings—Of the 20,000.

Senator MURRAY—Are phoenix?

Mr Jennings—Yes.

Senator MURRAY—I got a bit confused by your response. Are you telling me that, in your view, phoenix activity is lower in Queensland than in, say, New South Wales?

Mr Jennings—It is lower in Queensland because of the reforms that occurred in October 1999. The other states do not have these provisions. Directors of these companies are banned for five years. They cannot set up another building company. They cannot get a BSA licence for five years. In the other states they are able to do that, whereas in Queensland they are prevented from doing that. In Queensland, a partner may continue in a company; but, ultimately, they are probably behind it. So we have a number of investigations into those instances.

Senator MURRAY—Do you have a memorandum of understanding with bodies like the ATO or ASIC? For instance, when you are investigating and examining the books and the business relationships of a suspected phoenix operator do you to talk to these bodies?

Mr Jennings—We do. I would like it to go the other way, too. I am constantly asked for information from federal bodies, not just the tax office. Child protection and all sorts of other bodies ask us for files and financial records. We provide data to, and meet with, the tax office constantly. We exchange data, but it is always us giving.

Senator MURRAY—And ASIC?

Mr Jennings—Yes, we do talk to ASIC.

Senator MURRAY—Give me a sense of—

Mr Jennings—We do not have a memorandum of understanding with ASIC.

Senator MURRAY—Out of every 10 interactions with other agencies, how many would be ATO, how many would be ASIC and how many would be others?

Mr Jennings—The majority are ATO.

Mrs McCosker—Currently, we are supplying, almost on a daily basis, data to the ATO where it is taking individual audits against building companies or individuals on the number of contracts that a builder has undertaken in a certain period. On a quarterly basis, we are supplying data into the specialist GST task force that is currently working with the building industry. They are getting full details of all contracts, including the consumer details—so they are working on the black economy. That data is supplied to them electronically every quarter.

Senator MURRAY—The reason I am pursuing this is that it seems to me that you have outlined a direct cost-benefit relationship for builders and consumers but there is also a very significant public benefit available from your activity. Obviously, minimising phoenix activity and black market activity and so on is for the public good.

Mr Jennings—The marketing equation is very healthy, I suppose, in the building industry and has been for seven years. I have had discussions with the ATO. I would like the data to come the other way because then I could move more quickly. Normally, the biggest debt that occurs when you have a collapse is the tax debt. My issue is that the tax office should have moved earlier or let me know because I would have moved. It does affect the industry. It affects the subcontractual chain and also the suppliers and the consumers. So it is trying to hold them accountable and also making sure that you do it earlier rather than later. Our whole issue is about making sure that we prevent the financial disasters that we know will ultimately occur. We are trying to make sure that there is minimal financial disruption to the community—the building industry and the consumers.

CHAIR—Thank you for your assistance today and your testimony.

Proceedings suspended from 4.47 pm to 5.06 pm

BRODY, Mr Gerard, Director of Policy and Campaigns, Consumer Action Law Centre

Evidence was taken via teleconference—

ACTING CHAIR (Senator Eggleston)—Welcome. As you know, this is a hearing of the Senate Standing Committee on Economics. I want to put on record that committee witnesses are protected by parliamentary privilege with respect to their submissions and evidence. Any act which may disadvantage a witness on account of their evidence is a breach of parliamentary privilege and action may be taken against anybody who so seeks to disadvantage a witness should that occur. While the committee prefers to hear evidence in public, we may agree to take evidence confidentially. The committee may still publish or present confidential evidence to the Senate at a later date, however, if that is done. But, before that was done, we would consult the witness concerned and discuss this with the witness. You should know the Senate can also order publication of confidential evidence. I invite you to make an opening statement before the senators question you.

Mr Brody—For those who do not know about our centre, Consumer Action is a campaign-focused consumer advocacy, litigation and policy organisation. As a community legal centre based in Melbourne, we provide free legal advice and representation to vulnerable and disadvantaged consumers across Victoria and we are the largest specialist consumer legal centre in Australia. We also pursue a law reform agenda across a range of important consumer issues at a governmental level, in the media and through the community directly. We are dedicated to advancing the interests of low-income and vulnerable consumers and of consumers as a whole.

We very much welcome the Senate economics committee inquiry into Australia's mandatory last-resort home building warranty insurance scheme. We have long been concerned that such schemes provide little or no protection for consumers, while coming at a significant cost. We note that this is consistent with a recent finding of the Productivity Commission in the draft report of its inquiry into Australia's consumer policy framework. We believe that problems with home building warranty insurance are actually interlinked with other aspects of the home building consumer protection regime, including licensing and registration requirements, access to alternative dispute resolution and access to low costs at tribunal. For that reason, home building warranty insurance cannot and should not be looked at in isolation, but rather from a holistic consumer protection perspective.

Home building consumer protection is particularly important, considering that a home will typically be the largest single purchase a consumer will ever make. Considering the significant expense of home building and the dislocation and trauma that can occur when building defects occur and consumers have to relocate at their own expense, a comprehensive and effective consumer protection regime is essential in the area of home building. It is our view that an adequate and effective home building warranty insurance scheme is an essential part of that framework.

I want to touch on two issues in my presentation: firstly, consumer protection problems in the building sector and, secondly, potential reforms which may lead to better consumer protection. I will deal first with what we see as problems in the building sector, particularly with the last-

resort home building warranty schemes. We believe that the last-resort private home building warranty schemes provide little or no consumer protection despite significant premium costs. The primary reason for this is the significant hurdles a consumer faces before they can make a claim on the insurance. Home building warranty insurance does not provide genuine coverage for common building problems such as noncompletion or poor-quality work. Instead, the last-resort schemes only provide coverage if a builder is dead, disappeared or insolvent, and even then they contain numerous carve-outs that limit any claim that a consumer might make. The practical result of this in Victoria, where I am from, is that a consumer must pursue a complaint through the Victorian Civil and Administrative Tribunal before any rights against the insurer accrue. Indeed, even if they are successful at VCAT consumers must take further action to wind up a company in order to demonstrate insolvency in accordance with the policy wordings.

Such action comes at significant cost to the consumer. We have been assisting a consumer in our legal casework practice recently, and I will provide a more detailed explanation of that case study in our written submission. The case study demonstrates that without free legal assistance the consumer would have incurred legal costs of around $92,000 to $103,000 to make a claim of around $63,000. Such legal costs are not recoverable from the insurer. Other costs, relating to alternative accommodation, removal and storage, will also be incurred, but insurers are only liable for such costs up to a limit of 60 days. This matter has gone on for over two years. These additional limitations mean that home building warranty insurance will not compensate a consumer for their entire loss even if they are successful in any claim.

I will move on to issues with the last-resort private schemes in relation to conciliation and dispute resolution. One issue that has coincided with the last-resort schemes that have operated is that government regulators typically no longer have the power or resources to order builders to rectify defaults. While the consumer affairs ministries of the various states and territories often provide mediation services, these are not typically reinforced with any determinative powers on the part of the regulator. In Victoria consumers with a complaint about a builder can complain to Building Advice and Conciliation Victoria, which is a program jointly managed by Consumer Affairs Victoria and the Building Commission. The problem with dispute resolution at BACV, as demonstrated in our case study, is that the builders do not have an incentive to resolve cases on a conciliator basis. This is especially the case for builders who have little concern for their reputations. Furthermore, BACV has no capacity to enforce an outcome.

In 2006-07 there were over 2,000 complaints to BACV. While Consumer Affairs Victoria state that many are resolved through conciliation, in cases where conciliation did not resolve the complaint BACV had no power to order a builder to repair defaults. The inability of conciliation to provide a rectification order leaves a very significant gap. The more unscrupulous builders will be well aware of this lack of power and may be aware that the only option consumers have if conciliation does not work is to litigate through VCAT, which can be a highly expensive process in residential building dispute matters. While VCAT is theoretically a cost-free jurisdiction, the complex nature of building disputes has resulted in increasing formality of the building list at VCAT, such that legal representation is now the rule and not the exception, highly expert and technical evidence is required and costs orders are not uncommon. Each of these features renders VCAT increasingly court like, with the resulting disincentives—both financial and psychological—to consumers pursuing legitimate claims. Further, as I mentioned before, legal costs are not recoverable from the insurer. As such, many consumers do not pursue the matter as it is uneconomical to do so.

The last-resort home building warranty insurance schemes also do not complement the relevant systems of licensing or registration of builders. This is because the only time a claim on home building warranty insurance can impact on a builder's licence or registration is when the builder is already excluded from future building by death, disappearance or insolvency. This contrasts with a first-resort scheme, which to remain tenable must respond to builder claims by penalising or deregistering builders who are subject to repeat claims.

In Victoria the Building Commission is responsible for the administration and registration of building practitioners and for monitoring their conduct. In 2006-07 the Victorian Building Commission cancelled only three building practitioner registrations out of a total of 20,998 registrations. That number is statistically very small even when compared with the figure of 1,209 complaints made to Building Advice and Conciliation Victoria. While that commission does include a register of prosecutions and of inquiries concerning registered building practitioners on its website, it does not appear that it actively considers complaints to the Building Commission of Victoria, including those as to whether builders are willing to conciliate through that process in determining ongoing registration.

I want to make a few more comments about the proposals for reform. It is our view that all states and territories should adopt a first-resort government monopoly, mandatory home building warranty insurance scheme. It would be similar in form to the one that is currently operated in Queensland by the Queensland Building Services Authority. The ability of the Queensland Building Services Authority to make binding rectification orders and its responsibility for considering builders' ongoing registration provide an incentive for builders to resolve disputes and undertake rectification work. Importantly, however, there are not significant limits on the insurance cover, as there is in other jurisdictions. In Queensland coverage is available during the course of a contract where a builder becomes bankrupts or goes into liquidation or fails to complete the contracted works for reasons that are not the consumer's fault or fails to complete the contracted works and those works are found to be defective. The consumer is not required to get a tribunal order to pursue that matter. While there are monetary limits and conditions on the insurance cover, it is clear that this scheme provides a far wider coverage than last-resort home building warranty insurance schemes.

In many of the current jurisdictions in which private last-resort schemes exist relatively little enforcement action has been taken against registered builders. One view is that the move to a private last-resort scheme facilitates a reduction in builder oversight as both information about builder noncompliance and the need to ensure regulation of non-compliant builders reduce. In a first-resort government scheme builders who continue in business may be subject to claims, and this provides information about builders who may be persistently non-compliant. In a last-resort scheme this is not the case because any claim under a last-resort system can only occur once the builder who is the subject of the claim is dead, has disappeared or is insolvent. Therefore information from claims about these builders is of little use in preventing future noncompliance.

Likewise, first-resort government insurers could not remain viable unless they incorporated and developed a system for detecting and punishing non-compliant builders. Thus the success of the Queensland Building Services Authority is due in part to its appropriate access to and use of remedial action against builders for noncompliance. We recommend that to be effective building dispute resolution services and claims under home building warranty insurance must be closely linked to compliance enforcement regimes and registration requirements.

Access to no-cost dispute resolution forums is essential for any scheme that seeks to resolve disputes involving consumers and traders. Consumers should have access to an independent conciliation process that is underpinned by a binding power to order that faults be rectified. A dispute resolution scheme needs to also have the scope for—or at least links to—deregistration of or disciplinary action for builders who do not participate in alternative dispute resolution procedures in good faith. Only if there is such an incentive to participate in conciliation procedures will builders actually attempt to resolve disputes in the low-cost alternative dispute resolution environment.

Another mechanism that has been effective in other industry based ADR schemes is to charge members subject to complaint on an escalating basis, therefore creating an incentive for early resolution. We recommend that all jurisdictions have an independent conciliation system which has the power to make binding decisions that affect builders; for instance, the power to order builders to rectify faults. Furthermore, we believe that tribunals should operate on the principle that each party is ordinarily responsible for their own costs, and efforts should be made to ensure tribunals remain low-cost jurisdictions.

In conclusion, I would like to emphasise our recommendation that the home building warranty insurance scheme be returned to a government controlled warranty body, as it has previously operated in Victoria through the Housing Guarantee Fund and currently operates in Queensland through the Building Services Authority. I would be happy to take any questions from senators.

Senator MARSHALL—I wonder whether you could explain to me how a last-resort insurance building warranty insurance scheme, which is difficult to access, difficult to enforce and ultimately only provides 20 per cent of the cost of the building works that were insured, can be five times more expensive than a first-resort insurance system that pays 100 per cent of the cost of the building work insured, is easily enforceable and is delivered on a no fault basis?

Mr Brody—That is a very good question. I do not have the answer to it. That is inexplicable to us. We do not understand why last-resort schemes are so expensive to run, when there do not seem to be many claims made against them at all.

Senator MURRAY—I suspect there is a very big middle man!

Senator MARSHALL—We do know from just the one example I have in front of me that 60 per cent of the costs of last-resort insurance seem to go in agents' fees but, even putting that to one side, it is still more than twice as expensive. Is it simply market failure in terms of competition?

Mr Brody—In our view, it is. Insurers know that builders and consumers ultimately must buy the insurance, and their system is set up through the ministerial orders to make it very difficult to claim upon. So there is no need for them to compete to try to reduce the cost of that insurance.

Senator MARSHALL—If I heard you correctly in reading your submission, you are, in effect, describing that what should happen should be what happens now in Queensland. Is there any downside to the scheme that operates now in Queensland, as far as you are aware? Hearing the submission earlier, it sounded almost too good to be true, which often suggests that maybe it

is too good to be true. In this instance, it may not be. But I wonder whether you are aware of any downsides to that form of insurance?

Mr Brody—I am not. Being located in Victoria, we have not had experience with that scheme. I have been in contact with consumer colleagues based in Queensland, and they have said that that scheme is effective when consumers use it. I have not known of any significant downsides. That is not to say that there aren't any, but I am not aware of any.

Senator MURRAY—Some of the earlier witnesses, whom you might not have heard, said exactly what you said—I will paraphrase and not use your words or their words—that access through mediation in Victoria has become a lawyers picnic and very costly. Have you any idea of the typical costs, the average costs, the range of costs that consumers are experiencing in trying to go through the formal process that you described earlier?

Mr Brody—Yes. I can give you a bit of a flavour from the case study that we have recently dealt with. The dispute related to a couple who had purchased a demountable home from a company. That company offered to build a home on their property, which was in regional Victoria. The couple were of limited income and they did not have a lot of assets. The building that was put up had numerous defects and, despite numerous contacts over about an eight-month period with the builder, they were not repaired. The clients then contacted Building Advice and Conciliation Victoria. It organised an inspection of the dwelling. That inspection revealed serious defects and stated that the builder should rectify those defects. The builder concerned did not participate at all in that conciliation. The Building Commission attempted to contact the builder but that did not assist, either. That took about 12 months.

The builder then issued proceedings in VCAT seeking orders that our client pay for variations to the home building contract. They were saying that they had not actually paid out the entire contract. Our clients then filed a defence. They stated that variations that were being claimed were included in the original contract price. That matter did not proceed. About 12 months later our clients still were not happy with their building and sought to go back to VCAT to get the matter reinstated and claim that the defects be repaired. The matter was reinstated and the day before the hearing the builder entered into a deed of settlement and that was drawn up. Unfortunately the builder defaulted on the reasonable terms of that settlement and our centre was forced to apply to have the matter reinstated. That took another three months. The matter was successfully reinstated and eventually VCAT ordered an award of around $60,000 in damages to our clients plus an amount of interest. We had our services independently costed to obtain a cost order against the builder and that cost order amounted to $88,000. So in that instance, just to get the order at VCAT, if the consumer had not had our assistance they would have had to expend around $88,000 to get a $63,000 damages claim, not to mention their relocation costs and other costs.

Senator MURRAY—Do you and your organisation have sufficient experience in this area of law to indicate whether those costs are typical or atypical?

Mr Brody—Our experience is that those costs are typical. We also believe that not a lot of consumers go ahead and make those complaints or end up incurring those costs, because they are advised early on that the costs would prohibit any sort of claim that they take on.

Senator MURRAY—The second issue I want to raise is with respect to the Productivity Commission's views on this area. They did not recommend, did they, the adoption of the Queensland system?

Mr Brody—My understanding is that they did not recommend the adoption of the Queensland system but they acknowledged the particular faults with the system that operates currently and they said that home building warranty insurance was a cost to consumers that offered little protection to them.

Senator MURRAY—I have not read that full report, so perhaps you can tell us whether the Productivity Commission gave reasons for not recommending the Queensland system?

Mr Brody—No, I do not believe they did. They did note that evidence they received was that the Queensland system largely worked in practice. Their recommendation was merely for a revamping of compulsory builders warranty insurance to ensure that the product was of genuine value to consumers.

Senator MURRAY—Without being too harsh, I thought that the recommendation that you quoted was weak. Would you agree with that?

Mr Brody—I would agree. We provided a submission to the draft report suggesting that that recommendation go further and that a first-resort system be recommended in the final report to government.

Senator MURRAY—Would you regard the Productivity Commission's work in this area as being less than helpful in providing a real way forward?

Mr Brody—I am not sure about that. I think the Productivity Commission's work in this area is welcome. My understanding is that the Productivity Commission received the most submissions out of any area on its wide-ranging review on building warranty insurance and for that reason alone it made comment that it was not specifically within its draft of reference, although broadly it was. So I think that recommendation does need to be revamped. It encourages government to look at the issue and see what is the best way to implement this scheme of insurance.

Senator MURRAY—Again—and I qualify my question by saying that I have not read that report in full—did the Productivity Commission produce any adverse findings on the way in which some state schemes or private schemes operated?

Mr Brody—No, not in particular. They just noted the evidence it provided to them that some of the schemes were not offering value or were not effective, and they did note that the Queensland scheme had been largely effective.

Senator MURRAY—Given the sorts of material that comes to me in emails and as evidence to the committee, I would have thought that people would have acquainted the Productivity Commission with strong criticisms of other participants in this area. Is that correct?

Mr Brody—I am sure they would have. I think the Productivity Commission did receive a lot of evidence from consumers who have had problems in dealing with building disputes and claiming on building warranty insurance, so I think that is true.

Senator MURRAY—I am asking you these questions not to try and get into the rumours on the Productivity Commission but because I am concerned that a body of its authority and ability did not make clearer and more precise recommendations as to a way forward in what is obviously a very upsetting area of consumer concern and dispute.

Mr Brody—I agree that more-specific recommendations would have been welcome, but in the wide scope of its review, which covered the full gamut of consumer policy in Australia, I think that even highlighting this as one area of concern—which they only did to a few other specific areas—is a welcome addition. I hope that will ensure that governments look at the area concerned.

Senator MURRAY—Is it your view that a national scheme would be the best way to go—or do you not really mind so long as each state scheme picks up the broad approach of the Queensland system, which you support?

Mr Brody—From a consumer protection perspective and from a consumer perspective, we want a scheme which can be effective and be implemented as soon as possible. If that means it is done by the states then that should be the way forward. But I think a harmonised system in Australia, whether it is harmonised by the states or is a national scheme, will reduce the costs to those administering the scheme. That should be looked at as well.

Senator MURRAY—Did you hear the evidence that preceded you?

Mr Brody—No.

Senator MURRAY—I will recap some of the last elements of it because I want to know if you have any concerns about it. The Queensland system has some direct and attractive cost-benefit relationships, which have been spelt out to us, but there are also some indirect consequences which I personally see as being of public benefit but which might concern others—that is, in their collection of data and their investigation of builders and their operations, the ATO take an express interest where they suspect malfeasance, and information is shared. Does that worry you at all?

Mr Brody—If two governments share information in that way, if the overall purpose of that is to have regard for or promote the public interest, that really should not concern you.

Senator MILNE—You say in your submission that last-resort insurance is not available for most of the common problems that your organisation deals with. Do you have any figures on what proportion of domestic building dispute situations involve builders who are dead, disappeared or insolvent? Do you have any numbers on that or the value of that? If you do not, can you tell us who might know that? It would seem to us that the big problem here is that the overwhelming majority of these situations do not come under the category of dead, disappeared or insolvent and there are huge legal costs. Do you have any figures on either the number or the value?

Mr Brody—I do not have specific figures. As I said before, there were over 2,000 complaints made to Building Advice and Conciliation Victoria in 2006-07. I am not aware of any claims that have succeeded on home building warranty insurance. I imagine the insurers themselves would have that information.

Senator MILNE—I suppose the tribunals around the country, or the courts, are where we need to go.

Mr Brody—The tribunals would have information. In our situation, with our clients for example, if we got an order against a builder at the tribunal and that was not enforced, we would then have to seek to use that enforcement notice to wind up the company, and that would take the extra step of undertaking insolvency proceedings through the County Court. So another option might be to consider how many applications for insolvency have been made against builders in the County Court.

Senator MILNE—Why do you think state governments do not seem to like the Queensland system?

Mr Brody—I cannot be sure of why they do not particularly like the Queensland system. It does seem to have an administrative cost to the state, but at the same time there is a consumer benefit that should outweigh the cost. I would encourage the state governments to consider where the consumer benefit is in their current private schemes.

ACTING CHAIR—In some earlier evidence today we were told that the ACCC were excluded from being involved in this area because of a change in regulation. Would you like to see the ACCC involved, and how would you view the role they might play?

Mr Brody—I imagine that, if it were a national scheme dealing with home building warranty insurance, we would still require some sort of body that was independent from the ACCC to deal with disputes, and then perhaps the ACCC could take an enforcement role to ensure that builders who are not complying with their registration or licensing requirements are dealt with appropriately. That would be the role I would see for the ACCC.

ACTING CHAIR—Thank you for appearing before the committee today and for the evidence you have given. It has been very useful. I thank the witnesses, Hansard and the secretariat.

Committee adjourned at 5.37 pm