

BETTER REGULATION STATEMENT

HOME WARRANTY INSURANCE – CLARIFICATION OF CLAIM PERIOD

1. Introduction

It is intended to retrospectively clarify legislation prescribing the claim period for home warranty insurance in light of a Supreme Court decision which disallows existing time limits under the *Home Building Act 1989*. The decision effectively means that the private home warranty insurance scheme in place in NSW since 1997 contains no time limit on the notification of claims. This decision has the potential to open the door to claims being made against all insurers who have operated in the home warranty insurance market since 1997 – for matters which industry and government had previously considered to be “out of time”. Clarification of the previously understood time periods for making a claim is essential to avoid this increase in liabilities and would ensure that insurers are not forced to leave the market, home warranty insurance premiums do not rise significantly, homeowners do not face higher building costs, builders can continue to obtain insurance cover, taxes on general insurance premiums levied under the *Insurance Protection Act 2001* are not increased and reinsurance liabilities for the NSW Government are not increased.

2. Need for Government Action

On 3 October 2008 Justice McDougall gave a ruling in the Supreme Court on certain preliminary or interlocutory issues in a claim appeal *SP 57504 v. Building Insurers' Guarantee Corporation* [2008] NSWSC 1022. The decision has the effect that the private home warranty insurance scheme in place in NSW since 1997 contains no time limit on the notification of claims. This decision has the potential to open the door to claims being made against all insurers who have operated in the home warranty insurance market since 1997 – for matters which have previously been considered to be “out of time”.

The retrospective increase in insurance liability will be several million dollars and future costs for home warranty insurance are expected to rise as a result. The decision has the potential to increase the costs of home building and to create a major impediment to participation in the industry at a time when the industry is already facing high levels of financial stress and low levels of activity. It is possible that insurers and reinsurers will reconsider their future participation in the market, possibly creating ongoing difficulties for building contractors and developers who must have insurance to work in the home building industry. A significant proportion of the retrospective liability will fall on the NSW Government through an indemnity that the Government has provided to homeowners insured with the collapsed HIH insurance group.

Supreme Court decision – SP57504 v BIGCorp

The Supreme Court decision relates to a claim made by the Owners Corporation of Strata Plan 57504 for breaches of home warranties by the builder converting the property from a warehouse in 1998. The home warranty insurer contract was with HIH and the claim is against BIGCorp, the Corporation established by the NSW Government to indemnify HIH policyholders after its collapse.

BIGCorp argued that the Strata did not notify of a claim within the time required in the policy and could not recover compensation. The Strata asserted that BIGCorp was unable to rely on the terms of the policy because clause 53 of the *Home Building Regulation 1997* prevented the insurer from reducing its liability as the claim had been notified no later than six months after the defects had become apparent to the Strata.

The Supreme Court ruled in favour of the Strata breaking the previously understood relationship between the period of insurance and the time available to make an insurance claim.

The decision has the effect that a homeowner is covered by the insurance if they establish that they suffered a loss during the insurance period specified in section 103B of the *Home Building Act 1989*. Contract law traditionally uses the date of loss as being the date of the contract or the date of hand over of the residential works. In this scenario, a loss will always occur within the period of insurance irrespective of when the defect becomes apparent. The defect could become apparent at any time, possibly many years after the statutory period of cover. A homeowner would then have six months to lodge a claim after the defect became apparent – even if this was twenty or thirty years after the building was completed.

The decision of the Supreme Court does not immediately apply to any determination of the claim in question as it is an interlocutory matter but has considerable bearing on claims that potentially can be made in the future.

Impact on approved insurers

Eighteen insurers have been approved to provide insurance and have participated in the home warranty insurance market at some stage since 1997. A number of mergers and acquisitions have occurred during this period and some insurers have left the market. Currently there are six approved insurers.

All insurers who have been active in the home warranty insurance market since 1997 will need to make provision for the expected retrospective increase in liability arising from the Supreme Court decision. All insurers who are currently approved to provide insurance will need to reassess the price charged for future insurance contracts and may need to increase capital reserves to ensure that the reserves are adequate for their increased exposure to claims. Insurers may also need to renegotiate arrangements with reinsurers.

Impact on home owners and the public

Home warranty insurance is mandatory for contracts with a value of more than \$12,000. The cost of home warranty insurance is usually included in the overall cost charged to a homeowner. Increased costs for home warranty insurance arising from the Supreme Court decision will be passed onto homeowners.

It is not possible to accurately estimate the expected increase in home warranty insurance costs to consumers. The amount is likely to be influenced by:

- further decisions by the Courts about the losses that are able to be claimed under a policy after the contracted insurance period;
- the future costs of reinsurance;
- whether insurers charge a premium on future contracts to cover losses made in the early years.

Some insurers and reinsurers may choose to leave the market due to the uncertainty surrounding the product. A decrease in the number of insurers may reduce competition and also act to increase the price of insurance. It could also be expected that insurers will impose more rigorous eligibility criteria on builders, making it harder for some small builders to obtain insurance and stay in the industry.

A significant proportion of the retrospective increase in liability will fall on the NSW Government under an indemnity for homeowners covered by policies with the HIH insurance group. This indemnity is funded from a tax on general insurance premiums levied under the *Insurance Protection Act 2001*, by recovery from building contractors and developers and by claims made against the reinsurers for HIH and FAI. The increase in liability arising from the Supreme Court decision will not be able to be recovered from building contractors and developers due to the seven year limit on commencing proceedings for breach of statutory warranty. As a consequence, the increased liability will be funded by the existing tax on general insurance premiums and will extend the period that this tax continues to be collected. This tax will impact on all NSW residents who purchase insurance.

3. Objective of Government Action

The Government's objective is to clarify the legislation establishing the privately underwritten home warranty insurance scheme and to confirm that - since the introduction of the private scheme in 1997 - a claim for insurance has needed to be made during the period of insurance cover required under section 103B of the *Home Building Act 1989*.

In clarifying the legislation, the Government seeks to prevent unexpected and retrospective increases in the liabilities arising from insurance contracts entered into in the period since the private insurance scheme commenced in 1997.

This action will ensure that:

- home warranty insurance premiums do not rise significantly causing homeowners to face higher building costs;
- builders do not have difficulty obtaining home warranty insurance cover;
- NSW consumers do not face increased taxes on general insurance premiums levied under the *Insurance Protection Act 2001*; and
- the NSW Government does not face higher reinsurance liabilities.

5. Consultation

The Home Warranty Insurance Scheme Board has unanimously recommended that retrospective legislation be introduced as a matter of urgency to address the decision made by the Supreme Court. The Board is established under the *Home Building Act 1989* to monitor the operation of the scheme and to provide advice and recommendations to the Minister with respect to the scheme. The Insurance Council of Australia also supports the proposal.

The Office of Fair Trading consulted the Attorney-General's Department on the appropriateness of retrospective legislation and with the NSW Treasury regarding potential liabilities for the NSW Government and the need for immediate legislative action.

During the development of the legislation, the Office of Fair Trading expects to consult with relevant affected parties including the Insurance Council of Australia, insurers currently approved to provide home warranty insurance, the Home Warranty Insurance Scheme Board, the provisional liquidator for the HIH insurance group and the reinsurers for that group. If appropriate, the Office of Fair Trading will also consult with the Australian Prudential Regulation Authority (APRA) which regulates the insurance market and the Australian Securities and Investment Commission (ASIC) which administers the *Insurance Contracts Act 1984 (Cth)*.

It has not been possible to consult with homeowners in relation to this proposal. There is no peak body which specifically represents the interests of all homeowners. Consultation with homeowners that are currently involved in legal action appealing a refusal of a home warranty insurance claim would not be appropriate and would disadvantage other homeowners. The proposal will not disadvantage the vast majority of homeowners – but will ensure that the current understanding about the scope of the home warranty insurance scheme is maintained.

6. Preferred Option

The preferred option is to undertake a staged series of legislative amendments which will ultimately confirm that - since the introduction of the private scheme in 1997 - a claim for insurance has needed to be made during the period of insurance cover required under section 103B of the *Home Building Act 1989*. This option ensures that home warranty insurance premiums do not rise significantly, homeowners do not face higher building costs, builders can continue to obtain

insurance cover, taxes on general insurance premiums levied under the *Insurance Protection Act 2001* are not increased and reinsurance liabilities for the NSW Government are not increased. These benefits are considered to outweigh the costs to the limited numbers of homeowners who would be prevented from recovering compensation for a badly built property.

7. Evaluation and Review

The *Home Building Regulation 2004* including provisions dealing with the time period for making a home warranty insurance claim will be reviewed as part of the ongoing process of reviewing legislation which is subject to automatic repeal by the *Subordinate Legislation Act 1989*. The *Home Building Regulation 2004* is subject to automatic repeal on 1 September 2009 unless action is taken prior to that date to defer the repeal by one year.

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