ESSENTIAL SERVICES COMMISSION

Victoria's domestic building insurance scheme

Performance report 2018-19

29 November 2019

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Contents

Summary

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

Builders take out DBI on behalf of home owners. It is insurance to provide compensation to home owners for losses resulting from non-completion or defects in domestic building work where the builder cannot be pursued directly because they have died, disappeared, or become insolvent.[1] In Victoria, it is compulsory for builders to obtain DBI in all domestic construction contracts over $16,000 in value.[2]

Insurers may have incurred some DBI losses

A broad indication of the collective performance of insurers to price DBI profitably and general measure of the sufficiency of the DBI scheme is the simple loss ratio. For certificates and policies issued in a given year, it represents the cost of claims as a percentage of the premium revenue that was collected.

The simple loss ratios for certificates and policies issued in 2007, 2008, 2009 and 2010, are over 100 per cent. This means that the cost of claims made on certificates and policies issued in each of these years exceeds the premium revenue collected for those certificates and policies. It may appear insurers collectively made a loss on DBI in each of these years. However, this may not necessarily be the case as the simple loss ratio does not account for income insurers may have earned from investment returns on the premium revenue they collected.

Most registered builders seek eligibility with the Victorian Managed Insurance Authority

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

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

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

The Victorian Managed Insurance Authority (VMIA) issues the majority of DBI eligibility certificates to registered builders, with AssetInsure and Berkshire Hathaway Speciality Insurance (BHSI) only recently entering the DBI market.

The number of project certificates has increased

The total number of project certificates has increased by around six per cent each year since 2013, reaching 80,366 in 2018, with new dwellings accounting for the largest share.

The average premium per $1,000 of project value has decreased

The average premium per $1,000 of project decreased in 2017 and 2018 and is currently around $3.50. The decrease coincided with two insurers entering the DBI market and the VMIA establishing a new system for selling DBI.

Claims are made infrequently

As DBI is a long-tail insurance product, it is difficult to present claim numbers in their true context until at least seven years after the issue date of project certificates and policies. Nevertheless, on the whole it appears that claims are relatively infrequent in relation to the number of project certificates issued. The data for registered builders shows that insurers received 12,750 claims (compared to 970,068 certificates issued) since the DBI scheme commenced in 2002.

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

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

The time it takes for a claim to go through each stage of the claim process can be used to examine how the scheme is generally operating. It may also indicate how well consumers are being served. Since the scheme started in 2002, the average time between when a notification is received and when a claim is finalised is 429 days, or around 14 months.

The number of owner-builder policies has decreased

The number of owner-builder policies has been declining for 10 years, from a peak of almost 6,000 issued per year to less than 1,400 per year. Owner-builders are considered a higher risk category than registered builders and have a higher rate of claims, even though the total number of claims is very small (just 197 since 2002). The most common reason for claims against owner-builders is disappearance of the previous owner.

1. Introduction

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

1.1. What have we been asked to do?

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

We collect quarterly data from insurers. Although we undertake a series of checks, the data is not audited, so we rely on the accuracy of the data insurers provide. This latest performance report covers the period up to 30 June 2019.

We also have another ongoing role in reporting on DBI. This is to undertake reviews into the adequacy and validity of the VMIA's premiums every two years. Our latest review, the fourth, covering premiums for the period 1 July 2016 to 30 June 2018, was released in April 2019.

1.2. What is domestic building insurance?

Domestic building insurance (DBI) — also known as builders warranty insurance — is compulsory on all domestic construction contracts over $16,000 in value,[3] such as ***new dwellings***, renovations and swimming pools.[4] It compensates a home-owner for losses resulting from non-completion or defects, where their builder cannot be pursued directly for redress because they have died, disappeared, or become insolvent.[5]

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

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

4 DBI insurance is required for all residential buildings, except multi-storey residential buildings containing more than three storeys of accommodation.

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

DBI is taken out and paid for by builders on behalf of home-owners. A home-owner then has six years from a project's completion to make a claim, although experience shows it is possible for claims to be made up to 11 years following the issuing of a certificate.[6]

An ***owner-builder*** is a home-owner who is legally allowed to undertake building work over $16,000 on their property. They must also take out DBI if they sell the property within six and a half years of construction being completed. DBI cover for owner-builders is referred to as a policy rather than a project certificate.

1.3. The development of domestic building insurance

The current DBI scheme was first introduced in 2002, when the market was served by five competing private sector insurers. In 2010, all but one of these insurers announced that they would cease issuing DBI. This was likely due to uncertainty about the profitability of DBI. At this point, the VMIA began offering DBI following an official mandate from the government. Arrangements were made with QBE for it to act as the agent that sold DBI for the VMIA, with the VMIA initially adopting QBE's premium schedule. The VMIA has since developed its own premium schedule and established a new system for selling DBI which meant QBE ceased to act as its agent.[7]

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

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

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

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

All builders must obtain ***eligibility*** from a DBI insurer to maintain their registration with the ***Victorian Building Authority***.[8] Eligibility is a pre-approval from an insurer to take out DBI project certificates. Insurers use the eligibility process to evaluate the financial position of the builder and impose an annual ***turnover limit***, which is the insurer's assessment of the maximum value of building projects the builder can take on without risking insolvency.

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

DBI provides cover to a home-owner for defects in building work that occur up to six years from the completion of a building project.[9] It is referred to as ***long-tail insurance*** because of the long period of time faced by insurers between charging a premium and knowing the full cost of claims. This is distinct from other insurance products, like home contents policies or car insurance, where premiums are calculated annually, and the ***claims liability*** is generally known within a few months of the year's end.

The period of time that insurers must consider home-owners' claims against a policy is known as the ***liability period***.[10] As noted above, this period can vary between six and 11 years. The construction of a domestic dwelling could take three years while a renovation could be completed in two or three months. For our analysis, we assume that construction is completed 12 months after the certificate issue date. Insurers do not collect data on completion times from builders.

There is no limit in legislation on the time that can elapse between when a home-owner notifies an insurer of a claim and the submission of information required to open the claim. It is also possible for notifications that have been closed, to be re-opened for assessment years after they are first received by an insurer.

It is difficult to calculate the length of the liability period on a project certificate given that the construction period varies, and notifications can be re-opened. We consider seven years to be a reasonable assumption for analysis, while accepting that the liability period could extend to 11 years or even longer.

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

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

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

Insurers who leave the market are still liable for claims on the project certificates they issued before they left. This is known as a ***run-off period*** and will continue for at least six or seven years after the issue of a project certificate.

There are several key dates used to track a claim's progress that are used throughout this report (see table 1.1).

Table 1.1 Key dates in the DBI claim process

Date	Description
Certificate issue date	The date the project certificate is issued by the insurer, at the start of construction. This date is also known as the 'underwriting date' as it is the time when the premium is charged.
Loss date	The date a claimant became aware of a defect or failure. This date is supplied by the claimant.
Notification date	The date the insurer first receives notification of a potential claim. These 'notification-only claims' can be escalated into claims once the insurer has received the minimum information it needs to process it. If the notification has not been escalated within 90 days, it is closed on the insurer's system, but it can be re-opened at any time.
Claim received date	The date the insurer receives the minimum information required to open a DBI claim on their system.
Liability decision date	The date the insurer made the decision to accept or deny a claim. If no decision is made within 90 days, the claim is deemed to be accepted.
Claim finalised date	The date the claim was closed on the insurer's system with all costs paid out.

2. Scheme performance

Key messages

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

There is a lag between when premium revenue is collected and when claims can be made, which we assume to be seven years. The lag means a comparable assessment of scheme sufficiency cannot yet be made for certificates or polices issued after 2012.

The simple loss ratio for certificates and policies issued in 2007, 2008, 2009 and 2010 is over 100 per cent. While it may appear that insurers have collectively made a loss on DBI for each of these years, the simple loss ratio does not account for the income insurers may have earned from investment returns on the premium revenue they collected in those years.

This chapter examines the overall performance of the domestic building insurance (DBI) scheme in Victoria using a simple measure of scheme sufficiency that compares the cost of claims to premium revenue collected.

2.1. We assume a seven year lag in assessing scheme sufficiency

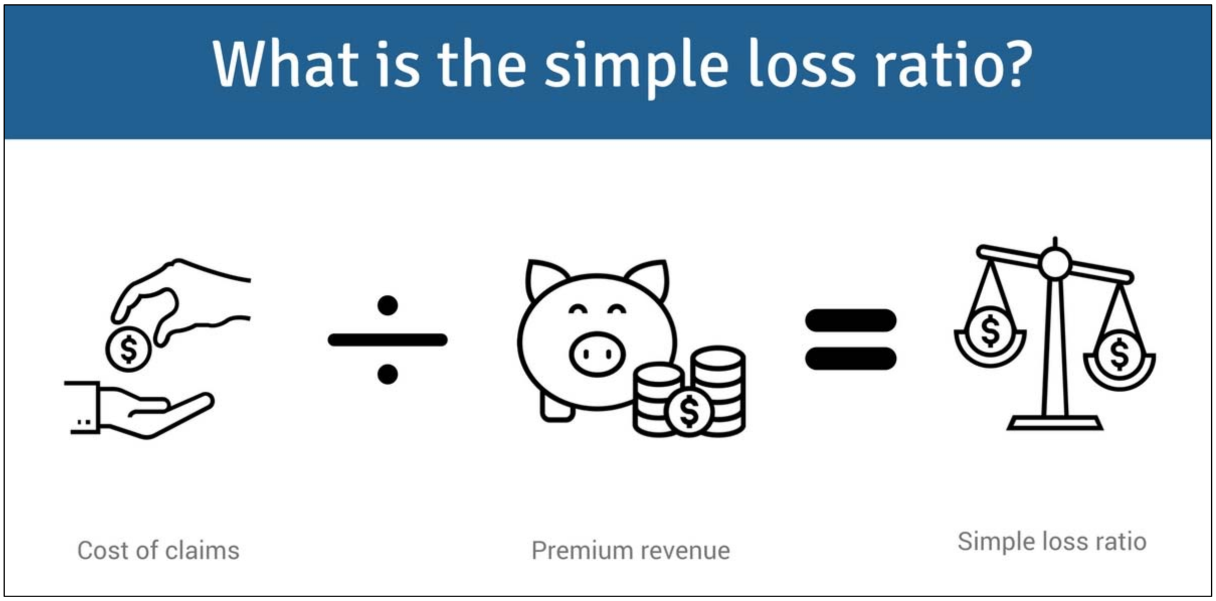
DBI is a type of long tail insurance. That is, there is a lag between when premium revenue for certificates and policies issued in a given year is collected, and when claims on those certificates and policies can be made. We assume this lag to be seven years.

The lag means that the cost of claims on certificates and policies issued in a given year may not be known for several years, and a reliable assessment of the scheme sufficiency cannot be made until at least seven years after those certificates and policies are issued. For this report, such an assessment cannot be made for certificates and policies issued after 2012. The assumed liability period on these certificates and policies has not yet ended so more claims could be made, and further costs could be incurred in the future.

2.2. Insurers may have incurred DBI losses from 2007 to 2010

A measure of the sufficiency of the DBI scheme is the simple loss ratio (represented in figure 2.1). The simple loss ratio compares the cost of claims made on certificates and policies issued in a given time period as a percentage of the premium revenue collected for those certificates and policies. This report uses calendar years as the given time period. The simple loss ratio does not account for inflation, investment returns or any other operating expenses.

Figure 2.1 The simple loss ratio



The simple loss ratio for a given year usually increases over time until the liability period on certificates and policies issued in that year has ended. This is because the total premium revenue collected in a given year does not change (premium revenue is collected when a certificate or policy is issued) while the cost of claims may change over time as new claims are made. The simple loss ratio for a given year should stop increasing when the liability period has ended. We assume the liability period to end seven years after the certificate or policy is issued.

Table 2.1 shows the premium revenue collected for certificates and policies issued each year and the cost of claims made on those certificates and policies as at 30 June 2019. These two data sets are used to calculate the simple loss ratio for each year. For example, in 2018, premium revenue collected was $68.9 million and the costs of claims made on those certificates and policies was $6.8 million as at 30 June 2019. This means the simple loss ratio for 2018 was 9.9 per cent as at 30 June 2019.

For reference, the table also shows the assumed number of years of liability remaining and the number of certificates and policies issued each year. The data covers all insurers and both registered builders and owner-builders.

Table 2.1 Scheme performance – Simple loss ratios

All insurers – as at June 2019

Calendar year	Number of certificates / policies	Premium excluding charges ($'000)	Net incurred costs ($'000) [a]	Assumed years of liability remaining [b]	Simple loss ratio (%)
2002	17,731	10,661	4,728	0	44.3
2003	40,305	27,521	14,662	0	53.3
2004	34,720	27,536	17,514	0	63.6
2005	46,975	31,986	20,899	0	65.3
2006	53,142	32,119	22,604	0	70.4
2007	54,690	30,574	30,682	0	100.4
2008	53,113	27,650	39,544	0	143.0
2009	61,555	34,251	46,035	0	134.4
2010	65,101	41,881	54,421	0	129.9
2011	61,355	44,330	41,738	0	94.2
2012	57,701	46,678	32,531	0	69.7
2013	61,221	54,925	25,583	1	46.6
2014	66,818	67,688	24,715	2	36.5
2015	71,119	75,715	38,490	3	50.8
2016	74,524	81,127	41,981	4	51.7
2017	80,034	76,061	19,473	5	25.6
2018	81,755	68,860	6,821	6	9.9
2019 (Jan-Jun)	36,200	30,717	255	7	0.8

[a] Includes all claim costs including for denied claims and notification only claims. Costs have been assigned to the year in which the project certificate was issued.

[b] Assumes a 12-month construction period plus a six-year liability period.

Figure 2.2 shows the simple loss ratio for each year as at 30 June 2019 (as listed in the table above). As at 30 June 2019, the simple loss ratios for certificates and policies issued in 2007, 2008, 2009 and 2010 are over 100 per cent. This means that the cost of claims made on certificates and policies issued in each of these years exceeds the premium revenue collected for those certificates and policies. It may appear insurers collectively made a loss on DBI in each of these years. However, this may not necessarily be the case as the simple loss ratio does not account for income insurers may have earned from investment returns on the premium revenue they collected.

Figure 2.2 Simple loss ratios for each calendar year
All insurers – as at 30 June 2019

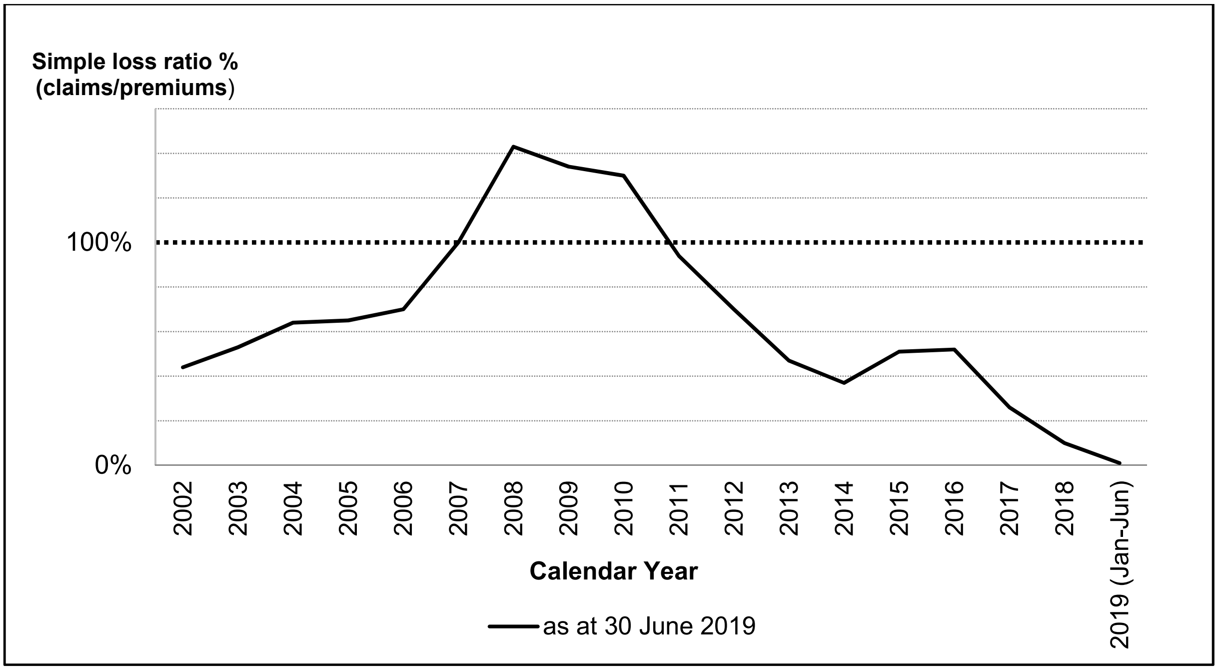
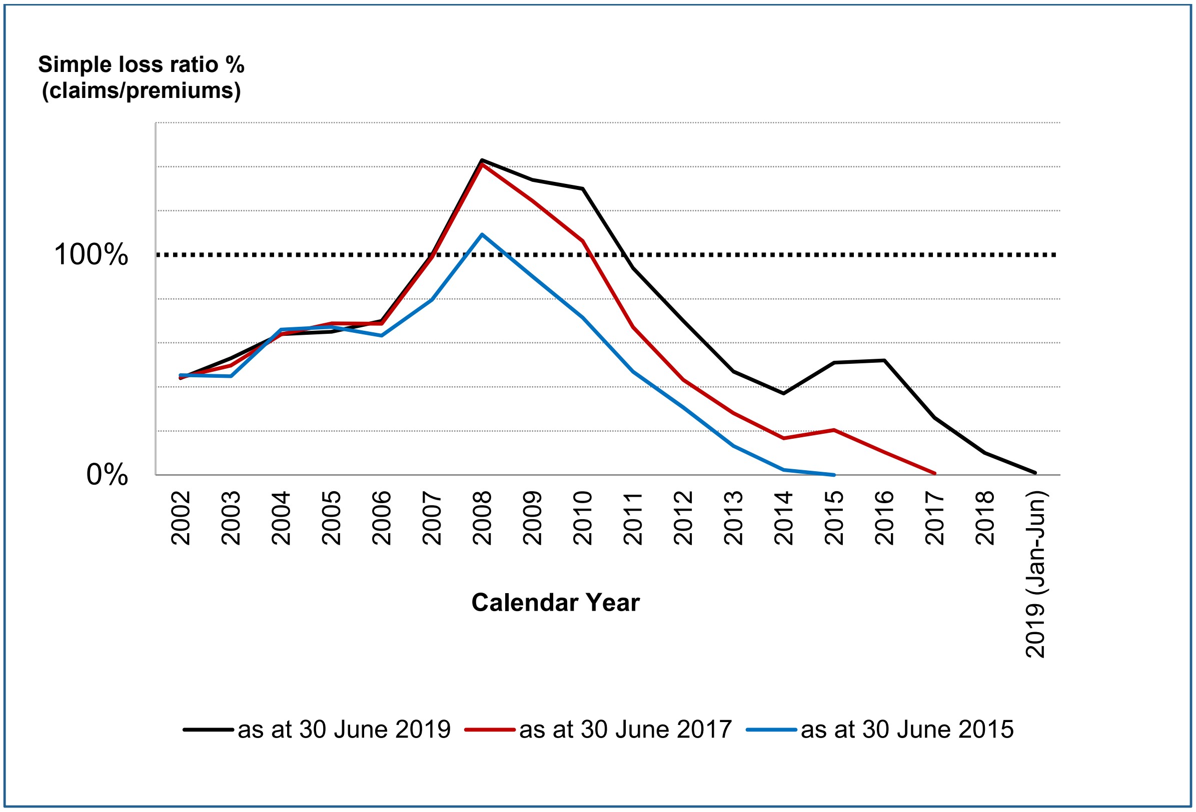


Figure 2.3 expands on figure 2.2 and shows how the simple loss ratio has changed over time. It shows the simple loss ratio as at 30 June 2019 (black), as at 30 June 2017 (red) and as at 30 June 2015 (blue). It shows that the simple loss ratio is over 100 per cent for four years as at 30 June 2019 (2007, 2008, 2009 and 2010) compared to three years as at 30 June 2017 (2007, 2008 and 2009), and one year as at 30 June 2015. These changes in the simple loss ratio over time illustrate the long tail nature of DBI with the years over 100 per cent only becoming apparent towards the end of the observed period.

Figure 2.3 Change in simple loss ratios over time

All insurers – as at 30 June 2015, as at 30 June 2017 and as at 30 June 2019



3. Eligibility, project certificates and premiums

Key messages

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

The total number of project certificates issued has increased each year since 2013.

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

The average premium for a project certificate per $1000 of project value decreased in 2017 and 2018. This coincided with two new insurers entering the DBI market and the VMIA establishing a new system for selling DBI.

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

This chapter presents data on eligibility, project certificates and premiums for registered builders. It also compares the number of new dwelling project certificates to new dwelling approvals as published by the Australian Bureau of Statistics (ABS).

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

Eligibility with an insurer for DBI is a form of pre-approval for taking out project certificates. Under the Domestic Building Contracts Act 1995, each time a builder enters a domestic building contract over $16,000 with a customer, the builder must take out a project certificate specific to the works covered by the contract.

Before granting eligibility, an insurer reviews a builder's business history and finances to assess their potential risk to the scheme. Insurers impose an annual turnover limit (the maximum value of building works the builder can undertake) based on their assessment of the value of works that a builder can prudently undertake given their financial position. In some circumstances, insurers require financial security or indemnity of some form before granting eligibility.

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

Turnover limits

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

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

Figure 3.1 sets out the share of eligible registered builders in each turnover band. It shows that most registered builders have a turnover limit of less than $1 million (46 per cent), $1 million to $2 million (24 per cent) or $2 million to $5 million (22 per cent). In contrast, only a small share of registered builders has a turnover limit of $5 million to $20 million (7 per cent) or $20 million plus (1 per cent). The share of eligible registered builders in each turnover band is similar to the same time last year.

This cannot be directly compared with the shares reported for 30 June 2017 and earlier due to a break in the time-series.[11] This means the shares of eligible registered builders for the years up to 30 June 2017 are counted on a different basis to any year that follows.

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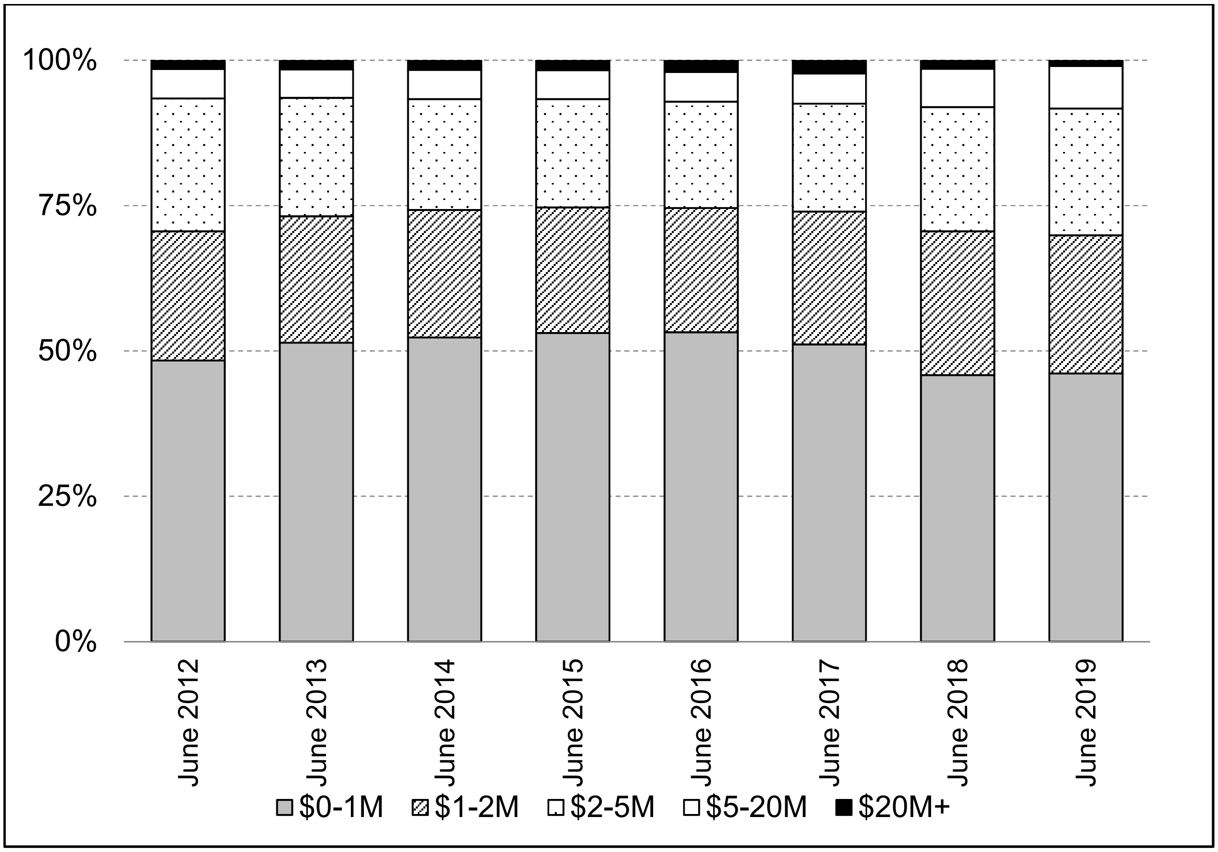
[11] The break in time-series is for eligibility data only. It does not affect any other data in this report.

Figure 3.1 Eligible builders by turnover band

Registered builders – June 2012 to June 2019



Note: the data for 30 June 2012 to 30 June 2017 is counted on a different basis to the data for 30 June 2018 and 30 June 2019.

3.2. The number of project certificates has increased

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

Table 3.1 shows the number of certificates issued for each category since 2005. On average, the total number of certificates issued has increased by six per cent each year since 2013 reaching 80,366 in 2018.

Table 3.1 Number of project certificates issued by type
Registered builders – January 2005 to June 2019

Calendar year	New dwellings	Structural renovations	Non-structural renovations	Swimming pools	Total
2005	27,978	8,105	3,424	3,049	42,556
2006	30,052	10,125	3,887	3,273	47,337
2007	32,400	10,905	3,959	3,310	50,574
2008	32,155	9,377	4,301	4,113	49,946
2009	40,681	9,681	4,298	3,865	58,525
2010	43,474	10,778	4,997	3,165	62,414
2011	40,241	10,263	6,706	2,046	59,256
2012	34,684	12,205	7,270	1,759	55,918
2013	36,658	13,091	5,121	4,185	59,055
2014	43,141	13,616	4,103	4,057	64,917
2015	47,126	14,297	3,435	4,389	69,247
2016	50,062	15,254	3,223	4,420	72,959
2017	53,598	16,753	4,266	3,774	78,391
2018	52,681	17,025	4,914	5,746	80,366
2019 (Jan-Jun)	22,536	8,686	2,292	2,163	35,677

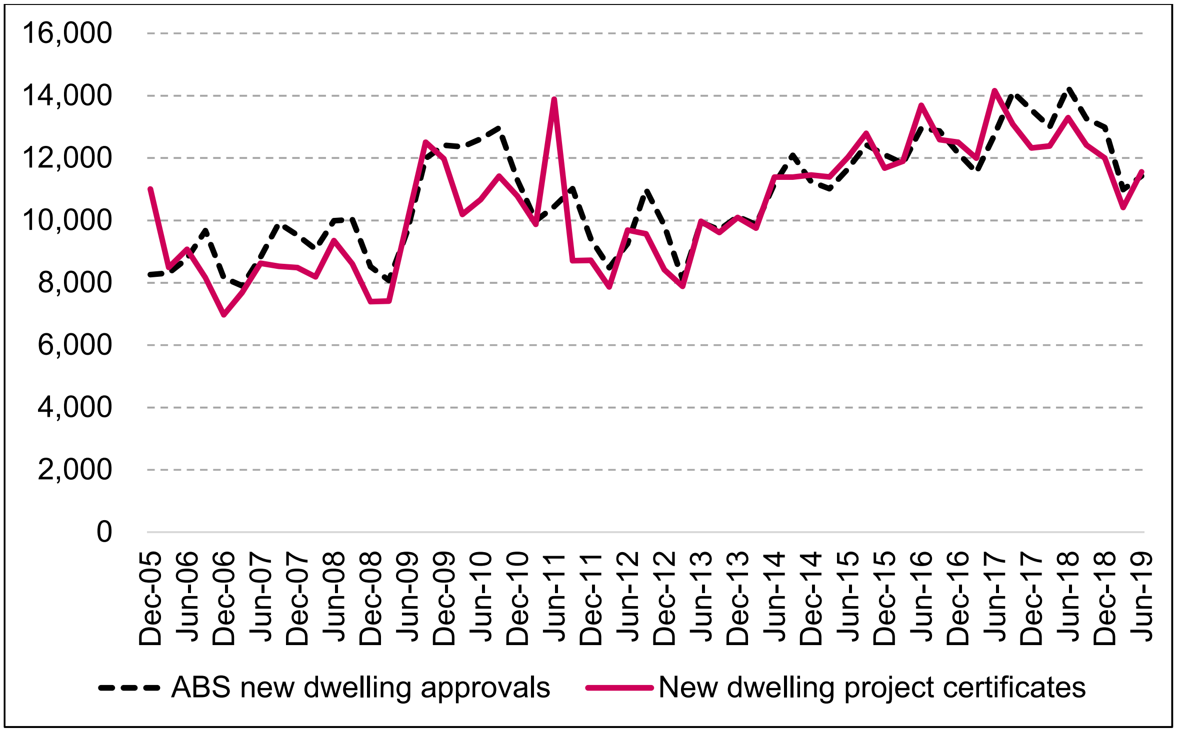
New dwelling project certificates

Most project certificates are issued for the construction of new dwellings. Around 66 per cent of certificates issued in 2018 were for new dwelling construction. This is slightly lower compared to 2017 (68 per cent).

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

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

Figure 3.2 Number of new dwelling approvals and project certificates in Victoria
Registered builders – December 2005 to June 2019



3.3. The average premium has decreased

Insurers set DBI premiums so that premium revenue, combined with investment and other income, adequately covers the expected future cost of claims and administration costs to ensure profitability. Insurers calculate a premium for a specific project, taking into consideration the value of the work, the type of work and the builder's risk rating (as determined by the insurer).

Premiums may differ according to project type, builder risk rating and project value.[12] Table 3.2 shows the total premium revenue collected, the average premium, the total project value, the

[12] For example, the VMIA publishes its premium schedule on its website and it is based on the following parameters:
- the value of the contracted works (in bands)
- the category of work (structural, non-structural, swimming pools) and
- the insurer's rating of the builder's individual risk (A, B, or C).

average project value, the average premium and average premium per $1,000 of project value for each year since 2005.

Despite fluctuations in in recent years, the average premium per $1,000 of project value is 19 per cent lower as at 30 June 2019 compared to 2005.

Table 3.2 Number of project certificates issued, value of project and premiums
Registered builders – January 2005 to June 2019

Calendar year	Number of project certificates	Premiums ($m)[a]	Average premium of a project certificate ($)	Value of project certificates ($m)	Average project value ($'000)	Average premium per $1,000 project value ($)
2005	42,556	27.4	644	6,839	161	4.01
2006	47,337	28.3	598	8,035	170	3.52
2007	50,574	27.3	540	8,779	174	3.11
2008	49,946	25.2	504	8,954	179	2.81
2009	58,525	32.0	546	10,718	183	2.98
2010	62,414	39.7	636	12,195	195	3.25
2011	59,256	42.3	714	12,059	204	3.51
2012	55,918	44.9	804	10,917	195	4.12
2013	59,055	52.9	896	11,609	197	4.56
2014	64,917	65.9	1,015	13,828	213	4.76
2015	69,247	73.9	1,067	15,750	227	4.69
2016	72,959	79.5	1,089	17,657	242	4.50
2017	78,391	73.8	941	19,731	252	3.74
2018	80,366	67.1	835	20,616	257	3.26
2019 (Jan-Jun)	35,677	30.2	848	9,312	261	3.25

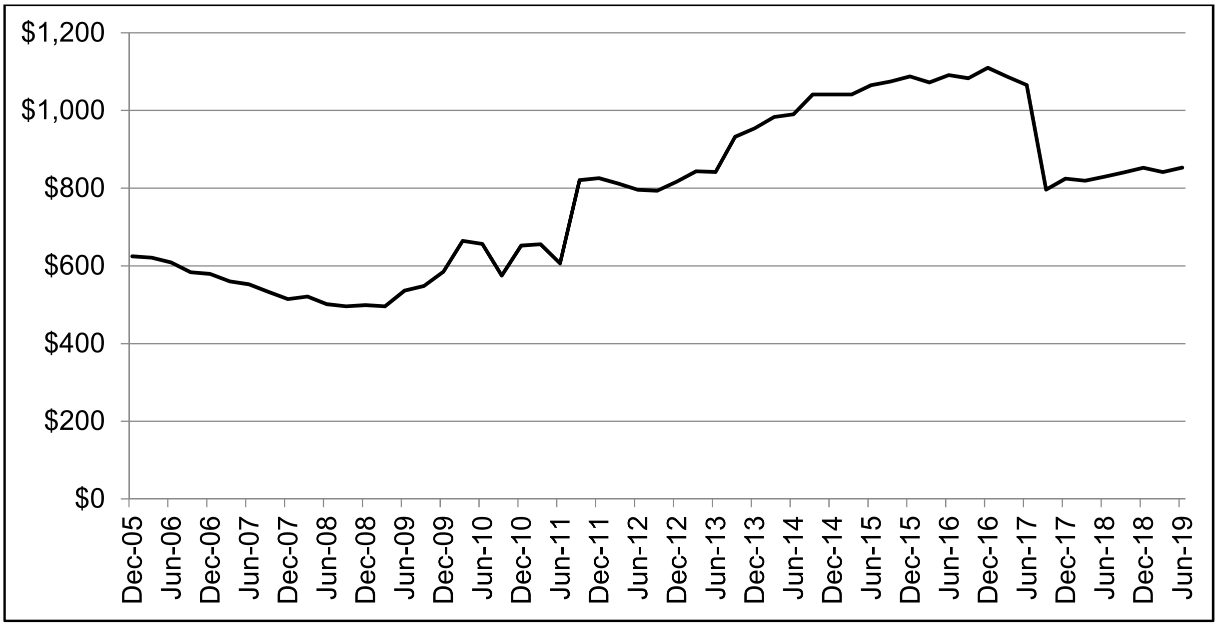
[a] Excludes GST, stamp duty and brokerage

3.3.1. Average premium of a project certificate

Figure 3.3 shows how the average premium has changed each quarter since December 2005. The average premium decreased each year between 2005 and 2008 reaching around $500 per quarter in 2008, possibly due to competitive pressures and the newness of the DBI market at the time. Following the withdrawal of all but one of the competing insurers, and the entry of the VMIA into the market, the average premium increased between 2008 and 2016 peaking at $1,100 in December 2016. The average premium then decreased from 2017 and is currently around $850. The decrease coincided with two new insurers entering the DBI market and the VMIA establishing a new system for selling DBI.

Figure 3.3 Average premium for a project certificate [a]

Registered builders – December 2005 to June 2019



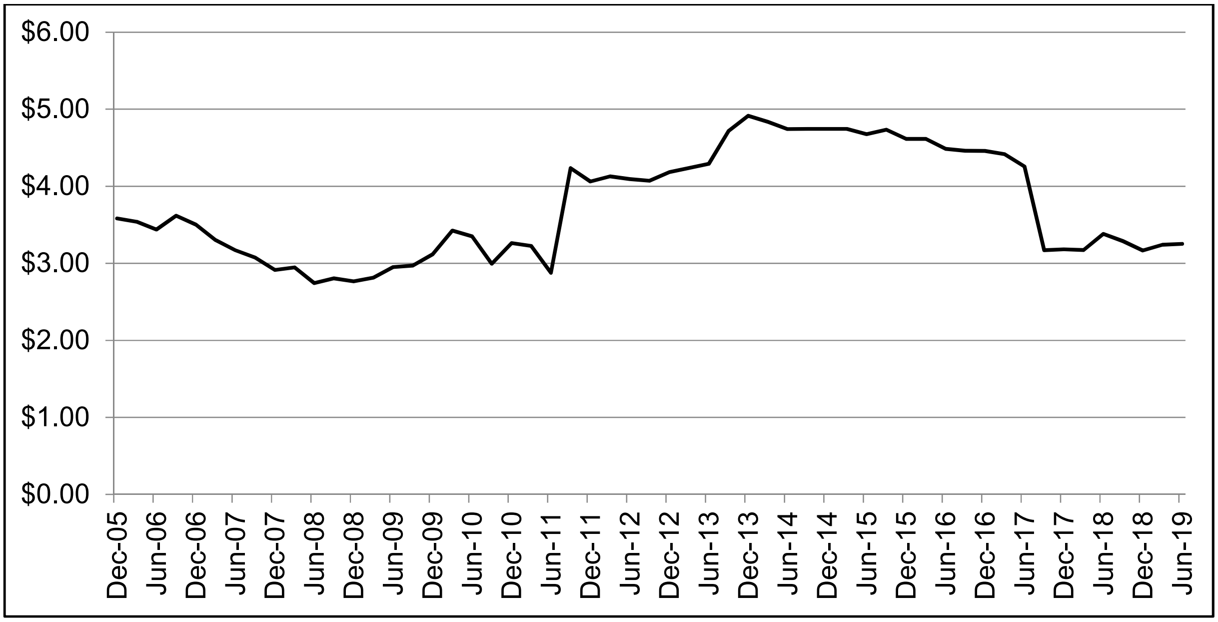
[a] Excludes GST, stamp duty and brokerage

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

Premiums can also be expressed per $1,000 of project value (premium rate) which allows for a comparison of premiums on a set level of project value over time. Figure 3.4 shows the average premium rate for each quarter since December 2005. The average premium rate was around $3.00 between 2005 and 2011 and increased to around $4.00 to $5.00 between 2011 and 2016. The average premium rate then decreased in 2017 and is currently around $3.50. The decrease coincided with two insurers entering the DBI market and the VMIA establishing a new system for selling DBI.

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

Registered builders – December 2005 to June 2019



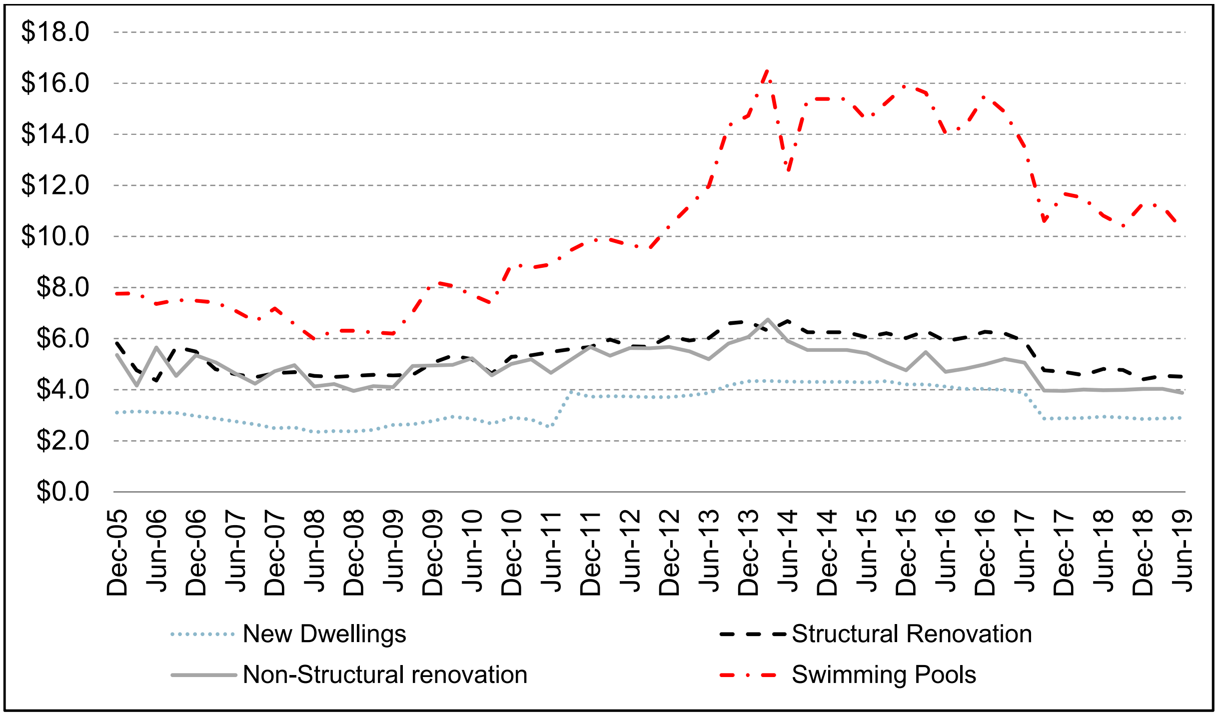
[a] Excludes GST, stamp duty and brokerage

The challenge for insurers is to set an efficient premium structure – that is, to match the premium paid for the project certificate with the risk to the insurer that is presented by the builder and project covered by the certificate. Historically, this has seen higher value projects generally presenting lower risk and therefore these projects have attracted lower premium rates. As such, high volume, high value categories of building (e.g. new dwellings) have always had the lowest premium rates. Swimming pools, which have a relatively low project value, have had the highest premium rates.

Figure 3.5 shows the average premium rate by project type for each quarter since December 2005. It shows that the average premium rate has been consistently higher for swimming pools than new dwellings, structural renovations and non-structural renovations. In particular, the average premium rate for swimming pools was around $10.00 compared to $3.00 for new dwellings in 2018.

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

Registered builders – December 2005 to June 2019



[a] Excludes GST, stamp duty and brokerage

Premium validation reviews

The VMIA's premiums are reviewed by the commission every two years. In our fourth and most recent DBI premium validation review, we concluded that (for the 1 July 2016 to 30 June 2018 period) the VMIA's:

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

4. Project certificate claims

Key messages

Domestic building insurance (DBI) claims are relatively infrequent compared to the number of project certificates issued each year (around 1 in 100). Insurers have received 12,750 claims from 887,138 certificates issued since the scheme was introduced in 2002.

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

Claim turnaround times are an important indicator of scheme performance. Since the scheme began, the average time between receiving a notification and a claim being finalised is 429 days, or just over 14 months. However, there can be large variations between insurers.

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

This chapter presents data on claims made on project certificates by claim status, type, cause, frequency, costs, time period and reasons denied.

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

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

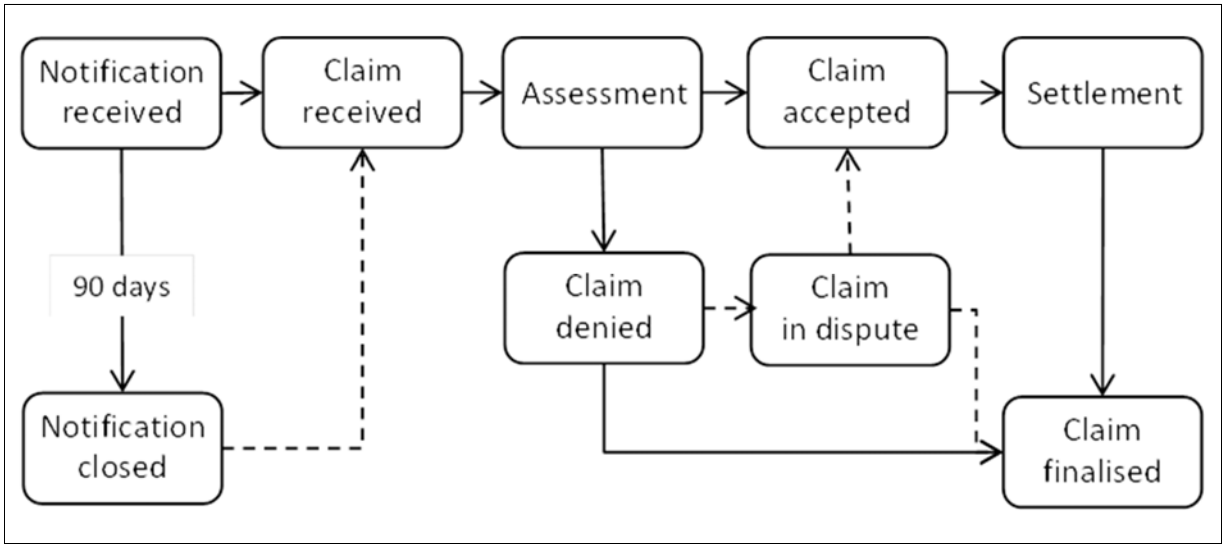
4.1. How are domestic building insurance claims made?

Claims under Victoria's domestic building insurance (DBI) scheme can only be made under specific circumstances. The Domestic Building Contracts Act 1995 contains a number of implied warranties concerning a builder's work. DBI claims are only available where rights under these warranties cannot be pursued through the legal system because the builder has died, disappeared or become insolvent.[13]

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

When a customer notifies their insurer that they would like to make a claim, the claim passes through multiple stages. This claims process is shown in figure 4.1.

Figure 4.1 DBI claims process



Notifications

A certificate or policy holder may notify an insurer of a fault at any time after the project certificate has been issued by providing basic information. This notification does not escalate into a claim until the certificate holder provides the minimum information the insurer needs to process it. If the minimum information is not received within 90 days, the notification is closed but remains on file. A notification may also be re-opened at a later stage and escalated into a claim.

Claims

In some cases, the minimum information is received immediately and a claim is opened without a notification period. Once a claim is opened, the insurer can complete its assessment and decide on

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

the liability of the claim. The insurer may, among other things, investigate the builder to determine whether their situation meets one of the triggers for a claim and examine whether the reported defect or non-completion qualifies for compensation.

The assessment period may be a matter of days or months depending on the individual circumstances. The insurer then accepts or denies liability for the claim. If the insurer accepts liability, a settlement period begins in which the compensation is calculated and paid. The claim is finalised and closed once the claim is fully settled with the claimant. If the insurer denies liability, the claimant may dispute the insurer's decision; otherwise the claim is finalised and closed.

4.2. Most domestic building insurance claims are accepted

The status of a notification can be considered as open or closed. While a notification is open, it can be escalated into a claim. A notification is opened when a certificate holder notifies an insurer by providing basic information of a fault at any time after a certificate has been issued. A notification is closed if the insurer does not receive the minimum information within 90 days.

A claim's status can be considered open or closed. A claim also has a liability status: pending, accepted or denied.

Table 4.1 shows the number of claims and notifications each year since 2002. Insurers have received 12,750 claims and 2,489 notifications since the scheme began in 2002. As at 30 June 2019, 85 per cent of claims (10,899 of 12,750) were closed and finalised and 92 per cent of notifications (2,286 of 2,489) were closed. Of the 10,899 closed and finalised claims, 71 per cent were accepted.

Table 4.1 Number of claims and notifications by status
Registered builders – January 2002 to June 2019

	Open	Closed / finalised	Total
Claims			
Accepted [a]	1,310	7,773	9,083
Pending [b]	488	0	488
Total accepted or pending	1,798	7,773	9,571
Liability denied	53	3,126	3,179
Total claims	1,851	10,899	12,750
Notifications	203	2,286	2,489
GRAND TOTAL	2,054	13,185	15,239

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

4.3. Most claims due to builder insolvency and structural defect

A claim can be defined by its cause (or trigger): insolvency, death or disappearance[14] and its type: failure to commence, failure to complete, structural defect or non-structural defect.

Table 4.2 shows the number of claims by cause and type. Insolvency is the most common claim caue (93 per cent) and structural defect is the most common claim type (49 per cent).

Table 4.2 Number of claims by type and cause

Registered builders – January 2002 to June 2019

Cause (→) Type (↓)	Insolvency	Death	Disappearance	Other / Unspecified [a]	Total	Type (%)
Failure to commence	293	4	7	0	**304**	2.4%
Failure to complete	3,187	39	150	9	**3,385**	26.5%
Structural defect	5,676	101	465	4	**6,246**	49.0%
Non-structural defect	2,499	37	97	3	**2,636**	20.7%
Not yet determined	171	0	8	0	**179**	1.4%
Total	**11,826**	**181**	**727**	**16**	**12,750**	**100%**
Cause (%)	92.8%	1.4%	5.7%	0.1%	**100%**	

Note: excludes notifications.

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

4.4. Claims are made infrequently

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

Table 4.3 shows the number of claims made on certificates issued in a given year and the total number of certificates issued in that year. 2002 to 2012 have been shaded to indicate that the assumed liability period on certificates issued in these years has ended. The liability period on certificates issued since 2012 is considered to be active.

On average, claims have been made on 1.55 per cent of certificates issued in each year between 2002 and 2012. The highest rates of claims have been made on certificates issued in 2010 (2.39 per cent) and 2011 (2.32 per cent).

For certificates issued from 2012 onwards, the highest rate of claims has been made on certificates issued in 2016 (1.52 per cent). However, it will not be known how this compares to years before 2012 until the liability period on these certificates has ended.

Table 4.3 Frequency of claims received over time

Registered builders – January 2002 to June 2018

Calendar year	Claims by certificate issue year	Number of certificates issued	Percentage of claims to certificates (%)	Years of liability remaining [a]
2002	158	14,663	1.08%	
2003	404	36,935	1.09%	
2004	364	31,332	1.16%	
2005	556	42,556	1.31%	
2006	604	47,337	1.28%	
2007	837	50,574	1.66%	
2008	790	49,946	1.58%	
2009	828	58,525	1.41%	
2010	1,489	62,414	2.39%	
2011	1,373	59,256	2.32%	
2012	1,020	55,918	1.82%	
2013	750	59,055	1.27%	1
2014	611	64,917	0.94%	2
2015	993	69,247	1.43%	3
2016	1,106	72,959	1.52%	4
2017	649	78,391	0.83%	5
2018	202	80,366	0.25%	6
2019 (Jan-Jun)	16	35,677	0.04%	7
Total	12,750	970,068		

Note: includes all open and finalised claims. Excludes notification only claims.

[a] This is an assumed number of years of liability remaining.

4.5. The average cost of claims

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

Box 4.1	Calculating net incurred costs	
	Item	Description
	$ Paid to claimant	Payments made directly to the home-owner to date
plus	$ Paid to third party	Includes cost of investigation, structural assessments, legal fees, etc
less	Third party recoveries	Monies recovered from builders, suppliers, other insurances, etc
plus	Outstanding estimate	Insurer's estimate of the future costs relating to the claim. A finalised claim has no outstanding costs.
equals	**Net incurred costs**	Insurer's total liability at given point in time

When setting premium levels, the total net incurred costs are more significant to insurers than the total number of claims received, as it is the cost of claims (as measured by net incurred costs) that drives insurers' profitability levels. Some accepted claims may incur no claim-related costs, while some rejected claims may incur claim-related costs.

Average cost of claims by stage of claims process

Table 4.4 shows the cost of claims (net incurred and average) at different stages of the claims process: notification only, open and pending, open and decided, and closed and finalised.

The average cost is lower for finalised claims ($36,823) compared with open and decided claims ($66,327) where insurers estimate the cost of the outstanding liabilities. This could indicate either that actual costs tend to come in under insurers' estimates or that costs are higher for more recent claims which are not yet finalised.

Table 4.4 Average cost of claims at different stages of claims process

Registered builders – January 2002 to June 2018

	Notifications	Claims				
	Notification only	Open and pending [a]	Open and decided	Closed and finalised – total	Closed and finalised – accepted	Closed and finalised – denied
Number of claims	2,286	488	1,363	10,899	7,773	3,126
Sum paid to claimant ($'000)	0	3,236	38,483	368,459	366,601	1,858
(plus) Sum paid to third parties ($'000)	88	527	6,799	43,705	40,295	3,410
(less) Sum of third-party recoveries received ($'000)	0	0	951	10, 760	10,693	67
(plus) Sum of net outstanding ($'000)	21	2,888	22,568	0	0	0
Sum of net incurred cost ($'000)	109	6,218	66,327	401,336	396,136	5,199
Average cost per claim ($)	48	12,743	48,662	36,823	50,963	1,663

[a] Includes claims in dispute

Average cost of claims by type

Table 4.5 shows the average cost of claims by type. The average cost is highest for failure to complete claims, which make up around 31 per cent of the total number of accepted-finalised claims. The average cost for failure to complete claims is nearly 20 per cent higher than the average cost of the next most costly type of claim (structural defect claims).

Table 4.5 Average cost of claims (accepted-finalised) by type
Registered builders – January 2002 to June 2019

	Number of accepted-finalised claims	Net incurred costs ($000)	Average cost per claim ($)
Failure to commence	236	4,435	18,793
Failure to complete	2,421	156,215	64,525
Structural defect	3,632	185,329	51,027
Other (non-structural) defect	1,484	50,156	33,798
Total	7,773	396,136	50,963

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

4.6. The average turnaround time for accepted claims is 14 months

The time it takes for a claim to go through each stage of the claim process can be used to examine how the scheme is operating in general, and may give an indication of how well consumers are being served by insurers. Looking at the claims that have been accepted and finalised claims since the DBI scheme started in 2002, the average time between a claim being received and a claim being finalised is 429 days (or about 14 months).

There are two key stages: time between when a claim is received and when a liability decision is made, and time between when a liability decision is made and when a claim is finalised.

The average time between when a claim is received and when a liability decision is made is 61 days. The average time between when a liability decision is made and when a claim is finalised is 386 days. The shorter initial stage is likely a result of DBI legislation; if an insurer has not made a liability decision within 90 days of receiving minimum claim information, the claim is deemed to be accepted. In contrast, the final stage can be influenced by many factors such as an insurer's approach to handling claims or whether a claimant contests the insurer's liability decision.

4.7. Most common reason for claims denied are fault not deemed a defect or builder not insolvent

There are several reasons why an insurer may deny a claim. Table 4.6 shows the number of claims denied by reason. The most common reason for insurers denying claims are the fault was not deemed a defect (39 per cent) or the builder was not insolvent (23 per cent).

Table 4.6 Number of claims denied by reason

Registered builders – January 2002 to June 2019

Reason	Number of claims	Proportion (%)
Incorrect insurer	142	4.5
Out of time	289	9.1
Builder found	218	6.9
Builder not dead	9	0.3
Builder not insolvent	741	23.3
Not deemed a defect	1,228	38.6
No loss	273	8.6
Owner did not proceed	279	8.8
Total	**3,179**	**100**

5. Owner-builder policies, premiums and claims

Key messages

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

The number of owner-builder policies has been declining since 2006, from almost 6,000 a year to less than 1,400 a year.

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

The average cost of a closed and finalised claim is around $17,770.

The most common reason for claims against owner-builders is disappearance of the previous owner. It is more difficult for new owners of a property to track down the original owner-builder to rectify faults.

This chapter presents data on policies, premiums and claims for owner-builders. The analysis in this chapter excludes Berkshire Hathaway Specialty Insurance (BHSI).

5.1. Which owner-builders require domestic building insurance?

An owner-builder is defined as someone who carries out building work on their own property. Owner-builders are generally not in the building industry but must obtain a 'certificate of consent' from the Victorian Building Authority if their building work is valued at more than $16,000.[15]

Owner-builders who sell a property within six and a half years of the completion of work, for which they have obtained a certificate of consent, must obtain domestic building insurance (DBI). They are required to provide the new owner with evidence of this DBI policy and a report on any building defects.[16] In this way, owner-builder DBI is quite distinct from the DBI purchased by a registered builder.

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

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

The insurance policy (which is similar to a project certificate issued to a registered builder) is for the benefit of the new owner and any subsequent new owners in the event that the owner-builder dies, disappears or becomes insolvent, and the building work is defective.[17]

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

5.2. The number of owner-builder policies issued has decreased

Table 5.1 shows the number of policies issued each year since 2002. It also shows the value of policies and premium revenue collected each year. There has been an overall downward trend in the number of policies issued since 2006 peaking at almost 6,000 in 2006 and declining to less than 1,400 in 2018. In particular, the number of policies issued decreased by 15 per cent in 2018. The value of policies and premium revenue collected also decreased by 11 and 23 per cent, respectively, in 2018.

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

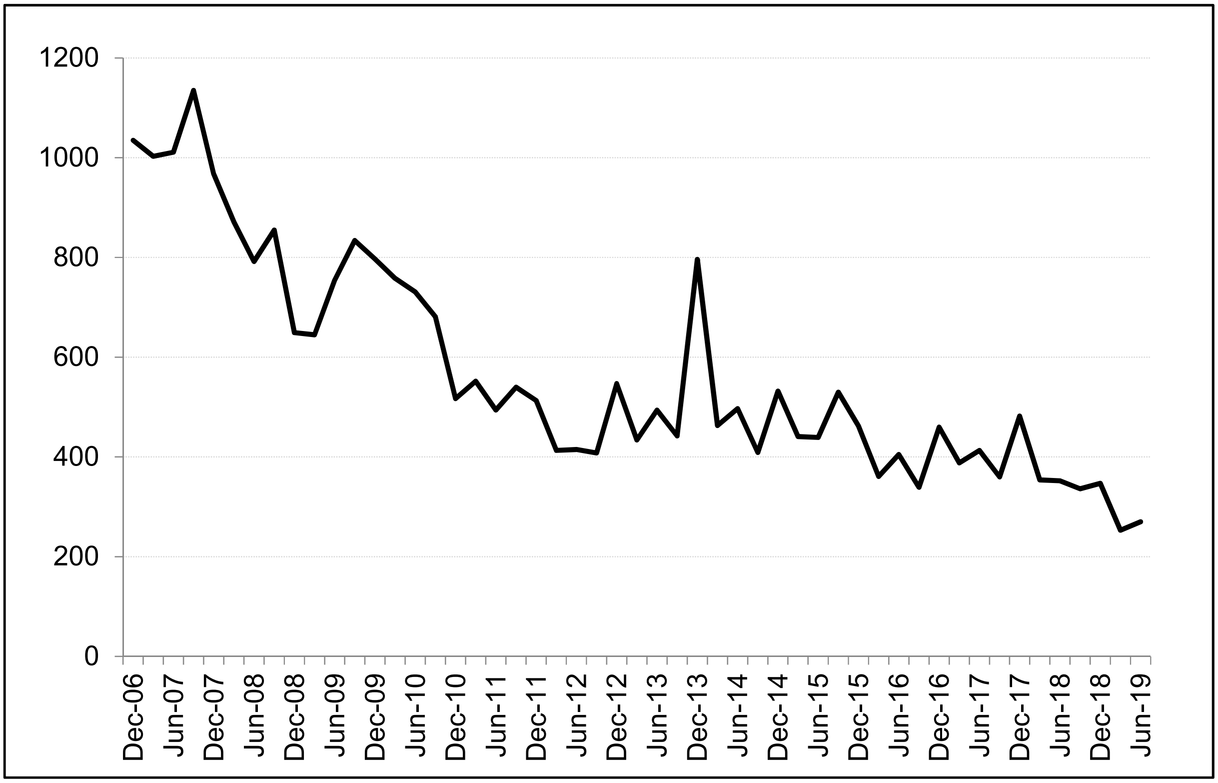
Table 5.1 Number of policies issued, value of policies and premiums
Owner-builders – January 2002 to June 2019

Calendar year	Number of policies	Value of policies ($’000)	Total premiums ($’000)	Average premium per $1,000 of project value ($)
2002	3,068	363 702	645	1.77
2003	3,370	405 389	744	1.84
2004	3,388	457 190	3,714	8.12
2005	4,645	694,034	4,983	7.18
2006	5,805	952,246	3,804	3.99
2007	4,116	674,972	3,285	4.87
2008	3,167	549,537	2,470	4.50
2009	3,030	492,269	2,301	4.67
2010	2,687	471,311	2,196	4.66
2011	2,099	373,092	1,992	5.34
2012	1,783	318,538	1,731	5.43
2013	2,166	383,343	2,022	5.27
2014	1,901	359,358	1,803	5.02
2015	1,872	350,733	1,801	5.13
2016	1,565	290,935	1,650	5.67
2017	1,643	451,980	2,270	5.02
2018	1,389	400,931	1,744	4.35
2019 (Jan-Jun)	523	112,574	480	4.26

Figure 5.1 shows the number of policies issued each quarter since December 2005. The number of policies issued peaked at over 1,100 in September 2007 declining to around 350 per quarter in 2018.

Figure 5.1 Number of policies issued by quarter

Owner-builders – September 2006 to June 2019



5.3. The average premium is higher for owner-builders than registered builders

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

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

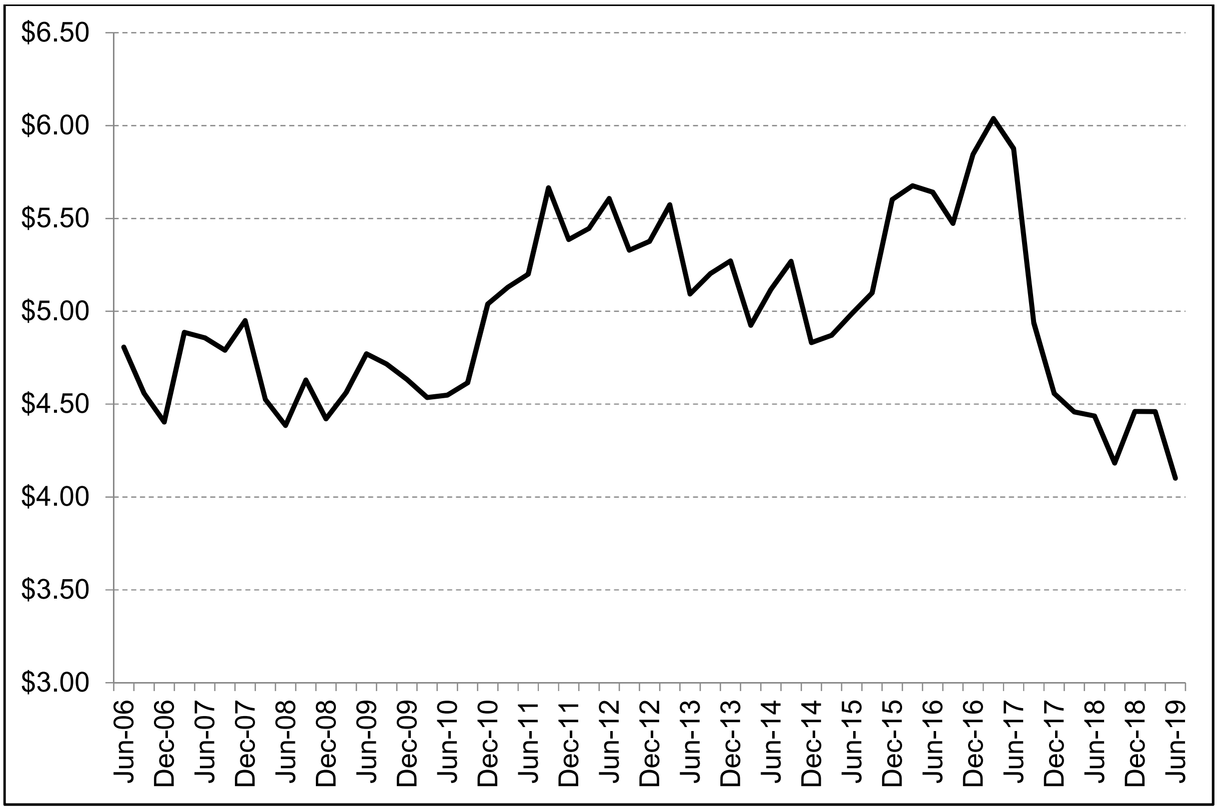
The difference in insurers’ treatment of owner-builder and registered builder risk is shown in premiums. The average premium rate for owner-builders was around $4.50 per $1,000 of project value in 2018, while the average premium rate for registered builders was around $3.00 per $1,000 of project value.

Average premium per $1,000 of project value

Figure 5.2 shows the average premium per $1,000 of project value for each quarter since June 2006. The average premium per $1,000 of project value was around $4.50 to $5.00 between 2006 and 2010, $5.00 to $5.50 between 2010 and 2015, and $5.50 to $6.00 between 2015 and 2017. It has since decreased and is currently around $4.00 to $4.50. The decrease coincided with the VMIA establishing a new system for selling DBI.

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

Figure 5.2 Average premium per $1,000 of project value
Owner-builders – June 2006 to June 2019



5.4. Owner builder claims

Owner-builders are considered a higher risk category than registered builders and have a higher rate of claims even though the total number of claims is very small. Table 5.2 shows the number of claims by status. 197 owner-builder claims have been accepted since 2002.

The ratio of accepted claims to denied claims is roughly 3:4 compared to 3:1 for registered builders. The higher proportion of denied claims for owner-builders (compared to registered builders) could be attributable to the lack of centralised information about the location of owner-builders, which leads consumers to use a DBI claim as a first step in investigating any problems.

Table 5.2 Number of claims by status

Owner-builders – January 2002 to June 2019

	Open	Closed	Total
Accepted [a]	6	191	197
Pending [b]	1	0	1
Total accepted or pending	**7**	**191**	**198**
Claims denied	1	269	270
Total claims	**8**	**460**	**468**
Notifications [c]	2	79	81
GRAND TOTAL	**10**	**539**	**549**

[a] Includes deemed, fully, and partially accepted claims. Excludes claims where cause not yet determined.

[b] Includes claims being assessed and claims in dispute.

[c] Notification only claims can be escalated into claims on provision of minimum information. If the notification has not been escalated within 90 days, it is closed on the insurer's system but can be re-opened at any time.

Number of accepted claims by cause

Table 5.3 shows the number of accepted owner-builder claims by cause. The most common reason for claims on owner-builder policies is disappearance of the previous owner. It is more difficult for the new owners of a property to track down the original owner-builder to rectify any faults.

Table 5.3 Number of accepted claims by cause
Owner-builders – January 2002 to June 2019

Cause	Number of claims	Proportion (%)
Insolvency	76	39
Death	5	3
Disappearance	116	59
Total	**197**	**100**

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

Number of denied claims by reason

Table 5.4 shows the number of claims denied by reason. The most common reasons for claims denied are builder found (46 per cent) and builder not insolvent (24 per cent).

Table 5.4 Number of denied claims by reason
Owner-builders – January 2002 to June 2019

Reason	Number of claims	Proportion (%)
Incorrect insurer	2	0.7
Out of time	32	11.9
Builder found	125	46.3
Builder not dead	2	0.7
Builder not insolvent	64	23.7
Not deemed a defect	38	14.1
No loss	0	0.0
Owner did not proceed	7	2.6
Total	**270**	**100.0**

Average cost of claims by stage of claims process

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

The average cost of closed and finalised claims ($17,770) is much lower than open and decided claims ($62,279) where the insurer is estimating the cost of the outstanding liability. This could indicate either actual costs tend to come in under the insurer's estimate, or the costs are higher for more recent claims which are not yet finalised.

Based on the 191 finalised-accepted claims to date, the average cost of claims made on owner-builder policies is $40,676.

Table 5.5 Average cost of claims at different stages of the claims process

Owner-builders – January 2002 to June 2019

	Notifications	Claims				
	Notification only	Open and pending [a]	Open and decided	Closed and finalised – total	Closed and finalised – accepted	Closed and finalised – denied
Number of claims	100	1	8	460	191	269
Sum paid to claimant ($'000)	0	0	341	6,164	6,029	135
(plus) Sum paid to third parties ($'000)	10	0	40	2,593	2,323	270
(less) Sum of third-party recoveries received ($'000)	0	0	0	581	581	0
(plus) Sum of net outstanding ($'000)	0	2	119	0	0	0
Sum of net incurred cost ($'000)	**10**	**2**	**498**	**8,174**	**7,769**	**405**
Average cost per claim ($)	98	2,000	62,279	17,770	40,676	1,505

[a] Includes claims in dispute

Glossary

Term	Definition
Berkshire Hathaway Specialty Insurance (BHSI)	A private insurer that started providing DBI in 2018.
Claims liability	The cost of a claim to an insurer. This includes money paid out as well as estimates of future costs.
Died, disappeared or insolvent	The three triggers for a claim under Victoria's DBI scheme. On 1 July 2015, the VMIA added a fourth trigger – failure to comply with a Tribunal or Court Order.
Domestic building insurance (DBI)	A mandatory insurance that compensates home owners for non-completion or defect where the builder is unable to rectify the works because they have died, disappeared or become insolvent (also referred to as builders warranty insurance).
Dwelling	A home as described in a project certificate or policy that can be owned individually.
Eligibility	Pre-approval from an insurer for a builder to purchase domestic building insurance for domestic building projects up to an approved turnover limit.
Investment returns	The revenue earned by an insurer from investing premium revenue.
Liability period	The period of time that an insurer is liable for claims on a project certificate/policy.
Long tail insurance	Insurance products where the full cost of claims is not known for a long time after the premium is charged.
New dwelling	One of four categories of domestic building insurance that refers to the building of a new home.
Owner-builder	A person who constructs or renovates a domestic building on his or her own land, who is not in the business of building.

Term	Definition
Policy	For owner-builders, DBI coverage is issued in the form of a policy. Owner-builders are only required to take out a policy if they sell the property within six and a half years of completion of the building work.
Premium	The charge for insurance coverage.
Private insurers	Independently trading insurance companies that previously competed in the DBI market. Generally they were publicly listed entities trading for profit.
Project certificate	For registered builders, DBI coverage is issued in the form of a project certificate that is specific to the domestic building work undertaken in a domestic building contract.
Run-off period	The time after an insurer has stopped issuing insurance, but is still responsible for claims on existing policies.
Simple loss ratio	Net incurred costs relating to claims made on project certificates and policies issued in a given year, divided by the total premium earned for that year. Excludes the costs of claims that are yet to be made. Excludes costs that the insurer incurs in administering the scheme, and income from investments.
Turnover limit	An insurer's calculation of a builder's capacity to undertake work. This is the total value of construction work that an insurer will issue certificates for in a 12 month period.
Victorian Building Authority	A statutory authority that oversees the quality and standard of professional services in the building industry in Victoria (from 1 September 2016 it includes the powers and responsibilities of the former Building Practitioners Board).
Victorian Managed Insurance Authority (VMIA)	A statutory body providing DBI.

Appendix A: terms of reference

Essential Services Commission Act **2001**

Essential Services Commission

Terms of Reference

Domestic Building Insurance – Data and Performance Monitoring

I, Tim Holding MP, Minister for Finance, WorkCover and the Transport Accident Commission, request the Essential Services Commission (the Commission) to provide ongoing monitoring reports on the pricing and performance of the Victorian Managed Insurance Authority's (VMIA) provision of domestic building insurance (DBI). The reports will cover claims management, the pricing of private domestic building insurers during the transition period from 29 March 2010 to the establishment of the new arrangements, and the claims management of the private domestic building insurers during the run-off period of their insurance policies.

Background

DBI has been compulsory in Victoria since 2002 for all residential building works in excess of $12,000 carried out by licensed builders.

DBI policies are taken out by the builder in favour of the homeowner and cover loss or damage resulting from non-completion of the work. This includes loss of deposit or breach of statutory warranty if the homeowner cannot recover compensation from the builder because of the death, disappearance or insolvency of the builder.

DBI was provided solely by private insurers. However, after a decrease in the number of private insurers and the associated levels of competition, the Government announced on 29 March 2010 that the VMIA would become a statutory monopoly provider of DBI after a transition period.

Scope of the Advice – Data and Performance Monitoring

The Commission is to annually monitor and report on the pricing and performance of the VMIA and private insurer's provision of DBI on an ongoing basis. The scope of the monitoring is to cover the:

- pricing and claims management of the VMIA;
- pricing of private domestic building insurers during the transition period; and
- private domestic building insurers' claims management during the run-off period.

The ongoing reporting is to be delivered in the form of annual reports.

The purpose of the annual reports is to inform the public of the performance of DBI.

The Commission will be required to publish a monitoring report each year that will be made publicly available. Any confidential or commercially sensitive material should be included in a separate attachment.

The purpose of the annual reports with the attachment is to inform the Government's consideration of DBI developments.

The annual reports will analyse quarterly data, including the number of eligible builders, project certificates, premiums levels, the number and amounts of claims for both the VMIA and private domestic building insurers and any other metrics the Commission and the Department of Treasury and Finance consider relevant.

Advice Process – Performance Monitoring

The monitoring reports are to be prepared independently by the Commission, under subsection 10(g) of the *Essential Services Commission Act* 2001 (the ESC Act), which provides the Commission with a general function to provide advice to the Minister for Finance.

The first data monitoring report is to cover the period from 1 July 2008 to 30 June 2010. Subsequent reports are to cover data for each financial year from 2010-11 onwards. The reports are to be provided by 30 November each year.

In providing this advice, the Commission is to have regard to its statutory objectives in section 8 of the ESC Act.

TIM HOLDING MP
Minister for Finance, WorkCover
and the Transport Accident Commission

Date: 9/07/2010