



**Government
of South Australia**

NATIONAL COMPETITION POLICY REVIEW

of the

BUILDING WORK CONTRACTORS ACT 1995

SUPPLEMENTARY REVIEW

ISSUES PAPER

The views expressed in this Supplementary Report are the views of the Review Panel only and do not represent the views of the South Australian Government. Any action taken in anticipation of the outcomes of this Supplementary Report or the review process is solely at the risk of persons taking such action.

OCTOBER 2001

Building Work Contractors Act 1995

Supplementary Review

ISSUES PAPER

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National Competition Policy Review

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Supplementary Review - Issues Paper

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PART 1: INTRODUCTION

1.1 WHY WAS THE ACT REVIEWED?

Economic and social imperatives, not only in Australia but also globally, have in recent times required the imposition of more rigorous market conditions on every sector of the economy. This process has affected the agricultural, mining, manufacturing and utilities sectors of the economy, and is ever increasingly impacting on the occupational and professional fields.

Formal governmental recognition of this process came at the Council of Australian Governments meeting on 11 April 1995 with the adoption by the Commonwealth and all State and Territory Governments of the National Competition Policy package.

The package comprised three separate agreements aimed at facilitating the implementation of National Competition Policy objectives.:-

- The **Competition Principles Agreement** consisting of six distinct areas of competition reform:-
 - Legislative review;
 - Process oversight for government business;
 - Structural reform of public monopolies;
 - Competitive neutrality;
 - Access to essential infrastructure; and
 - Application of competition principles to local government.
- The **Conduct Code Agreement** committing all governments to implementation of uniform competition laws as set out in the schedule version of Part IV of the *Trade Practices Act 1974*. Under this code all persons, including governmental bodies and professional and occupational bodies, are now subject to competition laws.
- The **Agreement to Implement Competition Policy and Related Reforms** committing all signatories to a reform timetable. The Commonwealth is also committed to making payments to State and Territory Governments subject to their meeting the necessary reform timetables.

It is the legislative review element of the Competition Principles Agreement which formed the basis for the review of the *Building Work Contractors Act 1995* during 1999 and 2000. In this context, it must be borne in mind that legislative reviews, such as that review, do not occur in isolation but rather form a part of a fully comprehensive economy-wide policy agreed to by all Australian governments.

The legislative review process extends not only to existing legislation, but also to new legislation. Further, the concept of "legislation" encompasses all Acts, Regulations, Rules, Proclamations, Notices, Amendments and By-Laws. The reform timetable contained in the Agreement to Implement Competition Policy and Related Reforms requires the legislative review process to be completed by the end of June 2002.

While competition is a notoriously difficult term to define globally, it may perhaps be most simply considered as a process of rivalrous behaviour by suppliers in a market that has many actual and potential buyers. National Competition Policy aims to make better use of competitive forces as a means to enhance overall material living standards, to improve Australia's social and environmental outcomes, and to extend the productivity enhancing effects of competition to virtually all sectors of the economy.

It has been said that National Competition Policy is about:-

*"ensuring that the way markets work serves the whole community, rather than resulting in back-room deals which benefit a few. It is about improving efficiency of the public sector to provide better services at lower prices. And it is about ensuring that legal protections from competition genuinely promote the welfare of all Australians, rather than the narrow interests of the businesses protected. The policy doesn't prevent governments guaranteeing desirable social objectives."*¹

Underlying National Competition Policy is the notion that greater competition will create incentives for producers:-

- to use their resources better, resulting in higher productivity;
- to increase their efforts to constrain costs and therefore lower prices; and
- to be more responsive to users' demands in terms of improved quality.

It is important to acknowledge at the outset that many laws restrict competition. It is also important to acknowledge that often these restrictions are essential to achieve a significant community benefit. However, National Competition Policy requires that all laws restricting competition be identified, so that the community benefits they provide and the necessity for the restriction can be reviewed in an objective fashion.

In this sense, National Competition Policy embraces competition as a means, not an end in itself. Any increase in competition in a sector of the economy can therefore only be justified under Competition Policy Principles insofar as it provides an increase in net public benefit.

¹ Mr G. Samuel, President, National Competition Council, *Australian Financial Review*, 22 June 1998, p. 20

That said, any National Competition Policy review must start with the presumption that any identified restriction on competition should be repealed unless it can be demonstrated that a net public benefit arises from its existence. In line with Competition Policy Principles, those who wish to maintain a legislative restriction on competition bear the onus of proving that there is such a net public benefit.

This presumption arises from the text of the Competition Principles Agreement, which states at clause 5(1):

The Guiding Principle is that legislation (including Acts, enactments, ordinances or regulations) should not restrict competition unless it can be demonstrated that:

a) the benefits of the restriction to the community as a whole outweigh the costs;

and

b) the objectives of the legislation can only be achieved by restricting competition.

Therefore, the only restrictions on competition permitted under the Competition Principles Agreement are those that are demonstrably in the public interest. However, clause 5(1)(b) further requires that those restrictions, which are so justified, must also be the most appropriate way of meeting the legislation's objectives.

To put matters another way, while a public interest defence is a necessary step for retention of a legislative restriction, it is not in itself a sufficient one; if the policy objectives can be achieved by other means, then the legislative restriction may be removed, even if in the public interest, and replaced by the less restrictive alternative.

The process of determining whether a restriction is in the public interest is known as the "public benefit test". Clause 5(1)(c) of the Competition Principles Agreement ~~requires~~ requires that competition and associated economic impacts be assessed under this test.

The Review Panel notes that in this regard clause 1(3) provides guidelines on the content of public benefits tests such that, without purporting to limit what may be considered, the following matters must be taken into account where relevant:

- (a) government legislation and policies relating to ecologically sustainable development;*
- (b) social welfare and equity considerations, including community service obligations;*
- (c) government legislation and policies relating to matters such as occupational health and safety, industrial relations and access and equity;*
- (d) economic and regional development and investment growth;*

- (e) *the interests of consumers generally or a class of consumers;*
- (f) *the competitiveness of Australian businesses; and*
- (g) *the efficient allocation of resources.*

These criteria contain a clear expectation that social, environmental and regional concerns will be considered alongside the more narrow economic criteria in arriving at an assessment of overall benefits and costs. However, it should also be appreciated that, where relevant, matters beyond those specifically set out in the Competition Principles Agreement, including rural issues, have been considered by the Review Panel.

However, the Review Panel notes that a restriction does not have to be removed if the conclusion concerning that restriction falls within a range of outcomes that could reasonably be reached based on the information available. Within that range of outcomes, Governments have a policy discretion to determine which particular outcome is in the public interest.

1.2 WHAT IS BEING REVIEWED?

A National Competition Policy review of the *Building Work Contractors Act 1995* was conducted under the auspices of the Competition Principles Agreement during 1999 and 2000. The review process involved the release of an Issues Paper in 1999, followed by the release of a Draft Report in 2000. On each occasion submissions were sought from interested parties on not only issues discussed in the report, but also on any other matters which those submitting considered had an effect on competition within the market.

Based on the submissions received, and further research conducted by the Review Panel, a Final Report was submitted to the Minister for Consumer Affairs in January 2001. That report contained a number of recommendations intended to remove unjustified restrictions on competition contained in the legislation.²

Two aspects of the legislation which were considered by the Review Panel to have an impact on competition were the building indemnity insurance requirements and financial resources licensing criteria. Both of these matters were the subject of competition analysis in the report submitted to the Minister for Consumer Affairs.

At that time there was no evidence of the market failing in terms of the provision of building indemnity insurance and the Review Panel's conclusion presented to the Minister was that the current scheme was justified.

Subsequent events, however, in particular the collapse of HIH Insurance Ltd, have changed the complexion of the market, and the Review Panel has now been

² National Competition Policy Review of the *Land Agents Act 1994* - Final Report. A summary of the conclusions and recommendations may be found at pages 63 to 66 of that report.

requested by the Minister for Consumer Affairs to re-consider the issue of the indemnity insurance scheme in light of those events by way of a Supplementary Review.

The Minister has noted that the issue of financial resources criteria imposed on licensees is closely linked to the issue of the building indemnity insurance scheme and has accordingly also been identified as a matter to be further considered by the Review Panel in the Supplementary Review.

The scope of this Supplementary Review is therefore limited to a consideration of the:-

- *Building Work Contractors Act 1995; and*
- *Building Work Contractors Regulations 1996*

to the extent of the building indemnity insurance and financial resources provisions of that legislation. However, references to other legislation are made where appropriate.

1.3 THE REVIEW PANEL

The Review Panel as reconvened by the Minister comprises:-

- *Ms Judy Hughes, Deputy Commissioner, Policy and Legal, Office of Consumer Affairs;*
- *Mr Adam Wilson, Senior Policy Officer (Competition Policy), Office of Consumer and Business Affairs;*
- *Mr Brett Williams, Policy Officer (Competition Policy), Office of Consumer and Business Affairs; and*
- *Ms Carolyn Wigg, Chief Project Officer, Building Standards and Policy, Planning SA.*

The Review Panel notes that it was appointed by the Minister for Consumer Affairs in accordance with the Department of Premier and Cabinet's guidelines for the conduct of legislative reviews under the Council of Australian Governments Competition Principles Agreement.³

³ "Guidelines Paper for Agencies conducting a Legislation Review under the CoAG Competition Principles Agreement", Department of Premier and Cabinet, February 1998, Part E, page 19 et seq.

1.4 CLASSIFICATIONS OF RESTRICTIONS ON COMPETITION

Restrictions on competition identified through this Supplementary Review will not be of uniform effect, with varying degrees of impact on competition inherent in each particular restriction. Therefore, the Review Panel has adopted the process of categorising potential restrictions on competition as **trivial**, **intermediate** or **serious** in order to assist in deciding on the depth of analysis to be given in each case.

The categorisations attributed by the Review Panel to the various restrictions are derived following a consideration of various factors including the height of barriers to entry and the impediments to rivalry in all dimensions of the price-product-service packages offered to consumers by market participants given the nature of the market.

1.5 PROCESS

In accordance with the Terms of Reference set by the Minister for Consumer Affairs, the Review Panel has conducted a series of meetings and conducted further research in its consideration of the issues. The Terms of Reference for the Supplementary Review are reproduced at Appendix 1.

As a result of those meetings, research undertaken and evidence received by the Review Panel, this Supplementary Report Issues Paper has now been prepared for comment.

The Issues Paper is designed to assist those wishing to make submissions to the Supplementary Review.

The Issues Paper should be read in conjunction with the *Building Work Contractors Act 1995* and the *Building Work Contractors Regulations 1996*. Copies of the legislation are available from Information SA, 77 Grenfell Street, Adelaide. The telephone number for Information SA is (08) 8204 1900.

Discussion points are raised to promote comment on various issues. Submissions should focus on the costs and benefits of restrictions, and be supported by analysis wherever possible.

Comments need not be restricted to those discussion points raised in the Issues Paper, however they should address issues which are directly related to the building indemnity insurance scheme and the financial resources requirements of the legislation.

Guidelines to assist in the preparation of submissions to the Supplementary Review are included in Appendix 2.

Following receipt of submissions, the Review Panel will submit its Supplementary Report to the Minister for Consumer Affairs.

The Review Panel notes that the Ministerial Council on Consumer Affairs has agreed to consider the issue of building indemnity insurance schemes generally through a review of such schemes operating within Australia.⁴ The Review Panel understands that the findings of this Supplementary Review may form the basis for the South Australian position in any such Ministerial Council deliberations.

⁴ Comprised of all State and Commonwealth fair trading Ministers.

PART 2: THE BUILDING INDEMNITY INSURANCE SCHEME

2.1 BACKGROUND

Following the collapse of the HIH group of insurance companies, the current regulatory scheme for building indemnity insurance under the *Building Work Contractors Act 1995* ("the Act") has received considerable attention from both consumer and building industry groups.

2.1.1 Operation of the building indemnity insurance scheme

Division 3 of Part 5 of the Act contains the details of the scheme for building indemnity insurance. In relation to domestic building work commenced after 1 May 1987, a building work contractor must not perform such work unless a policy of insurance which complies with the Act is in force in relation to that building work, and the building owner has been provided with a certificate evidencing that the policy has been taken out and that it complies with the legislative requirements.⁵

Domestic building work is defined as:-⁶

- the whole or part of the work of constructing, erecting, underpinning, altering, repairing, improving, adding to or demolishing a house; or
- the whole or part of the work of excavating or filling a site for work referred to above

and includes:-

- the construction, alteration, repair or improvement of a swimming pool or spa within the external walls of a house or within the curtilage of a house, and
- any other building work carried out within the curtilage of a house or on the boundary of the curtilage of a house.

"House" does not include hotels, motels, youth hostels, residential camps, boarding or lodging houses, university halls of residence, boarding school dormitories, barracks, nurses homes, residential facilities for workers or for training purposes.⁷

A contractor does not need to arrange insurance in circumstances where approval under the *Development Act 1993* is not required in relation to the domestic building

⁵ Section 34

⁶ Section 3 and Regulation 5(2)

⁷ Regulation 5(3)

work, or where the cost of the domestic building work to the building owner is less than \$5,000.⁸

The Act and Regulations specify that in order to comply with the Act, the policy of insurance must insure each person who is (or may become) entitled to the benefit of a statutory warranty in respect of the building work against the risk of being unable to enforce or recover under the statutory warranty by reason of:-

- the insolvency;
- death; or
- disappearance of the building work contractor.

Further, the policy must also insure the person with whom the building work contractor is contracting against the risk that the work will not be completed by reason of the:-

- the insolvency;
- death; or
- disappearance of the building work contractor.⁹

The statutory warranties are set out in section 32 of the Act:

Statutory warranties

32. (1) This section applies to a contract entered into on or after 22 January 1987¹.

(2) The following warranties on the part of the building work contractor are implied in every domestic building work contract:

(a) a warranty that the building work will be performed in a proper manner to accepted trade standards and in accordance with the plans and specifications agreed to by the parties;

(b) a warranty that all materials to be supplied by the contractor for use in the building work will be good and proper;

(c) a warranty that the building work will be performed in accordance with all statutory requirements;

(d) if the contract does not stipulate a period within which the building work must be completed-a warranty that the building work will be performed with reasonable diligence;

⁸ Section 33(2), Regulation 5(4), and Section 3. Note that after 15 October 2001, this amount will increase to \$12,000.

⁹ Section 35

(e) if the building work consists of the construction of a house-a warranty that the house will be reasonably fit for human habitation;

(f) if the building owner has expressly made known to the contractor, or an employee or agent of the contractor, the particular purpose for which the building work is required, or the result that the building owner desires the building work to achieve, so as to show that the building owner relies on the contractor's skill and judgment-a warranty that the building work and any materials used in performing the building work will be reasonably fit for that purpose or of such a nature and quality that they might reasonably be expected to achieve that result.

(3) A person who has purchased or otherwise acquired a house succeeds to the rights of the person's predecessor in title in respect of statutory warranties.

(4) If a person has purchased a house from a building work contractor who performed domestic building work in relation to the house, the purchaser has rights under statutory warranties as if the house had been purchased from a third party for whom the vendor had performed the building work under a contract subject to statutory warranties.

(5) Proceedings for breach of a statutory warranty must be commenced within five years after completion of the building work to which the proceedings relate.

(6) The period of limitation prescribed by subsection (5) may not be extended.

(7) In proceedings for breach of a statutory warranty, it is a defence for the defendant to prove that the deficiencies of which the plaintiff complains arose from instructions insisted on by the building owner contrary to the advice in writing of the defendant.

¹ 22 January 1987 was the date of commencement of the corresponding section of the repealed Builders Licensing Act 1986 .

There are currently two providers of indemnity insurance in South Australia:-¹⁰

- Dexta Corporation Limited; and
- Home ~~Centers~~ Waranty Limited.

Both of these bodies arrange policies of insurance through private underwriters.

It appears to be the practice in South Australia that a separate policy of insurance is taken out in respect of each building work project. The Act does not prevent "blanket" insurance policies, although there is only one known instance where such a blanket policy is in place. There may be efficiencies to be gained in contractors obtaining "blanket" indemnity policies, although the costs of such policies may be prohibitive for smaller contractors.

¹⁰ The Act does not provide for the Commissioner for Consumer Affairs to approve individual providers of building indemnity insurance, therefore no accurate register of providers is maintained.

The Review Panel has assessed this requirement as an **intermediate restriction on competition**.

2.1.2 Objectives of the Requirement

The existence of indemnity insurance is a super-added consumer protection measure along the lines of the statutory warranties. It is clearly designed to provide continued protection when those warranties cannot be enforced by the consumer. Thus, as with the statutory warranty provisions, this requirement is aimed at addressing transaction cost problems within the market.

2.1.3 Benefits of the Requirement

Indemnity insurance is a risk management device which benefits consumers, even if they bear the costs of the insurance (the costs of premiums would usually be passed on through fees or contract prices.)

The insurance requirement provides an ongoing measure of consumer protection through the underwriting market's assessment of the viability of the contractor. Insurance will not be offered, or will be offered at prohibitive rates, in the case that the contractor is assessed as too great a risk.

It is here that the Review Panel has noted the potential for duplication in market entry requirements, as a contractor may be assessed both in the licence application process and when seeking building indemnity insurance.

2.1.3 Costs of the Requirement

Obtaining indemnity insurance will lead to increased costs of doing business for the contractor. These costs will ultimately be passed on to the consumer through a contractor's pricing structures. In this way, what is initially a private cost may become a public one. If the cost or availability of indemnity insurance is keeping people out of the industry, then this is a further cost. It means that competition is reduced, which can have the effects outlined in the general discussion earlier in this report of the costs and benefits of regulation.

2.1.4 Assessing the costs and benefits

The submissions received by the Review Panel in the course of the initial review process were generally supportive of the retention of the building indemnity insurance requirement.

CASA submitted that:-

"The risk of loss to the consumer is great and so insurance taken by the builder to cover any warranties not honoured by them is a justified restriction."

The Review Panel considers that the benefits provided to consumers through the requirement outweigh the costs of insurance. Whilst it is recognised that there are costs, it is necessary that consumers be protected from the risks involved in this market. Building work is often a transaction that is of tremendous importance to the consumer, and may involve a large portion of their assets. The risk of warranties not being honoured is too great to leave unprotected.

2.1.5 Conclusion 1 - building indemnity insurance

CONCLUSION 1

The conclusion of the Review Panel is that the benefits to the community as a whole of a legislatively mandated building indemnity insurance scheme of some form outweigh the costs that such a scheme imposes.

2.2 THE IMPACT OF THE MARKET EXIT OF HIH INSURANCE LIMITED

A provisional liquidator was appointed to the HIH group of companies by order of the New South Wales Supreme Court on 15 March 2001. By way of a further order of the New South Wales Supreme Court on 27 August 2001, the HIH group of companies was placed into formal liquidation. The liquidator of the HIH group has estimated that it may take ten years to complete the liquidation. Estimates of the likely dividends to be paid in the liquidation have varied widely, with some lower than 10 cents in the dollar.

Until it went into liquidation, the HIH group offered builders indemnity insurance in NSW, Victoria, South Australia, Western Australia and the Australian Capital Territory. The HIH group was one of only two providers of such insurance in South Australia.

The immediate effect of the liquidation was to make policyholders unsecured creditors of the insurer. They could prove in the liquidation, but had uncertain prospects of any recovery under their policies. Where the policies of insurance were written for the benefit of third parties, as is the case with policies of building indemnity insurance in South Australia, then those third parties also had uncertain prospects of recovery.

The various assistance packages developed by the Commonwealth and States to address the potential losses of consumers directly affected by the HIH collapse is not a matter under consideration by the Review Panel. However, for completeness, the Commonwealth and South Australian schemes are briefly described below.

The Commonwealth Government has announced the establishment of the HIH Claims Support Service Limited, which will allow certain policyholders, affected by the collapse, to effect some recovery in respect of the risks for which they were insured. The operation of HIH Claims Support Service Limited scheme does not extend to the provision of hardship assistance to those who have a claim against their builders indemnity insurance, nor does it extend to assisting builders who are experiencing difficulties in obtaining insurance cover as a result of HIH's collapse.

On 7 June 2001, the South Australian Government announced a package of measures to address both consumer and building industry hardships resulting from the market exit of HIH. One aspect of this package was the establishment of a fund to assist consumers suffering hardship in respect of their home building contracts as their building work contractor has died, disappeared or become insolvent and they are no longer able to rely on their building indemnity insurance policy as a result of the collapse of HIH. The maximum possible payment in respect of any one claim has been capped at the maximum insurable amount of \$80,000 per policy.

To fund this scheme, the South Australian Government has allocated an amount of \$1,000,000 and has temporarily increased licensing fees to raise sufficient funds to meet all accepted claims.¹¹

The South Australian scheme also addresses building industry concerns over the availability of building indemnity insurance by raising the dollar threshold over which such insurance is required from \$5,000 to \$12,000.¹²

2.3 COMPETITION ANALYSIS OF CURRENT SCHEME

As is clear from the foregoing discussion, the market exit of one of only two providers of building indemnity insurance in South Australia has had significant consequences for the market. In competition terms, the immediate impact was to change the market from a duopoly to a monopoly. However, the Review Panel notes that the market has reverted to a situation of duopoly with the entry of a new building indemnity insurance provider to the market, Delta Corporation Limited.

Notwithstanding this new entry into the market, and thus return to a situation of duopoly, the Review Panel is concerned that such a market may not provide the most efficient outcomes for either the building industry or consumers of building services.

¹¹ Fees will be reduced to their amounts immediately prior to the introduction of the scheme (subject to other increases) once it is apparent that the Fund can meet all accepted claims.

¹² This change will take effect from 15 October 2001.

2.3.1 Discussion point 1 - Current legislative scheme

DISCUSSION POINT 1

- 1.1 Is the current legislative scheme for building indemnity insurance appropriate in the South Australia market?
- 1.2 What are the costs of the scheme?
- 1.3 What are the benefits of the scheme?

2.4 LACK OF SUPPLY SIDE COMPETITION

The Review Panel considers that there may be a linkage between the nature of the current legislative scheme and the lack of competition in the supply side of the building indemnity insurance market. In order to explore this possible linkage, the Review Panel has undertaken a preliminary consideration of the advantages and disadvantages of the current legislative scheme.

2.4.1 Advantages of South Australian scheme

Other jurisdictions (Victoria¹³, New South Wales¹⁴, Tasmania¹⁵, Western Australia¹⁶) have similar schemes to South Australia; requiring contractors to carry insurance which is provided by the private sector.

The Northern Territory has no building indemnity insurance scheme but is currently considering one and has an issues paper presently out for consultation.¹⁷ The elements of the scheme that is proposed are similar to the requirements already set in South Australia.

The Review Panel notes that it is arguable that insurers who face competition for customers have greater incentives to keep their customers satisfied or risk losing market share. Competitive insurers are therefore more likely to offer a wider range of products and services, better suited to individual customers at competitive prices. The current South Australia scheme does not restrict entry of insurers directly, nor does it mandate, as do other State schemes such as the New South Wales scheme, which insurers may provide insurance.

¹³ *Building Act 1993 (Vic), Domestic Building Contracts Act 1995 (Vic)*

¹⁴ *Home Building Act 1989 (NSW)*

¹⁵ *Housing Indemnity Act 1992 (Tas)*

¹⁶ *Home building Contracts Act 1991 (WA)*

¹⁷ The NT discussion paper can be found at:

<http://www.lpe.nt.gov.au/PlanBuild/building/RBIS/paper.htm>.

It is also arguable that it is the insurance market where the skills and expertise necessary to operate an efficient insurance scheme reside. Again, this is reflected in the current South Australian scheme, which does not seek to regulate the conduct of insurers, but rather seeks to lightly regulate the product offered.

Further, the current South Australian scheme ensures that risks and costs to government, and taxpayers, associated with administering an insurance fund are shifted to the private sector.

2.4.2 Disadvantages of South Australian scheme

Notwithstanding that the scheme is theoretically open to competition, it is or is potentially precarious because of the limited number of participants in the market. In the immediate aftermath of the HIH collapse some contractors complained of delays in obtaining insurance and an inability to obtain insurance.

As discussed above, there are currently two providers of indemnity insurance in South Australia:-

- Dexta Corporation Limited; and
- Home Owners Warranty Limited.

Like many of its counter-parts across Australia, the Master Builders' Association of South Australia acted as a sub-agent for the HIH group in a building indemnity insurance master policy scheme. Policies were issued and underwritten by HIH.

The HIA operates a scheme whereby members are entitled to apply for insurance through the HIA's agent, Home Owners Warranty Ltd. The underwriters for the scheme, Royal and Sun Alliance Ltd, has indicated that it will offer, at its discretion, limited short term policies to builders previously covered by HIH.

Another insurer, Dexta Corporation Limited has now entered the market and is providing building indemnity insurance policies. Dexta Corporation has also indicated that it may offer cover for building works previously covered by HIH.

The high-risk nature of building indemnity insurance makes it a less profitable segment of the market than other forms of insurance. The product offered may be characterised as a pure risk product, as it does not attract ongoing payments as do other products such as life or car insurance. The product also suffers the relative disadvantage of being a "long-tail" product, insofar as it has a life of 5 years to match the statutory warranty period under the Act. The effect of this once off premium and long-tail is that insurers need to make an assessment of the uncertain long term risk associated with the building work and construct a premium which takes this risk into account.

On this basis, and on the basis of the available evidence of an unwillingness on the behalf of insurers to enter the market, the Review Panel considers that new entrants to this part of the market may not be easy to attract.

Further, where the market is limited, more stringent prerequisites introduced by insurance companies attempting to reduce risk and improve profitability may affect the ability of contractors to obtain insurance or the cost of it. In South Australia, the premiums paid by insureds are subject to market forces. This has the potential to adversely affect builders (and, consequently, home-owners) if there is not sufficient competitive force to create benefits to contractors and policy beneficiaries.

The Insurance Council of Australia has identified that there is pressure on insurance companies to increase their capital which may further reduce the number of players entering the market.¹⁸

The Review Panel notes that the Australian Prudential Regulatory Authority has recently put in place a new prudential regime for general insurers that will come into effect on 1 July 2002¹⁹. The regime, which entails amendments to the *Insurance Act 1973* passed recently and the issuing of new Prudential Standards by APRA, is aimed at improving corporate governance arrangements within the industry and thereby reducing the risk of insurers being unable to meet their liabilities as and when they fall due. The Review Panel notes that increased compliance costs associated with the transition to the new corporate governance arrangements may act as a disincentive to new insurers considering entry into the market.

Finally, the Review Panel notes that the general insurance industry can expect to experience the adverse impact of the extensive losses suffered by under-writers following the terrorist attacks in the United States on 11 September 2001. The largest insurance loss from a single event in history is estimated to sink some under-writers and lead to demand not being met²⁰. In such a climate, and in light of the low-profitability of this segment of the market, the Review Panel notes that building indemnity insurance is unlikely to be identified by insurers or under-writers as an area for expansion in the next few years.

2.4.3 Discussion Point 2 - HIH group market exit

DISCUSSION POINT 2

2.1 Have the short term effects of the removal of HIH from the market subsided?

¹⁸ ICA media release 21/5/01. The reference presumably relates to APRA's introduction of a \$5m minimum capital requirement, replacing the existing \$2m.

¹⁹ A discussion of the regime can be found in APRA's discussion paper entitled "Prudential Supervision of General Insurance" March 2001 and is available from APRA's website.

²⁰ The Australian Financial Review Weekend, September 29/30, 2001, p 24.

2.2 If not, what are those effects and how long are they likely to continue?

2.4.4 Discussion Point 3 - Effects of insurance provider duopoly

DISCUSSION POINT 3

3.1 Does the small number of insurers offering building indemnity insurance in the market present problems in the short or long term to the industry as a whole?

2.5 OPTIONS FOR ALTERNATIVE MODELS OF BUILDING INDEMNITY INSURANCE

The Review Panel has considered a number of options for alternative provision to building indemnity insurance. These options are as follows:-

- Status quo option - a continuation of current scheme whereby the Government requires building indemnity insurance to be in place, but allows the market to provide the policies on a competitive basis;
- Master policy option - an alternative scheme under which the Government requires building indemnity insurance to be taken out from a mandated insurer, chosen through a competitive tendering process;
- Statutory indemnity fund option - a further alternative scheme whereby a statutory fund to provide redress for consumers is established and operated by the Government on the basis of building industry contributions.

A consideration of these latter two options follows. The Review Panel does not consider it necessary to further explore the current scheme, as comment on this scheme has been sought earlier in this Issues Paper.

2.5.1 Statutory Indemnity Fund

An alternative model mandates insurance through a legislated indemnity fund. Such a fund would be administered by the Government, attract mandatory contributions from building contractors and pay claims where claimants meet certain criteria (eg.,

unfinished work and/or defects and the insolvency, disappearance or death of the builder).²¹

Queensland operates a statutory insurance scheme by which the Queensland Building Services Authority administers an insurance fund and a general statutory fund. The Authority operates under the control of a board established by the Queensland *Building Services Authority Act 1991*.²²

The insurance fund is administered by the Authority and holds premiums paid by builders and is the source of payments for claims against the fund.²³ The general statutory fund holds money other than insurance premiums and is used to administer the scheme, and it may be supplemented by money from the insurance fund (but not vice versa) in some circumstances.²⁴

Under the scheme, contractors must pay premiums into the insurance fund prior to commencing residential construction work.²⁵ Where a construction job is performed on multiple dwellings, a formula for determining the notional price and premium payable for the work done on each individual dwelling applies.²⁶

Upon payment of the premium, the authority issues a certificate of insurance, which is required to obtain development approval.²⁷ The consumer must be provided with a copy of the insurance policy and the certificate of insurance.²⁸

The policy of insurance comes into force if:-

- A consumer enters into a contract for the performance of residential construction work; and
- The contract:-
 - bears the licence number of a licensed contractor, or
 - is with a licensed contractor; or
 - is with a person fraudulently claiming to hold a contractor's licence.²⁹

²¹ The Review Panel notes that there are existing scheme operating on this basis payment of claims arising out of the fiduciary default of conveyancers and land agents - see the Agents Indemnity Fund established under the *Land Agents Act 1994*.

²² See sections 5, 25, 26, 68-71.

²³ Section 25.

²⁴ Section 24.

²⁵ Section 68(1).

²⁶ Regulation 31 of the Queensland Building Services Authority Regulations 1992.

²⁷ Section 69(1).

²⁸ Section 69(4).

²⁹ Section 69(2).

Provided that these conditions are met, a policy is in force whether or not an insurance premium has been paid or a certificate of insurance has been issued.³⁰ The terms of the policy are determined by the Board. The authority assesses the claim, and the assessment can be appealed to a building tribunal established under the *Queensland Building Tribunal Act 2000*.³¹

Where a claim is paid out of the insurance fund, the Authority may recover the amount paid out, as a debt, from:-

- The building contractor by whom the relevant construction work was carried out, or was to be carried out, or
- Any other person through whose fault the claim arose.³²

From 1 July 2000, the Qld BSA introduced a new premium structure which calculates the premium at \$5.50 inclusive of GST for every \$1,000 of contract value.

The success of the BSA scheme depends to some extent on the imposition of strict financial criteria upon applicants, which are prerequisites for the re-insurance obtained by the BSA from the private market. The Queensland Government has a AAA credit rating and the scheme is reviewed by an independent actuary every six months to provide advice on viability and levels of reserves necessary to meet future claims. The actuarial advice forms the basis for setting premiums and negotiating reinsurance contracts.³³

Because it is a statutory insurer, no duplication of financial resources criteria exists – one test applies. It can depend upon the income of premiums of all contractors and creates efficiencies from the size of the pool of resources to which it has access. It can also exert control over loss-minimisation by implementing efficient debt-recovery processes.

Seventy-five per-cent of the risk borne by the Queensland Government is re-insured by the private market.³⁴

In considering whether such a scheme is appropriate for South Australia, it should be remembered that the scheme would impose considerable costs upon government and ultimately taxpayers. For one, administration of the scheme requires time and resources. Private insurers who already administer insurance schemes, are more likely to have the experience and framework needed to minimise administration costs. Furthermore, the scheme carries with it the risk of making a loss. The eventual payouts are uncertain and could very well exceed the premiums paid by builders. It may be that private insurers are better placed to bear this risk, given they have the expertise and skills for assessing and dealing with such risk.

³⁰ Section 69(3).

³¹ Section 70.

³² Section 71. Sections 71(4) – (6) set out various defences to such action by the authority.

³³ BSA Annual Report 1999/2000 p 43

³⁴ BSA Annual Report p 44.

2.5.1.1 Discussion Point 4 - Statutory indemnity fund

DISCUSSION POINT 4

- 4.1 Would a statutory indemnity fund be appropriate in the South Australian market?
- 4.2 What would be the costs of such a fund?
- 4.3 What would be the benefits of such a fund?

2.5.2 Master policy with mandated broker

A further option is for Government to mandate, through legislation, contractors' use of a particular insurer by way of a "master policy" scheme.

Under such a scheme, the requirement to hold insurance is mandated under the legislation, with provision being made for only one insurer to offer the insurance, thereby guaranteeing profitability for that insurer as an incentive to remain in the market. Competition principles would require that the mandated insurer would be required to compete for the right to be sole provider, and that this competitive process would need to occur on a regular basis.

As with the statutory indemnity fund scheme, one advantage of a single insurer is that its sheer size of the available premium pool enables economies in administration.

An example of such a scheme can be found in section 9 of the *Conveyancers Act 1994* which imposes an obligation on conveyancers to carry professional indemnity insurance "in accordance with the regulations". Regulation 7A states:-

Approved professional indemnity insurance scheme

7A. (1) For the purposes of section 9(1) of the Act, the Commissioner may approve a scheme to provide professional indemnity insurance, to an extent provided by the scheme, for the benefit of conveyancers.

(2) The approved scheme-

(a) must provide for insurance indemnity under a master policy negotiated with the insurer or insurers participating in the scheme; and

(b) must provide for all persons carrying on business as a conveyancer, or a class or classes of conveyancers, as specified in the scheme, to obtain coverage under the scheme; and

(c) may provide for the determination and settlement of claims against conveyancers covered by the scheme; and

(d) may impose on conveyancers covered by the scheme obligations to pay premiums, levies, fees or other charges (which may vary according to factors stipulated in the scheme); and

(e) may impose, or provide for the imposition of, penalties, sanctions and remedies against conveyancers who fail to comply with their obligations under the scheme; and

(f) may make any other provision reasonably necessary for, or incidental to, the administration or enforcement of the scheme.

(3) The approved scheme (as amended from time to time with the approval of the Commissioner) is binding on-

(a) the conveyancers covered by the scheme; and

(b) the insurer or insurers and other persons to whom the scheme applies.

(4) The Commissioner must keep a copy of the approved scheme (including any amendments to the scheme approved by the Commissioner) available for inspection at the Commissioner's office and must, on request for a copy of the scheme or amendment and payment of the fee, provide such a copy.

(5) In this regulation-

" conveyancer " includes a former conveyancer.

Requirement to be insured

7B. (1) A conveyancer who, according to the terms of the approved scheme, may obtain coverage under the scheme must do so unless the person was, immediately before the commencement of this subregulation, insured under some other professional indemnity insurance policy.

(2) The exemption under subregulation (1) ceases to apply to a conveyancer when the professional indemnity insurance policy under which the conveyancer is insured expires or 12 months after the commencement of subregulation (1), whichever is sooner.

Arguably, such a scheme unites the benefits of the existing scheme for building indemnity insurance with the advantages of a statutory scheme, in that the business of insurance is left to the market where the skills and expertise reside, but the mandated insurer enjoys the benefits of access to a predictable source and amount of funding. Government retains the ability to ensure that the level of protection for consumers is acceptable but does not bear the immediate risk of administering the scheme.

The disadvantages of a mandated insurer could be said to include the risk that service delivery will be adversely affected by the monopoly enjoyed by the insurer, and if that insurer ultimately fails, the community as a whole is likely to bear the burden of underwriting claims.

2.5.2.1 *Discussion Point 5 - "Master policy" scheme*

DISCUSSION POINT 5

- 5.1 **Would a master policy scheme be appropriate in the South Australian market?**
- 5.2 **What would be the costs of such a scheme?**
- 5.3 **What would be the benefits of such a scheme?**

PART 3: FINANCIAL RESOURCES

3.1 FINANCIAL RESOURCES

To be entitled to a contractor's licence a person must demonstrate sufficient financial resources for the purposes of carrying on business under the licence.³⁵ This represents a significant barrier to entry, as it precludes those who may be otherwise proficient, but lack "sufficient" financial resources, from obtaining a contractor licence.

The Review Panel assesses this requirement as an **intermediate restriction on competition**.

3.1.1 Objectives of the Requirement

This requirement is common to many forms of occupational licensing, and is largely a consumer protection measure. Consumers are perceived to be at risk of financial default by a contractor who may have accepted prepayments or deposits in respect of work to be rendered. It is intended to protect the consumer from losses caused by insolvent traders who are not able to complete contracts and honour their warranties. It also provides a secondary measure of protection for sub-contractors who may be affected by a head contractor collapsing.

The requirement also has as an implicit objective the protection of public health and safety. As has been noted in the New South Wales context:-

"the main cause of substandard work is not a lack of skill rather it is due to economic decisions to cut corners".³⁶

The Review Panel notes that the Act prohibits demands by a contractor for either prepayment of money, or for a deposit of more than \$1,000 in relation to domestic building work.—To this extent, the risk to consumers of financial default by contractors having accepted prepayment or deposits is lessened, and the relevance of the requirement in relation to the objectives is also lessened. However, it must be appreciated that these prohibitions only refer to domestic building work, and not to the broader field of building work generally.

More importantly however, in terms of the objectives of the requirement, is the protection of consumers from traders not being able to complete contracts and honour warranties through financial difficulties.

There is not a significant amount of evidence before the Review Panel that the requirement for applicants to display sufficient financial resources has had any effect on either prediction or reduction of insolvency within the market. By way of example, a review of disciplinary actions before the Commercial Tribunal between

³⁵ In relation to natural persons see section 9(1)(e) and bodies corporate see section 9(2)(d)

³⁶ NSW Green Paper, p.14

1986 and 1995 revealed that none of those actions were commenced on the grounds that the respondent had insufficient financial resources prior to the collapse of their business.

However, the Review Panel considers that to a greater extent, this lack of evidence may be attributed to the positive effect that regulation has had on the incidence of contractor insolvency. In light of this, the Review Panel considers that the prevention of consumer loss through contractors not completing contracts or honouring warranties is of sufficient concern to conclude that the objective of the requirement remains relevant.

3.1.2 Benefits of the Requirement

The key benefit provided by the restriction is, as discussed above, the protecting of consumers against the risk that suppliers will not honour contracts or complete works contracted for due to financial difficulties.

A further benefit provided by the restriction is the potential for reduction in levels of contractor insolvency or bankruptcy, and thus a commensurate reduction in the imposition of costs associated with these events on the wider community. The Review Panel notes in this regard the recent Staff Research Paper released by the Productivity Commissions "*Business Failure and Change: An Australian Perspective*" in which the negative effects that business failures have on the wider community are discussed in detail.³⁷ These negative effects include a decrease in the efficiency of resource allocation in the economy over time, the costs of business failures for creditors, which, while being prima facie private costs, are nonetheless reflected in the wider economy and also the effects of business failures on vulnerable groups, in particular employees of firms that fail.

In its submissions to the review, CASA submitted that both the consumer (through a reduction of the risk of loss due to provider failure) and the contractor (through an increased potential for a successful business) also benefit from the requirement.

The Review Panel also notes the existence of the "secondary" benefit provided by the restriction; the increased likelihood that corners will not be cut in the performance of work due to economic pressures on the contractor's business.

3.1.3 Costs of the Requirement

The Act is silent on what constitutes "sufficient financial" resources. The Explanatory Memorandum notes that the assessment of sufficiency of an applicant's financial resources involves an exercise of judgement on the part of the Commissioner for Consumer Affairs.

³⁷ Bickerdyke, I., Lattimore, R. and Madge, A. 2000, *Business Failure and Change: An Australian Perspective*, Productivity Commissions Staff Research Paper, AusInfo, Canberra.

Currently, the level of financial resources considered "sufficient" is dependent upon the type of work to be undertaken under the licence. The assessment method was developed by the former Commercial Tribunal and revolves around an assessment of access to "working capital", including the adjusted values of some types of assets and not others. The Review Panel notes that this is not a rigorous definition from an accounting or finance perspective, and has anecdotal evidence that it causes confusion with accountants and financially literate clients.

The financial requirements are the same for individuals and bodies corporate. However, the latter group must also have a minimum share issue to the value of \$5,000, which can be partly paid to 1 cent per share. The Review Panel understands that the share capital requirement was seen as a consumer protection mechanism, allowing for a call on unpaid capital in the case of financial difficulties. However, it notes that this scheme perhaps fails to recognise that in the majority of cases these calls will go unpaid, as the owners of the shares, who will also be the directors of the company in most cases, will have previously used all available finances to support the ongoing business.

In response to the initial review, Planning SA questioned whether the subjective assessment of financial criteria achieves the intended result, and may therefore be considered a barrier to entry.

The Small Business Advocate ("the SBA") submitted that in small business, "financial resources" can fluctuate on a daily basis:-

"My concern is that decisions based upon the financial resources at a particular point in time may not give an accurate indication of an applicant's ability to carry on the business in the long term."

Further costs of the requirement arise through the assessment of new licence applications and the routine checking of approximately 20,000 financial statements each year provided by current licensees. Although the information provided is checked by suitably qualified staff from the Office of Consumer and Business Affairs, the process is time consuming and difficult as much of the information is unaudited and may not have been prepared by an accountant. The type of information sought from licensees perhaps exacerbates this problem. Arguably, information which established a trend in the adequacy of a business' cash flow would be more useful to the Office of Consumer and Business Affairs than the current reliance on net tangible assets.

In recognition of the costs associated with these assessments, amendments have recently passed to a number of occupational licensing Acts, including the Building Work Contractors Act 1995, to enable continuous disclosure of material information in place of periodic returns. Under this system, the initial licensing process occurs as at present, but annual returns are replaced by a requirement upon licensees to disclose new material events (including financial events) within fourteen days of such events occurring. This system is supported by a new random auditing program undertaken by staff of the Office of Consumer and Business Affairs.

The Review Panel notes that the new system will reduce the costs associated with the financial resources requirements with respect to checking of periodic returns, whilst retaining the existing process with respect to the initial assessment of the sufficiency of applicants' financial resources.

CASA noted that the current system for determining "sufficiency" of financial resources is too vague, and that greater clarity *"benefits consumers as government resources are not unnecessarily spent on processing hopeless licence applications"*.

3.1.4 Assessing the costs and benefits

While the Review Panel has noted the various costs of this requirement, nonetheless it has come to the conclusion that assessment of financial criteria is a legislative restriction that is justified in the public interest. The benefits provided by assessing a potential supplier's financial resources at the point of entry, that is to say, at the time of first granting a licence, greatly outweigh the costs associated with this restriction.

3.1.5 Conclusion 2 - The need for financial resources tests

CONCLUSION 2

The conclusion of the Review Panel is that the benefits provided to the wider community through the imposition, at some point, of financial resources tests outweigh the associated costs.

3.2 FINANCIAL RESOURCE TESTING AND BUILDING INDEMNITY INSURANCE

When the licensing and insurance regimes are separated, the risk of duplication of market entry restrictions exists.

There is an emerging perception that the relationship between the eligibility criteria applied by providers of building indemnity insurance and the financial resource requirements which are assessed at the point of granting a licence may be inappropriate and out of balance. In this regard, there have been recent suggestions that the insurance market is acting as de facto regulator in financial resource assessment prior to issuing of a policy of building indemnity insurance.

It is clear that the scope and level of financial resource assessment by the Office of Consumer and Business Affairs has some potential impact on the market; either through excluding potential competitors or by allowing licensees to practice who are subsequently unable to meet insurers' requirements.

Where the financial criteria required for insurance are more stringent than the financial criteria required for obtaining a licence, the effect is that a hidden barrier to entry exists. There is also a tension created by the fact that the two sets of criteria seek to achieve different ends and therefore cannot seamlessly be amalgamated. Whereas the licensing criteria should seek to set its financial entry barrier as low as possible whilst maintaining adequate consumer protection, it may be commercially sound for an insurer to set the barrier higher to reduce the risk of loss, if it can do so and still make a reasonable profit.

3.2.1 Discussion point 6 - Duplication of financial testing

DISCUSSION POINT 6

- 6.1 Does the separation of the licensing and insurance schemes present an unnecessary duplication of entry barriers, particularly in relation to financial resource criteria?**

3.3 ALTERNATIVES TO CURRENT SCHEME

There are several ways in which financial resource requirements may be structured and imposed.

In some other jurisdictions, a financial threshold below which a contractor can operate without a licence exists. The Dodd Inquiry in NSW recommended a threshold of \$5,000. For work where the total value of labour and materials is under the threshold amount, contractors could be encouraged to take out insurance as a marketing initiative or guarantee. When this issue was raised with industry parties in the consultation process on the first issues paper, it did not attract industry approval. The Review Panel accepts the reasoning of the submissions made by industry and does not propose any further exploration of the proposal.

In any event, this proposal does not address the primary issue at hand, namely the duplication of financial resource testing in the licensing and insurance requirements, and the manner in which financial resources should be tested.

3.3.1 Removal of requirement from licensing criteria

One option is for financial resources to be removed from the licensing criteria altogether, leaving that function either with a statutory indemnity fund scheme or with a mandated insurer.

It is useful to examine the travel agents industry by way of comparison. A financial resources test is not a component of the licensing process for travel agents, but is a pre-requisite for application to membership of the compulsory indemnity fund, known as the Travel Compensation Fund.³⁸ Membership of the Travel Compensation Fund is, however, a prerequisite for the purposes of being granted a licence. In this sense, the financial resources test is "outsourced" from the licensing function to another entity, membership of which is required for licensing. This ensures that the entity best able to determine the appropriate level of financial resources makes the necessary checks and assessments.

³⁸ *Travel Agents Act 1986* section 9(1)(d)

The Travel Compensation Fund is a national trust fund administered by a Board of Trustees comprising nominees of each State Government that licenses travel agents, an equal number of industry representatives and a consumer representative. The Fund provides, as a last resort, compensation for consumers who suffer loss from dealing with a licensed travel agent. Each licensed travel agent contributes to the Fund³⁹, but no travel agent is admitted to membership of the Fund unless and until the Trustees are satisfied that the travel agent has sufficient financial resources to carry on business.⁴⁰

In order to admit an applicant to membership, the Trustees will consider the applicant's financial position generally. Agents are required to regularly submit financial data and pay annual administration fees and other contributions to the Fund to pay for consumer losses arising from the collapse of other travel agents.⁴¹ The Trustees have the power to require bank or similar guarantees from travel agents whom they consider expose the Fund to excessive risk.⁴²

3.3.1.1 Discussion Point 7 - Removal of financial testing from licensing

DISCUSSION POINT 7

- 7.1 Would transferral of the financial resources requirement away from the licensing authority to another entity be appropriate in the South Australian market?**
- 7.2 What would be the benefits of transferring the financial resources requirement?**
- 7.3 What would be the costs of transferring the financial resources requirement?**

3.2.1 Increased level of financial testing by Government

There are other examples of financial resource testing within the building industry. Building work contractors who wish to take up contracts with the South Australian Government are subject to a financial resources test separate from, and more rigorous than, the test associated with obtaining a licence.

The Department for Administrative and Information Services pre-qualification scheme for building contractors involves a financial capacity analysis in accordance with documented procedures.⁴³ The Department for Administrative and Information Services uses a panel of private sector Chartered Accountants and/or Certified

³⁹ *Travel Agents Act 1986* section 20

⁴⁰ *Travel Agents Act 1986* section 9(1)(d)

⁴¹ insert reference from Trust Deed

⁴² insert reference from Trust Deed

⁴³ "Financial Capacity Analysis Procedures" DAIS publication, edition 2000

Practising Accountants to analyse building contractors' financial information according to the Department's assessment guidelines. The consultants assess the following matters in respect of each applicant:

- Legal trading identity and history of directors;
- Asset backing of the business, particularly the assets available to the business;
- The financial performance of the business over the past three years, based on accounts

The consultants also assess a contractor's:-

- Net worth;
- Working capital;
- Capitalisation;
- Profitability ; and
- Turnover

Against pre-determined base-lines⁴⁴.

Similarly, under the Queensland scheme, a builder must, by virtue of section 31 of the Queensland Act, satisfy the financial requirements stated in the Board's policies. To apply for or renew a licence, a builder must satisfy⁴⁵ a:

- Net tangible assets test (minimum \$15,000);
- Liquidity ratio (minimum 0.8:1);
- Financial monitoring (management accounts to be kept at regular intervals);
- Independent review report or audit report

Schemes of this nature can be compared with the relatively light handed approach adopted under the current regulatory arrangements.

The Review Panel notes that a significant benefit of a more strict financial resource test being applied at the point of licensing may be greater acceptance, without further testing, of applications for building indemnity insurance.

⁴⁴ "Financial Capacity Analysis Procedures" DAIS publication, edition 2000.

⁴⁵ "Financial Requirements for Licensing" Building Services Authority publication, effective as at 1 October 2000.

3.2.1.1 Discussion Point 8 - Alternative financial testing schemes

DISCUSSION POINT 8

- 8.1 Would a more strict approach to financial resource testing by licensing authorities be appropriate in the current market?**
- 8.2 What would be the benefits of a more strict approach?**
- 8.3 What would be the costs of a more strict approach?**

APPENDIX 1 : TERMS OF REFERENCE

APPENDIX 2 : GUIDELINES FOR SUBMISSIONS

This Issues Paper has been prepared to assist those wishing to make submissions in relation to the competition impacts of the current building indemnity insurance and financial resource requirements of the *Building Work Contractors Act 1995*.

The purpose of the paper is to promote discussion in the industry and community, and to seek the views and obtain written submissions from consumers, licensed contractors, professional organisations and other interested persons. The Review Panel will carefully consider all written submissions in completing the competition review process.

Discussion points are raised to promote comment on various issues. Submissions should focus on the costs and benefits of restrictions, and be supported by analysis wherever possible.

Comments need not be restricted to those issues identified in this paper, however they should address issues which are directly related to restrictions on competition.

To ensure that your submission is as effective as possible, you are asked to observe the following guidelines:-

1. All submissions are to be in writing.
2. This Issues Paper is only concerned with Competition Policy issues. The only issues being considered are:
 - a. the effect of the Act and regulations on competition within the relevant market;
 - b. the costs and benefits associated with any restrictions on competition; and
 - c. any *less* regulatory alternatives or alternatives to regulation.
3. At various stages of the Issues Paper discussion points raised. Please read those discussion points and address them in your submission.
4. Please nominate a contact person who can provide further information if required.

ADDRESS FOR SUBMISSIONS

All submissions should be forwarded to the review contact officer, by the due date.

The contact officer for the review is:

Mr Brett Williams
Policy Officer (Competition Policy)
Office of Consumer and Business Affairs
GPO Box 1719
ADELAIDE SA 5001

Telephone: (08) 8204 9659
Facsimile: (08) 8204 1217
E-mail: williams.brett@agd.sa.gov.au

APPENDIX 3 : CONCLUSIONS AND DISCUSSION POINTS

CONCLUSIONS

CONCLUSION 1

The conclusion of the Review Panel is that the benefits to the community as a whole of a legislatively mandated building indemnity insurance scheme of some form outweigh the costs that such a scheme imposes.

CONCLUSION 2

The conclusion of the Review Panel is that the benefits provided to the wider community through the imposition, at some point, of financial resources tests outweigh the associated costs.

DISCUSSION POINTS

DISCUSSION POINT 1

- 1.1 Is the current legislative scheme for building indemnity insurance appropriate in the South Australia market?
- 1.2 What are the costs of the scheme?
- 1.3 What are the benefits of the scheme?

DISCUSSION POINT 2

- 2.1 Have the short term effects of the removal of HIH from the market subsided?
- 2.2 If not, what are those effects and how long are they likely to continue?

DISCUSSION POINT 3

- 3.1 Does the small number of insurers offering building indemnity

insurance in the market present problems in the short or long term to the industry as a whole?

DISCUSSION POINT 4

- 4.1 Would a statutory indemnity fund be appropriate in the South Australian market?**
- 4.2 What would be the costs of such a fund?**
- 4.3 What would be the benefits of such a fund?**

DISCUSSION POINT 5

- 5.1 Would a master policy scheme be appropriate in the South Australian market?**
- 5.2 What would be the costs of such a scheme?**
- 5.3 What would be the benefits of such a scheme?**

DISCUSSION POINT 6

- 6.1 Does the separation of the licensing and insurance schemes present an unnecessary duplication of entry barriers, particularly in relation to financial resource criteria?**

DISCUSSION POINT 7

- 7.1 Would transferral of the financial resources requirement away from the licensing authority to another entity be appropriate in the South Australian market?**
- 7.2 What would be the benefits of transferring the financial resources requirement?**
- 7.3 What would be the costs of transferring the financial resources requirement?**

DISCUSSION POINT 8

- 8.1 Would a more strict approach to financial resource testing by licensing authorities be appropriate in the current market?**
- 8.2 What would be the benefits of a more strict approach?**
- 8.3 What would be the costs of a more strict approach?**

APPENDIX 4 : CONSULTATION LIST

- Accreditation and Registration Council
- ACT Consumer Affairs Bureau
- Australian Competition and Consumer Commission
- Australian Institute of Building
- Australian Small Business Association
- Better Heating and Cooling Bureau
- Building Control Commission
- Building Industry Specialist Contractors Organisation of South Australia
- Building, Electrical and Plumbing Control, ACT
- Construction Industry Training Board
- Concrete Institute of Australia (South Australian Branch)
- Consumer Affairs Division, Treasury, ACT
- Department of Education, Training and Employment (South Australia)
- Department of Fair Trading (Victoria)
- Department of Industry, Science and Tourism
- Department of Transport, Urban Planning and the Arts (South Australia)
- HF Sarah and Sons
- Housing Industry Association Ltd
- Johnson Winter Slattery
- Local Government Association
- Master Painters Association
- Ministry of Fair Trading (Western Australia)
- New South Wales Consumer Protection Agency
- Office of Consumer Affairs (Tasmania)
- Office of Consumer and Business Affairs (South Australia)
- Office of Fair Trading and Business Affairs (Victoria)
- Port Adelaide Training and Development Centre
- South Australian Employers Chamber of Commerce and Industry Inc.
- ACT Building, Electrical and Plumbing Control
- Architects Board of South Australia
- Australian Institute of Building (South Australian Chapter)
- Australian Institute of Builders
- Builder's Registration Board of Western Australia
- Building Asset Policy
- Building Industry Specialist Contractors Association
- Building Services Authority Queensland
- Build-Tec Services Pty Ltd
- Concrete Pumping Contractors Association
- Consumer's Association of South Australia
- Department of Employment, Training and Further Education
- Department of Fair Trading (New South Wales)
- Department of Human Services (South Australia)
- Department of Premier and Cabinet (South Australia)
- Douglas Mawson Institute of TAFE
- Hindmarsh Group
- Insurance Council of Australia Ltd
- Law Society of South Australia
- Master Builders Association
- Master Plumbers Association
- MMAL
- Office of Consumer Affairs (Queensland)
- Office of Consumer Affairs and Fair Trading (Northern Territory)
- Office of Consumer Affairs and Fair Trading (Tasmania)
- Planning SA
- Queensland Building Services Authority