

Home building compensation (premium) insurance guidelines

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1. Introduction

- 1.1 The State Insurance Regulatory Authority (SIRA) is the NSW government organisation responsible for regulating insurance and alternative indemnity products (building cover contracts) under the *Home Building Act 1989* (the Act).
- 1.2 SIRA's adoption of principles-based regulation is intended to encourage a transparent, accountable and flexible model for licensed insurers.
- 1.3 The practices of licensed insurers, and those acting on their behalf, must align with these Guidelines.

2. Commencement

- 2.1 The Guidelines apply from 1 January 2018, until revoked or replaced.

3. Definitions

- 3.1 The terms used in these Guidelines have the following meanings:

Term	Definition
Act	<i>Home Building Act 1989</i> (NSW)
building cover contract	A contract of insurance under Part 6 of the Act or a contract or arrangement for the provision of cover by means of an alternative indemnity product
cohort	A subset of the licensed insurer's portfolio that exhibits claims experience that is statistically different from other subsets. Examples include construction type and project size
contract of insurance	A contract of insurance under Part 6 of the Act
contractor	A person who is required by Part 6 of the Act to enter into a building cover contract
construction type	The construction type as per the table in 7.1.2 of these Guidelines
dispute	A dispute regarding a licensed insurer's pricing decision for a contractor
Guidelines	<i>Home building compensation (premium) insurance guidelines</i>
HBC	home building compensation

Term	Definition
HBC legislation	Includes the Act, the Regulation and any insurance guidelines made under the Act
licensed insurer	An insurer that is the holder of a licence that is in force under Part 6C of the Act and includes the Self Insurance Corporation
premium	The amount to be paid for a contract of insurance
premium filing	A report provided by a licensed insurer to SIRA containing a range of information in support of its annual premium rating structure
product category	The product category as per Part 5 of these Guidelines
Regulation	Home Building Regulation 2014
Risk Premium	Inflated and discounted expected cost of claims
SiCorp	NSW Self Insurance Corporation
SIRA	State Insurance Regulatory Authority
written premium	The sum of the Risk Premium, expense loadings and profit / safety loadings

4. Regulatory framework

- 4.1 These Guidelines are issued under the following sections of the Act:
- 4.1.1 103BD insurance guidelines may provide for the determination of insurance premiums, and
 - 4.1.2 103ED (4) insurance guidelines may adopt the provisions of other publications, whether with or without modification or addition and whether in force at a particular time or from time to time.
- 4.2 Under section 103ED (7) of the Act, it is a condition of licence issued under Part 6C that licensed insurers comply with the relevant provisions of these Guidelines.

5. Scope of guidelines

- 5.1 These Guidelines specify:
- 5.1.1 the minimum requirements for policies of contracts of insurance
 - 5.1.2 how licensed insurers are to present premium filings to SIRA, and

- 5.1.3 how SIRA will assess those filings.
- 5.2 The Guidelines apply to all licensed insurers offering contracts of insurance under Part 6 of the Act.
- 5.3 SIRA will apply these Guidelines in conjunction with HBC legislation, NSW Government policy and other policies and guidelines issued by SIRA.

Product categories

- 5.4 Licensed insurers may offer any one or more of the types of contract of insurance provided for by the HBC legislation, being:
 - 5.4.1 construction period insurance contract
 - 5.4.2 warranty period insurance contract
 - 5.4.3 any other contract of insurance in relation to residential building work that is required by section 92 of the Act, or
 - 5.4.4 any other contract of insurance in relation to residential building work that is required by section 96 of the Act.
- 5.5 Licensed insurers may specialise and choose to offer a particular form(s) of contract of insurance.
- 5.6 Licensed insurers must price each contract of insurance according to the premium methodology approved by SIRA.

Additional products

- 5.7 Licensed insurers may offer additional products and/or product extensions that provide for matters beyond the minimum requirements set out in the Act, the Regulation and these Guidelines. Additional products/product extensions may include, but are not limited to:
 - 5.7.1 top-up cover for additional risks. For example, first resort cover where a home owner may claim in situations where a contractor is solvent and trading, or
 - 5.7.2 additional warranty cover for extensions to the warranty period.
- 5.8 Additional products must be submitted to SIRA for approval in compliance with these Guidelines.
- 5.9 The premium filing must separately address:
 - 5.9.1 the minimum requirements set out in the Act and the Regulation, and
 - 5.9.2 the additional product/product extension.
- 5.10 The certificate of insurance provided to the contractor must also display the premium charged to cover the minimum requirements and the premium required to cover the additional product/product extension. The price for each product must be clearly displayed.

6. Premium principles

- 6.1 Licensed insurer premium filings are required to demonstrate the following principles:

Principle 1: Premiums are fair and reflective of risk

- 6.2 Premiums should be fair and reflect each contractor's level of risk.
- 6.3 In general, fairness can be assessed relative to similar cohorts of contractors. The intention is that contractors that engage in similar industries, business activities, and share similar risk metrics should have similar premium rates.
- 6.4 The licensed insurer must show that its proposed target average premium rate for a particular cohort fairly reflects the expected claims costs, expenses and suitable profit margin for that cohort.

Principle 2: Premiums should not be excessive or inadequate

- 6.5 The HBC scheme should be fair, affordable, and financially viable.
- 6.6 At a scheme level, premiums should not be excessive or inadequate. Affordability in this context relates to the premium burden and the subsequent impact on the NSW economy.
- 6.7 In accordance with section 103BG of the Act, SIRA may reject a licensed insurer's premium filing if it is deemed to be excessive or inadequate, or does not conform to the relevant provisions of these Guidelines.

Principle 3: Premiums should not be unreasonably volatile

- 6.8 Premiums should not be unreasonably volatile year on year.
- 6.9 Licensed insurers must demonstrate that premium movements reflect changes in the actual or perceived level of industry and contractor risk.
- 6.10 Premiums should consider experience over the entire building cycle. In doing so, premiums should not vary according to the phase of the building cycle.

Principle 4: Premiums should provide incentives for risk management and good business practices

- 6.11 Premiums should provide incentives for contractors to improve business practices thereby reducing both the likelihood and severity of potential future claims.
- 6.12 Licensed insurers may offer contractors discounts or load premiums based on the licensed insurer's risk management practices. Discounts and loadings must conform with principles one, two and three and should be designed, to the extent possible, to generate incentives to reduce the level of risk.
- 6.13 At the same time, perverse incentives or incentives that might compromise the scheme must be avoided.

Principle 5: Premiums to be consistent with licensed insurer's capital requirements

- 6.14 Licensed insurers are required to have a capital management plan in place that recognises the financial and insurance risks inherent in HBC portfolios. A licensed insurer's premium basis needs to be consistent with their approved capital management plan.
- 6.15 In setting premiums, licensed insurers must comply with NSW government competitive neutrality principles.

7. Premium requirements for licensed insurers

- 7.1 Licensed insurers must quote a premium for all contractors the licensed insurer has deemed eligible, in accordance with the *HBC (eligibility) insurance guidelines*.
- 7.2 Part 7 outlines details of:
 - 7.2.1 risk factors to be used in pricing (additional factors may be approved upon request)
 - 7.2.2 premium compliance program, and
 - 7.2.3 disclosure of the premium methodology.

Risk factors to be used in pricing

- 7.3 Licensed insurers must submit pricing for each contract of insurance option to SIRA for assessment and approval before making the offering to the market.
- 7.4 The factors that may be considered are:
 - 7.4.1 contract value
 - 7.4.2 construction type
 - 7.4.3 location of premises, and
 - 7.4.4 contractor risk factors approved by SIRA.
- 7.5 Additional risk factors may only be considered if they have been approved by SIRA. If a licensed insurer would like to use additional risk factors in the licensed insurer's determination of premiums, these must be submitted in writing to SIRA for approval with a sufficient basis for being used.
- 7.6 Any additional risk factors must comply with the principles as stated in Part 6 of these Guidelines. Additional risk factors must have a stated objective that demonstrates why they improve the licensed insurer's ability to provide accurately priced products.
- 7.7 SIRA can approve or reject these additional factors for use in premium pricing.

Contract value

7.8 Contracts of insurance must be priced in accordance with the total value of the construction work to be covered by the contract of insurance (inclusive of GST).

Construction type

7.9 Contracts of insurance must be priced in accordance with the agreed categories stated below. Any additional categories must be submitted to and approved by SIRA before being used to class premium pricing.

7.10 The construction type categories are:

Category	Additional detail
C01 - New single dwelling construction	New single dwelling construction - includes granny flats when an addition to an existing dwelling.
C02 - Multi dwelling alterations/additions (i.e. majority of work is structural)	Multi dwelling alterations/additions (i.e. majority of work is structural) where a strata or community title exists over any number of storeys and including terraces, villas, townhouses or multi dwelling units
C03 - New multi dwelling construction (three [3] storeys or less)	New multi dwelling construction (three storeys or less) - (e.g. blocks of units, flats etc.) where a strata or community title exists The C03 category <i>does not</i> include the construction of free-standing dwellings on individual sites without any shared services or structural components (e.g. common walls, roofing etc.) and which will not be subject to strata title or community title on occupation
C04 Single dwelling alterations/additions (i.e. majority of work is structural)	Single dwelling alterations/additions where the majority of work is structural work
C05 Swimming pools	Swimming pools as stand-alone building contracts
C06 Renovations (i.e. majority of work is non-structural) - single and multi-dwelling	May include the following structural contracts, which are considered renovations for premium purposes (i.e. coded as C06 contracts), even though a six-year period of warranty/cover may be deemed to apply: <ul style="list-style-type: none"> • the erection of prefabricated patios, garages and sheds • bathroom and kitchen renovations that may include projects involving window replacement and water proofing membranes • replacement of roof coverings without alteration to roof structure • timber decks (including timber slatted balconies) and pergolas

Category	Additional detail
	<ul style="list-style-type: none"> landscaping – where retaining walls do not exceed 25 per cent of the contract price solar panels driveways and other paving
C07 Other – not included above	Other construction types which do not fit any of the other valid codes like C01 to C06. For example, kit/transportable homes.
C08 Multiple dwellings renovations – non structural	Renovations (where the majority of the work is minor - Non Structural) to multi-unit dwellings over any number of storeys and including terraces, villas, townhouses or multi dwelling units
C09 New duplex, dual occupancy, triplex and/or terrace (attached) construction	<p>New construction of duplex, dual occupancies, triplex and/or terrace (attached) or</p> <p>A new single dwelling with a granny flat or studio with certificates issued for each occupancy</p>

Location

- 7.11 Premiums for projects in regional areas of NSW may be set at a lower rate than those located in metropolitan areas to reflect the level of risk and cost of claims.
- 7.12 SIRA sets the definition of regional and metropolitan locations. The definitions are in the table below.

Table 1: Regional and metropolitan locations by postcode

Metropolitan (Sydney, Newcastle, Central Coast)		Regional	
From	To	From	To
2000	2309	2311	2312
2315	2327	2328	2551
2555	2574	2575	2739
2745	2786	2787	2899
		Other - 3544, 3691, 3707, 4377, 4380, 4383, 4385	

Contractor risk factors approved by SIRA

- 7.13 Contracts of insurance may be priced in accordance with the risk factors stated below.

- 7.14 The introduction of risk based pricing means contractors will be offered premiums that aim to reflect the contractor's level of risk.
- 7.15 Premiums that better reflect a contractor's level of risk will result in a contractor with a high-risk profile paying a higher premium, and a contractor with a low-risk profile receiving a discount relative to base levels.
- 7.16 The contractor risk factors that licensed insurers can measure contractors against are set by SIRA.
- 7.17 Licensed insurers must only measure and price premiums based against the following factors:

Risk factor	Explanation
Time entity licence held	The period that the contractor entity has held its appropriate contractor's licence.
Business structure	The structure of the contractor entity that holds the building licence. The options are sole trader, partnership, trust or company.
Adjusted net tangible assets (ANTA) in entity	A contractor's adjusted net tangible assets (ANTA) value represents the net 'fire sale' position of tangible assets less third party liabilities.
Net profit before tax or taxable income	A contractor entity's net profit is the value arrived by subtracting cost of sales and operating expenses from the revenue.
Adverse trading history	A contractor is considered to have an adverse trading history if any of the following events has occurred: previous insolvencies, past HBC claims, contractor licence suspension/cancellation/fines/penalties, outstanding NSW Civil and Administrative Tribunal/court orders, unresolved complaints/disputes at NSW Fair Trading and loss notifications.
Reviews not current	Reviews are scheduled on a regular basis to assess a contractors continuing suitability to apply for a certificate of insurance. Failure to participate in scheduled reviews affects contractor's risk profile.
Audited Accounts	The contractor has submitted prior year end audited accounts for audit by external accountants. The most recent year end account will be subjected to external audit.

Disclosure of premium methodology

- 7.18 All disclosure of information must comply with section 121 of the Act.
- 7.19 Licensed insurers must make publicly available a premium calculator which can be utilised to accurately estimate or reconstruct the premium charged to contractors.
- 7.20 Licensed insurers must make available the terms and conditions of their contract of insurance policy to contractors and consumers on a publicly accessible website at all times. Licensed insurers must give adequate prior notice of any changes to these terms and conditions to affected contractors.

Limits

- 7.21 Adjusting for risk factors, licensed insurers must charge premiums within 50 per cent of the approved base level premiums.

8. Premium filing process

Frequency of submission of premiums

- 8.1 A licensed insurer must not offer a premium that has not been filed with SIRA.
- 8.2 Licensed insurers are to provide their premium filing every 12 months at a timeframe agreed with SIRA, unless SIRA authorises the licensed insurer to continue offering the licensed insurer's current filed premiums.
- 8.3 A licensed insurer may submit a revised filing to SIRA at any time.
- 8.4 SIRA may require a licensed insurer to lodge a new filing at any time, subject to the notice period of eight weeks to do so specified in section 103BF (2) of the Act.

Premium filing meetings

- 8.5 Each licensed insurer is encouraged to meet with SIRA for a pre-filing meeting.
- 8.6 Examples of items that may be covered in this meeting include, but are not limited to:
- 8.6.1 expected business volumes and contract values
 - 8.6.2 material assumptions underlying the proposed premium rates
 - 8.6.3 changes in premium rates or the approach to setting premium rates since the previous filing, and
 - 8.6.4 the licensed insurer's business plan, and how the business plan relates to the proposed filing.

Premium filing in accordance with sections 103BF of the Act

- 8.7 Information listed below is to be provided separately for each product category and construction type. The filing must include:
- 8.7.1 either confirmation that the policy will provide only the minimum coverage required by the Act, or a description of additional coverage to be offered
 - 8.7.2 a description of the proposed rating structure
 - 8.7.3 the base premium for the metro area
 - 8.7.4 the function that relates base premium to contract value
 - 8.7.5 proposed reinsurance arrangements and premiums and the impact of any allowance made for reinsurance recoveries
 - 8.7.6 the impact of any allowance made for indemnities
 - 8.7.7 the allowance made for expenses including, but not limited to, distribution, underwriting, policy administration, claims handling and overheads. Detail

as to how expense loadings are applied. For example, flat expense per policy or as a percentage of the base premium

- 8.7.8 the impact of inflating future cashflows and the inflation assumptions applied
- 8.7.9 the impact of discounting future cashflows and the discount rate assumptions applied
- 8.7.10 discounts and loadings applied to each level of each rating factor. Approved rating factors are listed in 7.4
- 8.7.11 profit/safety loadings, and
- 8.7.12 government taxes/levies applied.
- 8.8 The filing must include a projection of the following components over the next year, subdivided by rating factor and in aggregate:
 - 8.8.1 number of certificates issued
 - 8.8.2 contract value covered
 - 8.8.3 written premium before the application of loadings and discounts
 - 8.8.4 written premium after the application of loadings and discounts, and
 - 8.8.5 government taxes/levies charged.
- 8.9 Actuarial sign-off is required to support:
 - 8.9.1 the calculation of the risk premium. Information must be provided separately for non-completion and defect claims and cover average claim frequency and average claim size assumptions. There must be a demonstrated link between experience over the full building cycle and the assumptions presented in the premium filing
 - 8.9.2 the allowance for expenses. Expenses should be reasonable and the allowance made must be supported by evidence
 - 8.9.3 the profit/safety loading. The profit/safety loading should not be excessive or inadequate and should consider the licensed insurer's capital requirements, target rate of return on capital, and the compulsory nature of the contract of insurance, and
 - 8.9.4 risk factors and discounts/loadings.
- 8.10 Subsequent filings must include explanation, justification and quantification of effects on proposed premium changes from the licensed insurer's current in-force filing.
- 8.11 Subsequent filings must include a comparison of actual experience with the projections made in the previous filing. The comparison must cover:
 - 8.11.1 the number and breakdown by product category, rating factor and average premium of actual certificates issued during the previous 12 months with projections in the licensed insurer's previous filings covering that period, and
 - 8.11.2 actual expenses for this product by type during the previous 12 months with projections in the licensed insurer's previous filings covering that period.

- 8.12 Each premium filing must include the licensed insurer's assessment of how the proposed premiums meet the premium principles as specified in Part 6 of these Guidelines.

Assessment and rejection of premium filing in accordance with section 103BG of the Act

- 8.13 SIRA will assess a licensed insurer's premium filing (submitted as per Part 8 of these Guidelines) against the following criteria:
- 8.13.1 compliance with the premium principles as described in Part 6 of these Guidelines
 - 8.13.2 compliance with the premium requirements as described in Part 7 of these Guidelines, and
 - 8.13.3 compliance with the premium filing requirements described in 8.7 of these Guidelines.
- 8.14 Failure to demonstrate compliance to a reasonable degree with these Guidelines and in particular any of the abovementioned criteria, may result in a rejection of the premium filing.
- 8.15 SIRA will complete an assessment of a licensed insurer's premium filing within eight weeks of receipt. The assessment period will begin only when all of the required premium filing information has been received by SIRA.
- 8.16 As per section 103BE (5) of the Act, the period allowed for rejecting a premium is eight weeks.
- 8.17 SIRA may request additional information or amendments to the premium filing in order to ensure that the criteria of the Guidelines are met. Licensed insurers must respond to requests for additional information or amendments promptly.
- 8.18 SIRA will advise a licensed insurer in writing once the assessment is complete, advising that the premium filing has not been rejected.
- 8.19 Once SIRA confirms that an assessment is complete and the premium filing has been not been rejected, a licensed insurer must apply the rates and rating structure from commencement of the premium filing period without discretion.
- 8.20 Where a premium filing is rejected, SIRA will provide written notice of its rejection of a premium and the reasons for the rejection.
- 8.21 Where a premium is rejected, SIRA and the licensed insurer will adhere to the arbitration process outlined in section 103BG of the Act.

9. Transitional arrangements

- 9.1 To minimise disruption, the following transitional arrangements will apply to SICorp.

SICorp HBC premium filing

- 9.2 SICorp is required to provide a premium filing compliant with these Guidelines by 31 March 2018. SIRA will assess the filing in accordance with these Guidelines with the premium filing to take effect no later than 30 June 2018.

10. Compliance program for licensed insurers

- 10.1 Each licensed insurer must maintain a premium compliance/audit program to ensure that contractors within their portfolio of contracts of insurance are compliant with the relevant NSW risk ratings assessed to them, and the HBC legislation, and rulings as issued and maintained by SIRA.

11. Dispute resolution process

- 11.1 Licensed insurers must have a process in place where a contractor may appeal aspects of their premium determination. The dispute process must include as a minimum:
- 11.1.1 contact details for appeals and reviews within the licensed insurer
 - 11.1.2 a clear process for and internal register of complaints that can be reviewed by SIRA
 - 11.1.3 actions required by a contractor and the licensed insurer in the dispute process
 - 11.1.4 timeframes for lodging and resolving disputes
 - 11.1.5 procedures for acknowledgement by a licensed insurer of any request for review within five business days and completion and finalisation of the review in a timely manner
 - 11.1.6 further options for the contractor that include lodging a complaint with SIRA, and
 - 11.1.7 providing SIRA's contact details to the contractor so that they may seek a procedural review where they are not satisfied with the approach or outcome of the licensed insurer's determination.
- 11.2 A contractor may request that SIRA undertake a regulator compliance review to investigate potential breaches of the Act, the Regulation or the insurance guidelines. A regulator compliance review is not a mechanism of appeal to review of the merits of a particular premium, and does not overturn premium decisions.
- 11.3 SIRA may audit a licensed insurer to ensure compliance with these Guidelines.

Disclaimer

This publication may contain information that relates to the regulation of workers compensation insurance, motor accident third party (CTP) insurance and home building compensation in NSW. It may include details of some of your obligations under the various schemes that the State Insurance Regulatory Authority (SIRA) administers.

However to ensure you comply with your legal obligations you must refer to the appropriate legislation as currently in force. Up to date legislation can be found at the NSW Legislation website legislation.nsw.gov.au

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