

# Home building compensation (contribution) AIP guidelines

**State Insurance  
Regulatory  
Authority**

**31 August 2018**

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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 providers.
- 1.3 The practices of licensed providers, and those acting on their behalf, must align with these Guidelines.

# 2. Commencement

- 2.1 The Guidelines apply from 31 August 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)
AIP	Alternative indemnity product as defined under Part 6B of the Act
building cover contract	A contract or arrangement for the provision of cover by means of an alternative indemnity product
contractor	A person who is required by Part 6 of the Act to enter into a building cover contract
contribution	A contribution or membership payment in respect of fidelity fund cover for the purposes of Part 6A of the Regulation or a charge in respect of a specialised insurance arrangement for the purposes of Part 6B of the Regulation
contribution filing	A report provided by a licensed provider to SIRA containing a range of information in support of its annual contribution rating structure
construction type	The construction type as per the table in 7.7 of these Guidelines
dispute	A dispute regarding a licensed provider's pricing decision for a contractor
Guidelines	<i>Home building compensation (contribution) AIP guidelines</i>

Term	Definition
HBC	home building compensation
HBC legislation	Includes the Act, the Regulation and any insurance guidelines made under the Act
licensed provider	A provider of an alternative indemnity product that is the holder of a licence that is in force under Part 6C of the Act
product category	The product category as per 5.4 of these Guidelines
Regulation	Home Building Regulation 2014
SIRA	State Insurance Regulatory Authority

## 4. Regulatory framework

- 4.1 These Guidelines are issued under the following provisions of the Act and the Regulation:
- 4.1.1 Section 104E of the Act, Insurance Guidelines relating to alternative indemnity products
  - 4.1.2 Section 104E (1) (b) of the Act, Insurance Guidelines relating to the determination of premiums or other charges for provision of cover by means of alternative indemnity products,
  - 4.1.3 Section 103ED (4) of the Act, 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.
  - 4.1.4 Clause 62X of the Regulation, Insurance Guidelines for the determination of contributions or membership payments, and
  - 4.1.5 Clause 62ZY of the Regulation, Insurance Guidelines for the determination of charges.
- 4.2 Under section 103ED (7) of the Act, it is a condition of licence issued under Part 6C that licensed providers comply with the relevant provisions of these Guidelines. These guidelines apply to alternative indemnity products only.

## 5. Scope of guidelines

- 5.1 These Guidelines specify:
- 5.1.1 the requirements for setting and charging contributions for building cover contracts
  - 5.1.2 how licensed providers are to present contribution filings to SIRA, and

- 5.1.3 how SIRA will assess those filings.
- 5.2 The Guidelines apply to all licensed providers offering building cover contracts.
- 5.3 SIRA will apply these Guidelines in conjunction with relevant legislation, NSW Government policy and other policies and guidelines issued by SIRA.

## Product categories

- 5.4 Licensed providers may offer any one or more of the types of building cover contracts provided for by the HBC legislation, being:
  - 5.4.1 a construction period fidelity fund contract within the meaning of Part 6A of the Regulation
  - 5.4.2 a warranty period fidelity fund contract within the meaning of Part 6A of the Regulation
  - 5.4.3 construction period alternative indemnity contract within the meaning of Part 6B of the Regulation
  - 5.4.4 a warranty period alternative indemnity contract within the meaning of Part 6B of the Regulation
  - 5.4.5 any other contract or arrangement for the provision of cover by means of an alternative indemnity product in relation to residential building work that is required by section 92 of the Act, or
  - 5.4.6 any other contract or arrangement for the provision of cover by means of an alternative indemnity product in relation to residential building work that is required by section 96 of the Act.
- 5.5 Licensed providers may specialise and choose to offer a particular form(s) of building cover contract.
- 5.6 Licensed providers must price each building cover contract according to the contribution methodology filed with SIRA.

## Additional products

- 5.7 Licensed providers 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 example, first resort cover enabling a home owner to claim in situations where a contractor is solvent and trading), or
  - 5.7.2 additional warranty cover – extensions to the warranty period.
- 5.8 Additional products must be submitted to SIRA for approval in compliance with these Guidelines.
- 5.9 The contribution 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.

## 6. Contribution principles

- 6.1 Licensed provider's must demonstrate that their contribution methodology complies with the following principles.

### **Principle 1: Contributions are fair and reasonable**

- 6.2 Contributions should be fair and reasonable and based on a readily understandable and transparent pricing model.

### **Principle 2: Contributions should be sustainable, not excessive or inadequate**

- 6.3 The HBC scheme should be fair, affordable, and financially viable.
- 6.4 At a scheme level, contributions should not be excessive or inadequate. Affordability in this context relates to the contribution rate and the subsequent impact on construction in NSW.
- 6.5 Contributions collected (in total) should be consistent with a sustainable and stable business model. We would expect the licensed provider to demonstrate how they will manage the potential impact on the stability of their overall business model for known market participation issues (for example, potential adverse selection issues)."
- 6.6 In accordance with section clauses 62ZA and 62ZZB of the Regulation, SIRA may reject a licensed provider's contribution filing if it is deemed to be excessive or inadequate, or does not conform to the relevant provisions of the Guidelines.

### **Principle 3: Contributions should not be unreasonably volatile**

- 6.7 Contributions should not be unreasonably volatile year on year.
- 6.8 Licensed providers must demonstrate that contribution movements reflect changes in the cost of providing cover.
- 6.9 Contributions should consider experience over the entire building cycle. In doing so, licensed providers should not plan for contributions to vary according to the phase of the building cycle.

### **Principle 4: Contributions are to be consistent with licensed provider's capital requirements**

- 6.10 Licensed providers are required to have a capital management plan in accordance with the HBC prudential (insurance) guidelines.
- 6.11 A licensed provider's contribution basis and capital management plan must be consistent with each other.

## 7. Contribution requirements for licensed providers

- 7.1 Licensed providers must quote a contribution for all contractors they have deemed eligible, in accordance with the *Home building compensation (eligibility) insurance guidelines*.
- 7.2 Part 7 outlines details of:
- 7.2.1 factors to be used in determining the contribution rate
  - 7.2.2 the contribution compliance program, and
  - 7.2.3 disclosure of the contribution methodology.

### Factors to be used in contributions

- 7.3 Licensed providers must submit pricing for each building cover contract 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, and
  - 7.4.2 construction type.
- 7.5 Additional rating factors may only be considered if they have been approved by SIRA. If a licensed provider would like to use additional rating factors in the determination of contributions, these must be submitted in writing to SIRA for approval with a sufficient basis for being used.
- 7.6 Any additional rating factors must comply with the principles as stated in Part 6 of these Guidelines.
- 7.7 SIRA may approve or reject these additional rating factors for use in the determination of contributions

### Contract value

- 7.8 Contributions must be priced in accordance with the total value of the construction work to be covered by the building cover contract (inclusive of GST).

### Construction type

- 7.9 Contributions 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 as a factor for contribution 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	Multi dwelling alterations/additions (i.e. majority of work is structural) where a strata or community title exists over

Category	Additional detail
(i.e. majority of work is structural)	any number of storeys and including terraces, villas, townhouses or multi dwelling units
C03 - New multi dwelling construction (three [3] storeys or less)	<p>New multi dwelling construction (three storeys or less) - (e.g. blocks of units, flats etc.) where a strata or community title exists</p> <p>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</p>
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 dwelling	<p>May include the following structural contracts, which are considered renovations for contribution purposes (i.e. coded as C06 contracts), even though a six-year period of warranty/cover may be deemed to apply:</p> <ul style="list-style-type: none"> <li>• the erection of prefabricated patios, garages and sheds</li> <li>• bathroom and kitchen renovations that may include projects involving window replacement and water proofing membranes</li> <li>• replacement of roof coverings without alteration to roof structure</li> <li>• timber decks (including timber slatted balconies) and pergolas</li> <li>• landscaping – where retaining walls do not exceed 25 per cent of the contract price</li> <li>• solar panels</li> <li>• driveways and other paving</li> </ul>
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 or 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 building cover contracts issued for each occupancy</p>



## Disclosure of contribution methodology

- 7.11 All disclosure of information must comply with section 121 of the Act.
- 7.12 Licensed providers must make publicly available a contribution calculator which can be utilised to accurately estimate or reconstruct the contribution charged to contractors.
- 7.13 Licensed providers must make available the terms and conditions of their contract or arrangement for the provision of cover by means of an alternative indemnity product to contractors and consumers on a publicly accessible website at all times.
- 7.14 Licensed providers must give adequate prior notice of any changes to these terms and conditions to affected contractors.

## 8. Contribution filing process

### Frequency of submission of contributions

- 8.1 A licensed provider must not offer a contribution that has not been filed with SIRA.
- 8.2 Licensed providers are to provide their contribution filing every 12 months at a timeframe agreed with SIRA, unless SIRA authorises the licensed provider to continue to offer the provider's current filed contributions.
- 8.3 A licensed provider may submit a revised filing to SIRA at any time.
- 8.4 SIRA may require a provider to lodge a new filing at any time, subject to the notice period of eight weeks to do so as specified in clauses 62Z and 62ZZA of the Regulation.

### Contribution filing meetings

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

### Contribution filing requirements

- 8.6 Information listed in 8.7 and 8.8 is to be provided separately for each Product Category and Construction Type. Where licensed providers treat these items in aggregate (either across Product Categories or Construction Types), they should reasonably allocate them for filing.
- 8.7 The filing must include details of the assumed costs of providing cover:

- 8.7.1 the assumed cost of claims.
- 8.7.2 proposed insurance arrangements and contributions and the impact of any allowance made for insurance recoveries
- 8.7.3 the impact of any allowance made for indemnities
- 8.7.4 the allowance made for expenses including, but not limited to, distribution, underwriting, policy administration, claims handling and overheads, and detailing how expense loadings are applied (for example, a flat expense-per-building-cover contract or as a percentage of the contribution)
- 8.7.5 the impact of inflating future cashflows and the inflation assumptions applied
- 8.7.6 the impact of discounting future cashflows and the discount rate assumptions applied
- 8.7.7 profit/safety loadings, and
- 8.7.8 government taxes/levies applied.
- 8.8 The filing must include details of the cover contributions structure:
  - 8.8.1 either confirmation that the building cover contract will provide only the minimum coverage required by the Act and Regulation, or a description of additional coverage to be offered
  - 8.8.2 a description of the proposed contribution structure, and
  - 8.8.3 the function that relates contribution to Contract Value.
- 8.9 The filing must include a projection of the following components over the next year, sub-divided by construction type and in aggregate:
  - 8.9.1 number of building cover contracts issued
  - 8.9.2 contract value covered
  - 8.9.3 total contributions charged, and
  - 8.9.4 government taxes/levies charged.
- 8.10 Actuarial sign-off is required to support the approach to:
  - 8.10.1 the calculation of contributions. 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 contribution filing.
  - 8.10.2 the allowance for expenses. Expenses should be reasonable and the allowance made must be supported by evidence.
  - 8.10.3 the profit/safety loading. The profit/safety loading should not be excessive or inadequate and should consider the licensed provider's capital requirements, target rate of return on capital, and the compulsory nature of the building cover contract.
- 8.11 Subsequent filings must include an explanation, justification and quantification of effects on proposed contributions of changes from the licensed provider's current in-force filing.
- 8.12 Subsequent filings must include a comparison of actual experience with the projections made in the previous filing. The comparison must cover:

- 8.12.1 number and breakdown by product category and average contribution of actual building cover contracts issued during the previous 12 months with projections in the licensed provider's previous filings covering that period, and
- 8.12.2 actual expenses for this product by type during the previous 12 months with projections in the licensed provider's previous filings covering that period.
- 8.13 Each contribution filing must include the licensed provider's assessment of how the proposed contributions meet the contribution principles as specified in Part 6 of these Guidelines.

## Assessment and rejection of contribution filing

- 8.14 SIRA will assess a licensed provider's contribution filing (submitted as per Part 8 of these Guidelines) against the following criteria:
  - 8.14.1 compliance with the contribution principles as described in Part 6 of these Guidelines
  - 8.14.2 compliance with the contribution requirements as described in Part 7 of these Guidelines, and
  - 8.14.3 compliance with the contribution filing requirements described in 8.6-8.13 of these Guidelines.
- 8.15 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 contribution filing.
- 8.16 SIRA will complete an assessment of a licensed provider's contribution filing within eight weeks of receipt. The assessment period will begin only when all of the required contribution filing information has been received by SIRA.
- 8.17 Under clauses 62Y(5) and 62ZZ(5) of the Regulation, the period allowed for rejecting a contribution is eight weeks.
- 8.18 SIRA may request additional information or amendments to the contribution filing to ensure that the criteria of the Guidelines are met. Licensed providers are required to respond to requests for additional information or amendments promptly.
- 8.19 SIRA will advise a licensed provider in writing once the assessment is complete, advising that the contribution filing has not been rejected.
- 8.20 Once SIRA confirms that an assessment is complete and the contribution filing has not been rejected, a licensed provider must apply the contributions from commencement of the contribution filing period.
- 8.21 Where a contribution filing is rejected, SIRA will provide written notice of its rejection of a contribution and the reasons for the rejection.
- 8.22 Where a contribution is rejected, SIRA and the licensed provider will adhere to the process outlined in clauses 62ZA and 62ZZB of the Regulation.

## 9. Compliance program for licensed providers

- 9.1 Each licensed provider must maintain a contributions compliance/audit program to ensure that contractors within their portfolio of building cover contracts are compliant with the legislation, guidelines and rulings in regards to contributions as issued and maintained by SIRA.

#### 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](http://legislation.nsw.gov.au)

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