

11 January 2021

Design and Building Practitioners Regulation 2020
Policy and Strategy
Better Regulation Division | NSW Department of Customer Service
BCR@customerservice.nsw.gov.au

Dear Sir/Madam

DESIGN AND BUILDING PRACTITIONERS REGULATIONS

The Insurance Council of Australia¹ (Insurance Council) welcomes the opportunity to provide feedback on regulations under the Design and Building Practitioners Act 2020 (the Act).

The Insurance Council and its members support the Act's overall objectives to improve the quality and compliance of design documentation and to strengthen accountability across the design, building and construction sector in relation to multi-storey, multi-unit apartment buildings. We acknowledge that the reforms are part of the NSW Government's response to the Building Confidence Report.

The Insurance Council provided a submission to the Department of Customer Service's preliminary consultation with stakeholders in the development of the regulations and has previously made submissions on both the Act and regulations.

We reiterate that elements of the Act in combination with the draft regulations, are likely to exacerbate rather than address the lack of available insurance highlighted in the Building Confidence Report. Furthermore, the Commonwealth legislated unfair contract terms regime for insurance contracts takes effect in early April 2021 and is likely to add to expectations around exclusion free coverage by insurers. Attachment A provides an overview of market, notably the professional indemnity insurance market has experienced high loss ratios of over 95 percent for the past 3 years which is unsustainable.

¹ The Insurance Council of Australia is the representative body of the general insurance industry in Australia. Our members represent approximately 95 percent of total premium income written by private sector general insurers. Insurance Council members, both insurers and reinsurers, are a significant part of the financial services system.

Insurance Council members provide insurance products ranging from those usually purchased by individuals (such as home and contents insurance, travel insurance, motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability insurance, professional indemnity insurance, commercial property, and directors and officers insurance).

September 2020 Australian Prudential Regulation Authority statistics show that the general insurance industry generates gross written premium of \$51.8 billion per year and has total assets of \$136.5 billion. The industry employs approximately 60,000 people and on average pays out about \$171.4 million in claims each working day.

Over the 12 months to September 2020 the industry's net profit after tax (NPAT) was \$0.9 billion - a 73 per cent decrease from the prior year's NPAT of \$3.4 billion. The industry's underwriting result was \$1.6 billion, falling by 16 per cent from \$1.9 billion in the prior year.

Insurers will not have an appetite to provide cover for the historical stock of buildings where work was undertaken without sufficient oversight. We acknowledge that the critical elements of the reforms – lodgement and quality of regulated designs, along with oversight and compliance – go towards re-instilling trust in the industry. Willingness to underwrite the risks of building professionals will only return after these critical elements of the reforms have taken effect and there is evidence that the issues within the building industry have been successfully addressed.

At present, those regulated under the Act and regulations – design practitioners, principal design practitioners, building practitioners and engineers (collectively referred to within submission as building professionals) – will find it extremely difficult, or near impossible, to meet the insurance requirements stipulated under the regulations.

Any insurance requirements stipulated will need to recognise what is available in the market at present and commercially realistic. Otherwise, professionals could find themselves without the insurance they need to be authorised to practise. They will face significant financial penalties under the proposed regulations if they practise without the requisite insurance. This risk is increased where professionals find themselves subject to duty of care provisions on a retrospective basis. Some insurers are now issuing policies that seek to exclude coverage of claims arising as a result of new and retrospective obligations imposed by the Act.

We recognise that the building professionals, to be regulated under the Act and regulations, will be critical to the NSW Government focus on an infrastructure project led economic recovery following the recent pandemic. The Insurance Council has engaged with Engineers Australia, Consult Australia and National Insurance Brokers Association of Australia in developing this submission. We welcome further dialogue with the Department on practical solutions to fulfill professionals' insurance requirements under the regulations in light of the issues highlighted below.

Duty of care provision under the Act

Under Part 4, the Act provides that builders and certain designers, manufacturers, suppliers and supervisors now owe a statutory duty of care to current and future owners to avoid economic loss caused by defects in respect of certain buildings. Further, this duty applies retrospectively such that owners may enforce this new statutory duty of care for economic loss in respect of existing buildings where the loss first became apparent within the last 10 years, or for a loss that first became apparent on or after 11 June 2020.

As a result, insurers need to take into account any work building professionals have completed in the last 10 years in order to understand the scope of their liability. This has significant implications for the PII market which has already tightened because of the existing problems with defective construction.

It exposes building professionals to liability in circumstances when at the time of the relevant work being carried out the statutory duty of care did not exist. Further, given the "claims made and notified" nature of coverage triggers for professional indemnity cover, there is likely to be a review of underwriting criteria and guidelines for professions which are impacted by this duty. This review will be NSW-centric and position NSW exposed risks as outliers in an already challenging professional indemnity market for construction industry

participants. Some insurers may choose not to write NSW based risks or adjust their appetite for such risks.

As in our previous submission to the Department on the regulations, we reiterate that the new requirements for insurance cover should be for new projects rather than on a retrospective basis since the risks associated with past projects are unknown. Without certainty as to the risk that they would be taking on, insurers are unable to price for it. The existing premium pool from building professionals is also insufficient to rectify the issues stemming from past projects.

Exclusion free insurance requirements

The Act requires registered building professionals to be “adequately insured”. We note that under section 105 of the Act, the Secretary may require information about insurance policies for the purposes of the legislation. Standard wording provided to building professionals is generally publicly available from insurers’ websites, but specific exclusions are tailored to insureds and details of insurers’ underwriting approach would not be able to be shared.

The Insurance Council is concerned that the way in which the insurance requirements are worded may exacerbate rather than address the lack of available insurance highlighted in the Building Confidence Report. For instance, section 11 states that “adequately insured” in relation to work for design practitioners is if the practitioner:

- (a) is indemnified by insurance that complies with the regulations against *any liability* [italics added for emphasis] to which the practitioner may become subject as a result of providing the declaration or doing the work; or
- (b) is part of some other arrangement approved by the regulations that provides indemnity against the liability.

As noted in our previous submissions, professional indemnity insurance policies typically contain exclusions in relation to non-conforming products and practices, and certain other high risk exposures. To the extent that the reference in section 11 of the Act to “any liability” precludes an insurer from offering policies that contain these exclusions, insurers will not be able to provide cover.

We appreciate that, in response to the Insurance Council’s previous submissions, the regulations now refer to exclusions within professional indemnity insurance policies. However, this is not done consistently, and the scope of the building professional’s liability is unclear. For example, clause 71 notes that “exclusions” exist under policies but other clauses, such as 65 and 67, require that all liability be covered (Attachment B refers).

Overall approach to regulation: insurance requirements

When it comes to insurance, we note the differential treatment of two types of building professionals under the regulations – first, design practitioners, principal design practitioners and professional engineers; and secondly, building practitioners.

Building practitioners

As noted in our preliminary submission on the regulations, there isn’t any product readily available in the market which responds to the certification process for a building by a builder since this is more akin to a warranty which PII is not designed to cover. Nevertheless, the

regulations require registered building practitioners to be covered by an insurance policy in the same manner as other practitioners.

However, in recognition of our members' input on the lack of availability of such a product, the regulations exempt registered building practitioners for a two-year period from the commencement of the regulations. In addition, the Secretary is to still have the ability to exempt a building practitioner from insurance requirements in certain circumstances, including where the practitioner is unable to obtain an insurance policy that provides indemnity against liability associated with the certification.

For reasons articulated in our preliminary submission on the regulations, we do not envisage the development of new insurance products which would cater to the certification process for a building by a builder. While builders warranty insurance covers this type of activity, it has not been successful or adequate in terms of the amount of compensation required. The NSW Government has in the past considered schemes of last resort to cater for unexpected shocks within an industry but nothing concrete has eventuated thus far. Our members suggest that this would fill gaps where there was dishonesty or a collapse of firms.

Design practitioners, principal design practitioners and professional engineers

In meeting with our members, the Department of Customer Service explained that the regulations mandate insurance requirements for design practitioners, principal design practitioners and professional engineers, without the exemption provided for building practitioners, due to the market availability of PII products for such practitioners.

The RIS at page 52 states, "Following consultation with industry stakeholders and insurance providers, the Government considers that industry will take the steps necessary under the Regulation to put in place adequate insurance cover due to the comprehensive obligations imposed on practitioners and remedies available to customers under the new scheme."

We submit that our members are observing quite the opposite. In an already hard insurance market, insurers are showing little appetite to provide coverage to practitioners as envisaged by the reforms. We are starting to see policies that specifically seek to exclude coverage of claims arising as a result of new and retrospective obligations imposed by the Act. Even if cover is provided, insureds are unlikely to be able to afford the premium that an insurer would need to charge to provide that level of cover.

We appreciate that our members' feedback to avoid being too prescriptive in stipulating PII requirements, with general guiding principles provided to design practitioners and engineers on what would be adequate, has been taken into account. The intent of our feedback was to allow design practitioners and engineers to fulfill insurance requirements with reference to what is available in the market. While the regulations stipulate a number of factors practitioners and engineers need to take into account in determining adequacy of their cover, there is no recognition of the fact that such cover may be offered with exclusions.

In addition, as in our preliminary submission, members emphasise that the appropriateness of the insurance held should be subject to strong regulatory checks and oversight to ensure compliance. We seek clarification on whether such oversight is to be provided by a regulator under the proposed reforms or whether the approach is to rely entirely on self-selection by the practitioner.

Our members preference is for Government re-consideration or amendment of the duty of care provision within the Act. However, if the provision remains along with minimum professional indemnity insurance requirements for all professionals under the Act, we suggest that design practitioners, principal design practitioners and professional engineers should also be exempt for at least three years from the commencement of the regulations. Given the very long tail nature of the claims, it would take at least three years to start to see the effect of better compliance and enforcement flow through to claims figures. It is anticipated that insurers appetite to provide cover to these professionals, currently seen as high-risk professions, would return once improved claims figures become evident.

Insurance requirements for engineers

The Insurance Council notes the differential treatment of engineers relative to other building industry professionals. Unlike other industry professionals, under the proposals engineers can be deemed as having met the requirements for PII and training if the registrant is a member of a professional engineering body that operates with a professional standards scheme (PSS) and the member satisfies the body's requirements for PII and continuing professional development.

Broadly, the reforms contemplate three different options by which engineers could potentially be registered with related implications for how insurance requirements could be stipulated:

- Pathway 1: The Regulator is responsible for assessing, registering, monitoring and compliance of all engineers.
- Pathway 2: Co-Reg, Government approved Schemes. The Regulator will assess and approve the professional body and its scheme. The professional body will be responsible for assessing, registering, monitoring, auditing and compliance of the scheme.
- Pathway 3: Co-Reg: Professional Standards Council (PSC) approved Schemes. The professional body is responsible for assessment, monitoring, auditing and compliance.

Insurance Council feedback on proposed insurance options for engineers

Given that engineers have faced similar issues to other building industry professionals, Insurance Council members are concerned that responsibility may be diluted/divested through membership of a PSS and this will not address the concerns with adequate oversight of work being undertaken. Given this, Insurance Council members' preference would be for pathway 2 to ensure greater oversight of any scheme by a regulator as opposed to divesting responsibility to the PSC to approve a scheme.

Issues with professional standards schemes

A key issue with not stipulating mandatory PII requirements is that those that do not purchase the cover may well be the ones guilty of improper conduct (resulting in a case of the good supporting the bad).

There could be PSC oversight given the incentive of claims caps if professionals are members of an PSC approved scheme. However, not all the professions identified in the draft Design and Building Regulations have schemes in place and even where they are, it is

not compulsory to be a member so a proportion of professionals won't be subject to oversight.

If the PSC route is considered, there needs to be a disincentive to be outside the PSC regime. For example, a higher level of insurance stipulated for those who are not members of the scheme. However, the RIS at page 36 notes that professional bodies will be able to set, among other things such as knowledge and skills, insurance requirements. It is expected that the standards are the same or higher than the requirements under the Regulation. It is unclear how engineers may support co-regulatory options without the incentive of caps and potentially lower level of insurance.

Employees vs contractors

Another aspect of the regulations that raises concerns for insurer is that there is no distinction between employees and practitioner. It is expected that building practitioners hold cover for the "entire time".

General comments

The general comments in our previous submission on the regulations remain and are re-stated below.

Varying requirements across states and territories

A general observation by Insurance Council members is that NSW regulators need to recognise that stipulating additional requirements for design and building practitioners which are more stringent than other jurisdictions may lead to professionals seeking registration in other states relative to NSW as it would be easier and cheaper to take out insurance. Further, it is possible that more stringent NSW requirements, including for insurance, may endanger the NSW Government's focus on an infrastructure project led economic recovery following the recent pandemic.

Property developers and construction companies often operate nationally so the framework should take this into account. Some consideration should also be given to a nationally consistent approach involving state support to allow for rectification of existing issues within buildings.

Scope

The Insurance Council also urges consideration of how the proposed framework interacts with builders' warranty. Current regulations refer to "Class 2 Buildings" which could introduce competing remedies (for non-individual dwellings up to 3 storeys high) – being the home building compensation scheme and available commercial PII (to the extent that the PII market responds).

The RIS at page 15 notes that the regulations do apply to some class 2 buildings which are less than 3 storeys high (from ground level). Our members submit that this may increase the risk of forum shopping since there is no clear guidance as to the interaction between the home building compensation scheme and professional indemnity insurance. Without this clarification, professional indemnity insurance could be seen to be effectively subsidising the existing home building compensation scheme.

Summary

The Insurance Council strongly urges that insurance requirements should only be applied prospectively. In an already constricted market, any retroactive application of a duty of care to professionals which, in effect, requires insurance with retroactive coverage will risk professionals being unable to be registered.

The design of professional indemnity clauses is already being strengthened across industry such that it is imposing greater pressure on general liability cover for building construction. There is evidence that this is being exacerbated by a retroactive application of insurance requirements for building professionals.

The Insurance Council recognises that current reforms are aimed at re-instilling trust in building professionals going forward. However, the issues highlighted by the Insurance Council in previous submissions remain. Insurers have limited ability to provide cover for historical stock of buildings where work was undertaken without sufficient oversight. We appreciate the Department adopting our member feedback in recognising, in part, commercial availability of professional indemnity insurance within the market. The exemption from mandatory insurance requirements for building practitioners is a step in the right direction. We support a similar exemption being provided to the other professionals regulated by the Act to allow time for the key reforms, better compliance and enforcement, to take effect. Willingness to underwrite the risks of building professionals is likely to return after insurers start to see evidence that the issues within the building industry have been successfully addressed.

In the meantime, we would appreciate the opportunity to meet with you to discuss this submission as well as practical alternatives to meet professionals' insurance requirements under the regulations.

Yours sincerely

Andrew Hall
Executive Director and CEO

Market overview: professional indemnity insurance

The professional indemnity insurance market has experienced high loss ratios of over 95 percent for the past 3 years which is unsustainable (**Graph 1** refers). Gross loss ratios of more than 100 % indicate insurers do not have sufficient income from premiums alone to pay out insurance claims. Ultimately, this situation is unsustainable.

Premiums tend to be lower and stable where there is insurer competition, reinsurance is freely available and known risk factors. Combustible cladding related fires at Grenfell Tower in London and the Lacrosse Building in Melbourne have highlighted previously underestimated risks within the building sector to building professionals, property buyers, industry stakeholders and regulators. Domestic and overseas insurers have reacted by increasing premiums to reduce their losses, acquiring capital from reinsurers at higher rates (which are then passed back to their customers) or placing restrictions on cover that cannot be underwritten e.g. exclusions for non-compliant combustible cladding.

Some insurers are exiting the professional indemnity market or declining new business for certain professions now viewed as high risk, such as, design professionals. There has also been a significant contraction in policy cover for construction consultants due to potential cladding exposures and costs involved in ascertaining and allocating liability as well as concerns around the duty of care provisions under the *Design and Building Practitioners Act 2020* (NSW) which came into effect on 10 June 2020.¹

Claims incurred have grown from around \$1.2 billion in 2017 to \$2.7 billion in 2020, representing a 125 per cent increase over the past 4 years (**Graph 2**) while average premiums have risen from around \$2,504 in 2017 to \$4,078 in 2020, representing a 63 per cent increase (**Graph 3**) over the past 4 years.

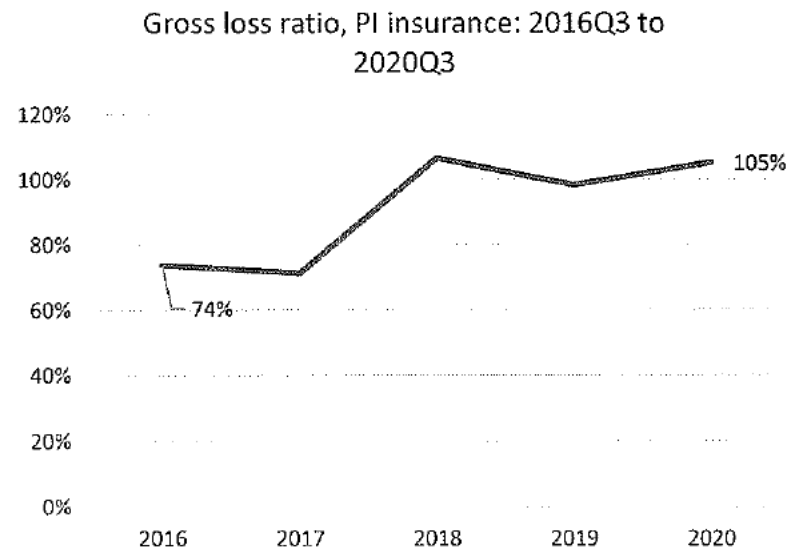
Table 1: Professional Indemnity Insurance, APRA Quarterly General Insurance Statistics

	2013	2014	2015	2016	2017	2018	2019	2020
Gross written premium	\$1,499,000,000	\$1,534,000,000	\$1,584,000,000	\$1,562,000,000	\$1,698,000,000	\$1,947,000,000	\$2,270,000,000	\$2,712,000,000
Incurred claims	\$707,000,000	\$1,182,000,000	\$1,043,000,000	\$1,243,000,000	\$1,196,000,000	\$2,020,000,000	\$2,113,000,000	\$2,699,000,000
Average premium	\$3,595	\$2,900	\$2,804	\$2,866	\$2,504	\$3,014	\$3,170	\$4,078
Gross loss ratio*	43%	75%	62%	74%	71%	107%	98%	105%

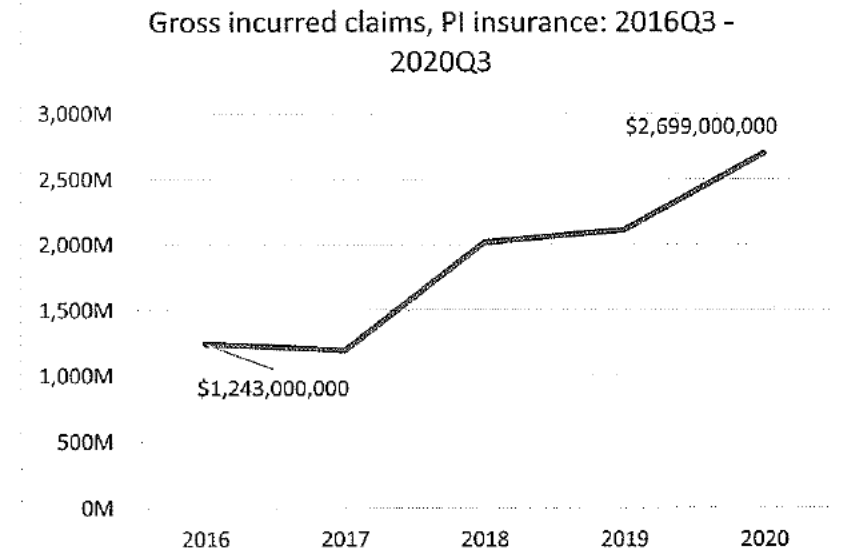
*Gross loss ratio is the gross incurred claims (current and prior years) (net of non-reinsurance recoveries revenue) divided by gross earned premium.

¹ https://aoninsights.com.au/wp-content/uploads/PI_market_update-2020_FINAL.pdf?utm_source=slipcase&utm_medium=affiliate&utm_campaign=slipcase; accessed on 22 December 2020

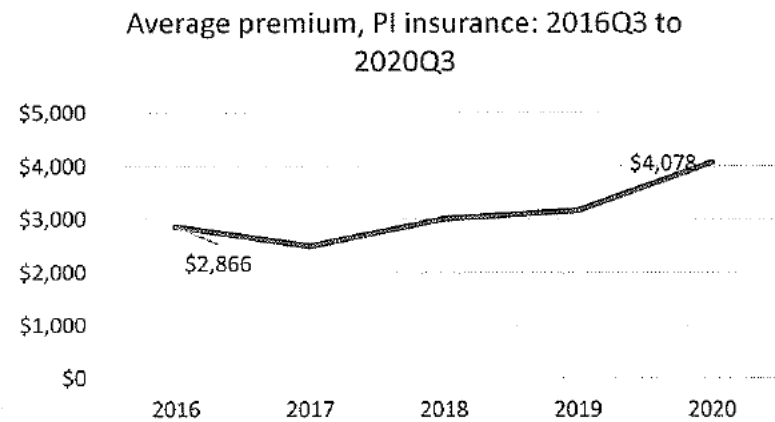
Graph 1



Graph 2



Graph 3



Potential inconsistencies in clauses within the draft Design and Building Practitioners Regulations

Clause	Commentary
Clause 62: individual policies extend to all liability	This could be as a former employee of a company that no longer exists or doesn't purchase (run-off) PI insurance. Insurer appetite for this is extremely limited as cover is typically written to a specific retroactive date and does not contemplate unrelated exposures to the risk assessed at a particular point in time. Building professionals will find it extremely difficult to get the coverage contemplated under this provision.
Clause 63: Partnership policies extend to all liability	Clarity of drafting is needed since clause 63(2) states "the indemnity must extend to a person who has been a registered partner or registered employee of the body corporate..". Members query the clause since it could be read in a way which suggests that registered partners could also be part of a body corporate.
Clause 64: Corporate policies to extend to all liability	Clarity of drafting is needed in relation to clause 64(1)(a) since a body corporate cannot be a registered professional engineer. The latter being individuals.
Clause 67: Registered professional engineers must meet insurance requirements	Firstly, the clause refers to individual practitioners, whereas most PI insurance applies to body corporates which could insure multiple registered individuals. Secondly, there needs to be regulatory guidance on how professionals gauge the availability of PI insurance, particularly where insurance brokers are not the primary source of information.
Clause 69: Matters occurring after expiry date of policy	This clause appears to restate the existing legal approach and administration of "claims made" nature of PI insurance policies. Given this, members query the need for this clause.
Clause 70: Policy may be subject to limit of indemnity	Since PI insurance policies are typically written on a claims made and notified basis, the reference to "occurring" may need to be amended with one possible suggestion that the clause refer to "all claims first made against the [Insured] during the Period of Insurance and notified to Insurers during the Period of Insurance." Additionally, the reference to "one year" could be substituted for "Period of Insurance".
Clause 71: Policy may be subject to exceptions or exclusions	This clause states that a PI insurance policy may, subject to clauses 65 and 67, contain exceptions or exclusions that are not inconsistent with the requirements of this Part. Since clauses 65 and 67 do not limit the operation of Division 2 and 3, our members seek clarity on the operation of this provision alongside other clauses such as clause 62 that require that "all liability" be covered.

