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Committee Secretary
Senate Economics Legislation Committee
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The Insurance Council of Australia (ICA) welcomes the opportunity to make this submission to the Senate Economics Legislation Committee regarding Non-Conforming Building Products (NCBP).

The ICA understands that the Committee may have previously inquired into this issue in 2015. From the insurance industry perspective, many insurers have also previously identified this issue as an emerging risk and many have incorporated the risk within their individual underwriting guidelines.

Executive Summary

- Aside from the risk to the safety of occupants and emergency services, the installation of NCBP has the potential to increase insurance premiums and other associated costs due to the increased risk associated with their use.
- The current Australian regulatory regime in relation to certification and identification of NCBP needs to be reviewed and adjusted to ensure that only properly tested and compliant materials are used in all buildings
- There should be consideration of a national approach to policing and enforcement of existing regulations, including a national audit of buildings to detect and quantify the current level of exposure to NCBP.

Insurance – Measuring risk, assisting recovery and signaling a need for adaptation

The general insurance industry provides financial risk offset and recovery services for Australian businesses, families and individuals – calculating the probabilities of damage, offering insurance cover¹ and then compensation when damage occurs.

Importantly, private insurance mechanisms also produce a price signal, or financial incentive, that can motivate adaptive activity to reduce exposures. Where exposures increase beyond the commercial appetite of global insurance markets to provide cover, a critical price signal is delivered. In these edge cases those in the community who face an ‘uninsurable’ risk are forced to adapt by absorbing the risk potential within their own finances (self-insurance), or by undertaking risk reduction activity to minimise exposures – move locations, mitigate the risk, or modify built structures to increase resilience.

Costs passed on to customers, including any insurance and compliance costs

Like the community, the general insurance industry critically relies upon building construction standards being delivered in a compliant manner. For example and with regard to external cladding, the Australian Building Code (ABC) specifically address² fire performance. It states, inter alia,

that a building must have elements that will avoid the spread of fire in a building and between buildings, in a manner appropriate for that building. This requirement is met, in part, under a Deemed-to-Satisfy Solution for buildings of Type A and Type B construction by non-combustible external walls (Specification C1.1 Clauses 3.1(b) and 4.1(b)). A non-combustible

¹ For insurable events

² ABCB Advisory Note 2016 -3, Fire Performance of External Walls and Cladding

external wall inhibits fire spread via the external face of the building, thereby contributing to a building's compliance with Performance Requirement CP2.

After assuming that a building has been constructed in accordance with the ABC, insurers calculate the residual risk of damage occurring, in order to set a premium for accepting that risk.

For multi-level buildings insurers typically use the worst-case loss estimation scenario being Probable Maximum Loss (PML), Estimated Maximum Loss (EML) or Maximum Foreseeable Loss (MFL) when underwriting policies. Each insurer relies upon their own in-house criteria in this regard.

Knowledge of the PML/EML/MFL is used by insurers as a tool to establish their risk exposure and this in turn influences the premium. For very large or expensive buildings, where the maximum loss may exceed an individual insurers risk appetite, insurance coverage may be shared with other insurers, for example through a co-insurance program and re-insurance. Nevertheless, premiums are priced to reflect the risk.

The installation of NCBP, for example combustible façade materials, that contravene the requirements of the ABC, critically undermines the ability for an insurer to rely upon the safety and performance of the building. This naturally has a direct impact on how an insurer will establish the quantum and occurrence probability for a PML/EML/MFL event.

Putting aside the risk to safety of life, the consequences of undetected NCBP within a building has a multi layered impact should a fire event occur. For example the primary insurer will have set their underwriting capacity upon their own interpretation of the estimated loss for the building. Should this estimation be incorrect, through the unknown existence of NCBP which has increased the quantum and frequency of loss events, the primary insurer may exceed their capacity. This will naturally sequentially impact any co-insurers and re-insurers who must each begin to absorb the costs of more frequent and costly events, in turn impacting future premiums.

The detected presence of NCBP in a building, where the consequential risks have not been adequately mitigated by the building owners, and where the estimated loss then begins to encroach on an insurers risk appetite, could result in the following types of responses from the market:

- Acceptance that the risk of the NCBP has been mitigated or can be contained to a sufficient extent.
- Unwillingness to insure the building in the first instance or to opt out of existing coverage at time of renewal,
- Reduction of participation on the total coverage forcing the policyholder to find additional coverage/insurers to join, or form a participation/share program,
- A significant increase in the premium due to the higher level of risk,
- The passing onto the consumer of additional reinsurance and associated costs
- An increase in the excess/deductible payable should a claim occur,
- Changes to other terms and conditions of the policy, for example, reduced limits, specific exclusions; and/or requiring the replacement of the combustible façade material or other non-conforming building products before coverage will be contemplated.

Each insurer will naturally determine their own responses on a case by case basis.

In the event that a policyholder becomes aware that they have NCBP present in the fabric of the building, there are a number of obligations that should be addressed, including:

- Notifying their insurer in accordance with their duty of disclosure under the *Insurance Contracts Act 1984*.
- Notifying the local development consent authority, for example the agency or local government that authorizes occupation and use of the building.

- Notifying owners and tenants regarding any increased risk profile and remedial actions that arise from the presence of the NCBP.

Policing and enforcement of existing regulations.

The ICA contends that the current regimes involving private certification within the building industry can be open to unacceptable failures.

The ICA believes there should be an independent specification and plan review process, including an inspection regime scheduled to coincide with critical stages of construction development. These regimes should conclude in a final certification process that precludes any potential for non-compliance and product substitution. Whilst likely to be an unpopular suggestion, giving rise to complaints about increased costs and impacts on building timeframes, a robust and independent compliance regime will ultimately save lives and costly rectifications where non-compliance is only detected in a building some time after occupation has commenced.

The ICA understands that the Queensland Building Construction Commission (QBCC) has the power to enter premises and building sites for the purpose of examining documentation, including chain of supply documentation and taking samples of products for testing if necessary. The ICA contends that while similar agencies in other jurisdictions may have similar powers there should be a national approach to policing and enforcing Australian building standards and codes.

A system to readily identify NCBP, such as code or trade marking, would also assist in identifying sub-standard and non-conforming products, especially if combined with suitably accessible reference sources, education and inspection regimes both at the time of manufacture, importation, purchase or arrival on-site.

Independent verification and assessment systems

It is important to ensure building material testing procedures are stringent enough to provide confidence that certification is a reasonable measure of quality and compliance. Building material testing should also reflect how the building product would behave in-situ and not in an artificial or isolated environment.

The ICA believes that assessment or product compliance and suitability should be administered and controlled in Australia. Whilst lacking any centralized capacity, for example how this matter is addressed in New Zealand³, there are a range of commercial entities throughout Australia who have the capability to conduct appropriate testing and certification of compliance with Australian standards of imported products.

The ICA also contends that the “Evidence of Suitability” in the National Construction Code (NCC)⁴ is open to misapplication and in need of amendment or clarification. “Evidence of Suitability” is;

“Any other form of documentary evidence that correctly describes the properties and performance of the material or form of construction and adequately demonstrates its suitability for use in the building”.

The ICA is concerned that there is no qualification on the type of documentation, who can prepare the documentation and what, if any, performance measures must be used. The ICA believes that this requirement is too wide and too open to abuse.

³ In NZ building products are performance tested by government funded agencies such as BRANZ. Funding is raised through a 1% levy on building projects above a certain value.

⁴ Volume 1, Part A2 – A2.2, items (i) - (vi)

Finally, “*appropriately qualified person*” in the NCC is open to interpretation as there is no definition. It is the experience of some of our members that opinions on the compliance of materials are all too frequently made by individuals who do not possess necessary qualifications and expertise.

To address these issues, the ICA contends that policing and enforcement of existing regulations could be most effectively achieved by a national building accreditation and listing body. A key deliverable of such a body should be an immediate audit of Australian buildings to assess the extent of the NCBP problem, identifying remediation and/or risk mitigation priorities.

CONCLUSION

The ICA recognises that the identification and use of non-conforming building products is a complex issue and it is pleased to assist the Committee in its inquiry. The ICA believes that the continued use of these products and the associated risks will increase risks to the community and therefore may have a consequential impact insurance premiums.

Furthermore, the ICA and its members believe that a review of the current regulatory regime is necessary to ensure that only compliant and properly certified materials are used in building construction.

Finally the ICA contends that the most appropriate way forward is through a national approach to building material certification, compliance and regulatory enforcement.

For further information and comment please feel free to contact Karl Sullivan, General Manager, Risk and Disaster Planning on ksullivan@insurancecouncil.com.au

Yours sincerely



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