

Regulatory Impact Statement

Building Act review: Regulation of guarantee products and services

Agency Disclosure Statement

This Regulatory Impact Statement has been prepared by the Department of Building and Housing.

It provides an analysis of options in respect of whether the regulation of building guarantee products and services is cost effective.

There are several risks for homeowners associated with guarantee products. It may be difficult for consumers to fully understand the guarantee product or service they are purchasing. In theory, a range of other risks for consumers also exist with these products that may result in a loss of cover. However, homeowners are not unprotected from these risks and consumer law reforms currently before Parliament and other Building Act reforms should help to reduce risks associated with guarantee products.

In light of the possible risks associated with guarantee products (and evidence), the current regulation of these products is considered sufficient at the present time (taking proposed consumer law and Building Act reforms into account). Rather than moving to any further regulatory intervention now, it is proposed that Building Act reforms be given time to 'bed in' so their impact can be properly monitored, considered and evaluated.

A monitoring and evaluation plan is being developed by the Department of Building and Housing and the issue of guarantee products and services will be considered as part of that work. The plan will include a rolling consumer survey and a watching brief on any new products that may enter the market. In the meantime, it is proposed that the Department of Building and Housing, in consultation with other relevant agencies, be directed to provide additional information and guidance to help homeowners understand and manage the risks associated with the current suite of guarantee products and services in the building sector as part of the Building Act review.

The policy option proposed will not:

- impose additional costs on businesses
- impair private property rights, market competition, or the incentives on businesses to innovate and invest, or
- override fundamental common law principles (as referenced in Chapter 3 of the Legislation Advisory Committee Guidelines).

Ann Clark, Acting Deputy Chief Executive, Department of Building and Housing

Signature [signed Ann Clark]

Date 10/6/11

Status quo and problem definition

The 2010 Building Act reforms propose changes to the building regulatory system that seek to contribute to a more productive, efficient and accountable building and construction sector [Cab Min (10) 27/10 refers].

In terms of accountability within the residential construction sector, the aim is to create a system in which legal roles and accountabilities of different parties for building work are clearly defined and to ensure these accountabilities can be managed and enforced in practice. The reforms include:

- amendments to the Building Act to clarify responsibilities of building practitioners, building consent authorities and consumers
- a move to risk-based consenting
- mandatory written contracts and disclosure by building contractors
- improved dispute resolution, especially planned changes to the Construction Contracts Act 2002
- clearer implied warranties and direct remedies where those warranties are breached.

Building practitioners will be required to disclose what (if any) surety backing they have available before entering into contracts with homeowners once the Building Amendment Bill (No 4), to be introduced into Parliament this year, is passed and comes into force. It is estimated that around 50% of new builds are covered by one of the two main surety products or services currently in the market. Enhanced disclosure is expected to drive demand for, and supply of, surety products and services on a voluntary basis going forward.

Guarantee products and services are one type of surety, and can help homeowners manage some of the risks when building work is defective and a building contractor defaults on obligations to remedy (including warranty obligations under the Building Act 2004). These products can also help building practitioners to manage their own risks and liabilities and reduce the impacts on territorial authorities from defective building work.

Anecdotal evidence suggests that it may be difficult for consumers to fully understand the product or service they are purchasing. In theory a number of other risks for consumers associated with these products also exist, including a risk:

- that a guarantee company may become insolvent because of a 'run' on the product leaving homeowners without cover
- of non-coverage of latent defects should a guarantee company be wound up (in accordance with the Companies Act 1993) and defects become apparent at a later date
- that a guarantee company may attempt to retrospectively decline cover for specific kinds of building defects should they become widespread.

Should these risks eventuate, homeowners could potentially suffer significant financial losses. The magnitude of any losses suffered will depend in part on the nature of the defect and the nature of work undertaken and guaranteed, whether that be an alteration/addition or a complete new home build.

Objectives

The objective is to ensure regulation of guarantee products and services is cost effective.

Regulatory impact analysis

Evidence of risks occurring

There is a level of risk for consumers who purchase these products. Primarily:

- consumers may lack understanding of how the products work or what they are getting
- consumers being left without cover, should the company that offers the guarantee product become insolvent or be legitimately wound up and latent defects subsequently discovered
- the risk that the company that offers the guarantee product retrospectively declines cover for specific kinds of building defects, should they become widespread.

In New Zealand the two main guarantee products on the market are offered through Registered Master Builders and the Certified Builders Association¹. These two products have relative market longevity; the Registered Master Builders product has been operating since the early 1990s and the product offered through the Certified Builders Association since the early 2000s. The Department is not aware of instances of consumers being left without cover in respect of these products, either through insolvency or winding up, or through a retrospective change in cover for specific kinds of defects.

In practice, at the present time there is no evidence of the theoretical risks identified above occurring. As such any case for change would be based on very limited information about the actual risk to consumers, the “best fit” regulatory response in relation to those risks, and the costs to consumers and business.

However, anecdotal evidence suggests consumers may lack understanding of what guarantee products are and their limitations and risks. There is limited independent consumer information and advice that is freely available to support informed decision-making about whether to purchase a product and what to expect.

Option one: status quo

Guarantee products are primarily regulated through general consumer law. General business law requirements also apply to the entities offering these products (eg, the Companies Act 1993).

Guarantee products fall within the definition of “service” in the Consumer Guarantees Act 1993. The Consumer Guarantees Act sets out the following requirements in relation to services that are provided to a consumer, there are guarantees that:

- the service will be carried out with reasonable care and skill
- the service and any product resulting from a service will be:
 - reasonably fit for any particular purpose
 - of such a nature and quality that it can reasonably be expected to achieve any particular result that the consumer makes known to the supplier
- the service will be completed within a reasonable time
- the consumer is not liable to pay more than a reasonable price.

¹ The Certified Builders Association product is supplied through a company called BuiltInNZ Ltd, which also offers the product for work undertaken by builders who are not members of Certified Builders as long as they meet certain risk-based criteria.

The Consumer Guarantees Act also provides remedies if the guarantee requirements are not met, which are enforceable through the Disputes Tribunal or the courts. The Consumer Guarantees Act is underpinned by private enforcement.

The Fair Trading Act 1986 also applies to guarantee products. It states:

13 No person shall, in trade, in connection with the supply or possible supply of goods or services or with the promotion by any means of the supply or use of goods or services,—

(i) Make a false or misleading representation concerning the existence, exclusion, or effect of any condition, warranty, guarantee, right, or remedy

The Commerce Commission is responsible for enforcing the Fair Trading Act, which means that it can take enforcement action in relation to alleged contraventions.

Option two: enhanced status quo

In addition to regulation described above, new consumer disclosure requirements will soon apply to these products when the Consumer Law Reform Bill currently before Parliament is passed and comes into force.

The Consumer Law Reform Bill will add a new part to the Fair Trading Act, which will include new requirements for warranty agreements. Advice from the Ministry of Economic Development is the guarantee products for building work will be captured by these new requirements. The new requirements will place an obligation on suppliers or manufacturers to ensure agreements meet minimum requirements, including:

- agreements must be in writing and use plain language
- agreements must be prefaced by a summary of the consumer's rights under the Consumer Guarantees Act
- agreements must contain all the rights and obligations of both the supplier and consumer.

These changes should help owners better understand the limitations and risks of these products.

Building Act reforms, which promote greater accountability, provide remedies where implied warranties are breached, and include an effective licensing scheme for building practitioners, should also help to reduce risks associated with guarantee products (for example, by helping to improve skill levels in the sector).

In addition to these regulatory options, and considering the lack of evidence to suggest consumers are experiencing financial loss from purchasing guarantee products, a consumer information and education package could be developed.

The package would involve the development and marketing of resources and tools designed to inform consumers about the limitations and risks of guarantee products and what their general rights and obligations are under consumer law in relation to those products.

Consumer information and education would be delivered under the wider Building Act review consumer information and education campaign.

A monitoring framework could also keep a watching brief on consumer experiences with the performance of their guarantee products and, if any risks or issues occur in the future, a case could be made for specific regulation.

This is the preferred option.

Option three: specific regulation for guarantee products

Due to the lack of evidence of risks associated with guarantee products actually occurring, options for additional specific regulation have not been considered in detail.

There are some generic regulatory options that could apply to guarantee products.

Should it be considered that further regulation is desirable at a future time, some of the possible regulatory options that could be considered to strengthen the regulatory framework might include the following.

Table one: Indicative range of possible regulatory options

Level of intervention (likely cost / impact)	Indicative range of options
<p style="text-align: center;">Lower</p> <p style="text-align: center;">↑</p> <p style="text-align: center;">↓</p> <p style="text-align: center;">Higher</p>	<p>Additional financial reporting + disclosure requirements for guarantee companies (regarding financial soundness)</p> <p>Negative licensing of guarantee companies (banning, etc)</p> <p>Government licensing of guarantee companies (eg, this could be similar to that for insurers)</p> <p>Provision of surety, options could include the following:</p> <ul style="list-style-type: none"> • Establishing a Government surety product to compete with current providers and products • Mandatory industry wide surety (eg, a fidelity fund financed by a levy on building consent applicants)

Consultation

This regulatory impact statement incorporates advice from the Department of Building and Housing and the Ministry of Economic Development.

The following government agencies have also been consulted on the proposals; The Treasury, the Department of the Prime Minister and Cabinet, the Ministry of Justice, the Department of Internal Affairs and the Ministry of Consumer Affairs.

To inform work on this issue, discussions have been held with a range of stakeholders. These include ConsumerNZ, the Registered Masterbuilders Federation, the Certified Builders Association of New Zealand, the Building Research Association of New Zealand (BRANZ), the Homeowners and Builders Association of New Zealand, the Insurance Council of New Zealand, and the Bankers Association of New Zealand and various individual banks.

Conclusions and recommendations

In light of the possible risks associated with guarantee products (and evidence), the current regulation of these products is considered sufficient at the present time (taking proposed consumer law and Building Act reforms into account, ie, enhanced status quo).

Rather than moving to any further regulatory intervention now, it is proposed that Building Act reforms be given time to ‘bed in’ so their impact can be properly monitored, considered and evaluated.

A monitoring and evaluation plan is being developed by the Department of Building and Housing and the issue of guarantee products and services will be considered as part of that work. The plan will include a rolling consumer survey and a watching brief on any new products that may enter the market. In the meantime, it is proposed that the Department of Building and Housing, in consultation with other relevant agencies, be directed to provide additional information and guidance to help homeowners understand and manage the risks associated with the current suite of guarantee products and services in the building sector as part of the Building Act review.

Implementation

Additional information and guidance to help homeowners understand and manage the risks associated with the current suite of guarantee products and services in the building sector will be provided as part of the wider communications strategy for the Building Act review.

Monitoring, evaluation and review

The Department is developing a monitoring and evaluation plan to test the effectiveness of regulatory and other changes resulting from the Building Act review, identify improvements as the implementation proceeds and provide a basis for further policy and operational decisions on an ongoing basis. The monitoring and evaluation plan will include a rolling consumer survey and a watching brief on any new products that may enter the market.