



# NSW building industry's mandatory insurance requirements begin to take shape

## The Design and Building Practitioners Regulation 2020 – the public consultation draft

2 DECEMBER 2020

*The NSW Government has introduced sweeping legislative changes that are intended to regain public confidence in the construction industry. This is **Part 5** of Wotton + Kearney's coverage of these landmark legislative changes and the implications for insurers. Click here to revisit [Part 1](#), [Part 2](#), [Part 3](#) and [Part 4](#).*

### AT A GLANCE

- On 17 November 2020, the NSW Government released the *Draft Design and Building Practitioners Regulation 2020 (NSW)* for public consultation, which is designed to support an effective legislative framework.
- The sweeping legislative reforms in the NSW building and construction sector are being implemented in stages.
- The duty of care provisions in the DBP Act commenced on 10 June 2020. Other provisions will commence on 1 July 2021, including that all design practitioners in NSW will be required to take out compulsory professional indemnity insurance.
- Whilst not in a final form, the Draft Regulation provides guidance about what legislators are thinking regarding mandatory insurance and the likely direction of the final version of the regulation.
- This article discusses what the operation of the mandatory insurance requirements may look like, including the implications for the insurance sector.

## THE NEW OBLIGATIONS

There are three critical new obligations imposed on design and construction practitioners under the *Design and Building Practitioners Act 2020* (DBP Act):

1. the establishment of a new statutory duty of care on design and construction practitioners to avoid economic loss caused by defective design and construction work (see our [article](#) on this topic)
2. a requirement for mandatory declarations by design and construction practitioners (see our [article](#) on this topic), and
3. mandatory insurance requirements for registered design and construction practitioners, including engineers.

## INDUSTRY CONSULTATION

Regulations are needed to support the operation of the mandatory insurance requirements. To develop those, the NSW Government consulted with industry stakeholders, including the Insurance Council of Australia, to help translate its policy proposals into an effective legislative framework.

On 17 November 2020, the Government released the *Draft Design and Building Practitioners Regulation 2020 (NSW)* – the public consultation draft ([the Draft Regulation](#)) – together with a [Regulatory Impact Statement](#). The *Regulatory Impact Statement* explains the rationale and objectives of the Draft Regulation.

The NSW Government’s public consultation is an open invitation for input into the proposed Draft Regulation. Feedback is to be provided to the NSW Government by January 2021. There will then be further stakeholder engagement before the regulation is finalised in late January/early February 2021.

Whilst not in a final form, the Draft Regulation provides guidance about what legislators are thinking and the likely direction of the final version of the regulation.

## MANDATORY INSURANCE

The authors of the [Building Confidence Report](#) noted that: “it is important that as many practitioners as possible hold professional indemnity and/or warranty insurance in order to support accountability.” The DBP Act requires that the following practitioners be adequately insured in line with the regulation against ‘any’ liability that they may become subject to as a result of carrying out their work:

- registered design practitioners
- registered principal design practitioners
- registered building practitioners, and
- registered professional engineers.

To be adequately insured, these practitioners must either:

- be indemnified under insurance that complies with the regulations against any liability to which they may become subject as a result of providing a mandatory declaration or doing design or construction work, or
- be part of some other arrangement approved by the regulations that provides an indemnity against such liability.

The requirement in the DBP Act that design and construction practitioners have cover for ‘any liability’ created some uncertainty. This is because insurance policies that are generally available in the market, including professional indemnity policies, do not cover ‘any liability’. Cover is limited by the terms of insuring clauses, exclusions, and any endorsements attached to the relevant policies.

## DESIGN PRACTITIONERS

The Draft Regulation proposes that design practitioners, principal design practitioners and engineers must be ‘adequately’ covered by an insurance policy against liability that could arise from their professional duties as practitioners<sup>1</sup> (i.e. professional indemnity insurance). In short, the requirement for cover for ‘any liability’ has been watered down in the Draft Regulation.

The Draft Regulation states that the insurance policy must, in the reasonable opinion of the design practitioner, provide for an adequate level of

<sup>1</sup> See sections 65 to 72 of the Draft Regulation

indemnity for liability that could be incurred. In determining whether a policy provides an adequate level of indemnity, the Draft Regulation requires the design practitioner to consider:

- the nature and risks associated with the work typically carried out by the practitioner
- the volume of the work typically carried out by the practitioner
- the length of time that the practitioner has been registered
- a reasonable estimate of claims that could be brought against the practitioner
- the financial capacity of the practitioner, and
- any limits, exceptions, exclusions, terms or conditions of the policy.

The legislative intent is for design practitioners to assess whether their insurance cover is ‘adequate’ according to their circumstances. This is intended to recognise that different design practitioners will have different levels of legal risk. In other words, different classes of design practitioners will have different risk profiles, and accordingly, different insurance needs.

This variability places a statutory obligation on design practitioners to carefully consider their insurance needs. This change has practical significance as it requires design practitioners to take a more active role in placing insurance. As design practitioners will have an ongoing obligation to assess whether cover remains adequate, this will necessitate more frequent broker engagement to obtain specialist advice on this issue.

The proposal to require the design practitioner to assess the adequacy of professional indemnity insurance was preferred rather than a general rule across industry. Importantly, there are no prescribed minimum limits of indemnity, or restrictions on exclusions or the scope of cover. This can be contrasted with the statutory minimum limits for professional indemnity cover required to be taken out by certifiers under the *Building and Development Certifiers Regulation 2020 (NSW)*.<sup>2</sup>

<sup>2</sup> Minimum limit \$ 1,000,000 any one claim (excluding legal costs) and Minimum limit \$ 2,000,000 any one claim (including legal costs)

The rationale for adopting this self-assessment approach is that:

- design practitioners are in the best position to determine the adequacy of cover for their businesses
- design practitioners’ regulatory insurance burden (i.e. level of cover) should be determined by specific circumstances, rather than a general rule across the industry as a whole, and
- prescriptive insurance requirements may lead to prohibitive costs that would be passed on to consumers.

## BUILDING PRACTITIONERS

The Draft Regulation requires registered building practitioners to be covered by an insurance policy, whether professional indemnity or other, in the same manner as design practitioners. This means that the insurance policy must, in the reasonable opinion of the building practitioner, provide for an adequate level of indemnity based on the same criteria outlined above for design practitioners. However:

- professional indemnity cover is not compulsory for building practitioners (this reflects the fact that some builders do not take on any design responsibility), and
- the mandatory insurance requirements do not apply to building practitioners during a ‘transitional period’ between 1 July 2021 to 30 June 2023<sup>3</sup>. In other words, the mandatory insurance requirements for builders are proposed to be deferred for two years.

The regulation also provides for a potential exemption<sup>4</sup> from mandatory insurance regarding the issuing of a building compliance declaration. The rationale for the exemption is so that the NSW Government “can adjust the obligations for Building Practitioners if behavioural change is not secured through the overall reforms. This allows Government to impose measures such as requiring Building Practitioners to hold specific insurance if determined necessary to protect consumers.”

<sup>3</sup> Clause 82 of Draft Regulation.

<sup>4</sup> Clause 66 of Draft Regulation.

This rationale reflects the commercial reality that there are currently no adequately adapted insurance products available in the market to cover building compliance declarations made by building practitioners.

Lastly, the NSW Fair Trading/Building Commissioner will be involved in monitoring compliance with the mandatory insurance obligations. The nature and extent of the regulator's monitoring is yet to be clarified.

## INSURANCE IMPLICATIONS

The primary purpose of the mandatory insurance requirements is consumer protection. This protection is integral to the NSW Government's stated aim of restoring confidence in the high-rise residential market. The insurance requirements are meant to compliment and build on the other reforms designed to achieve that aim. The mandatory insurance requirements are obviously intended to reduce the risk of claimants being unable to recover damages because of a practitioner's lack of financial resources.

In summary, the key takeaways are:

- the mandatory insurance requirements for design practitioners will commence on 1 July 2021
- the onus for assessment of 'adequate insurance' falls on practitioners – as design and construction professionals are not insurance experts, this will increase the need for insurance brokers to assist practitioners determine adequate levels of cover
- the commercial drivers that previously controlled the level of insurance cover (i.e. principals' requirement that insurance be obtained as a contractual pre-condition to the award of design and construct contracts) will be supplemented by an added statutory duty.

- building practitioners will be:
  - a) required to have 'adequate insurance', but they are not required to carry professional indemnity cover
  - b) exempt from mandatory insurance requirements until 30 June 2023
  - c) exempt from insurance requirements regarding the provision of building compliance declaration if the practitioner is:
    - a) unable to obtain insurance, reflecting the absence of suitable products currently in the insurance market, or
    - b) adequately insured regarding the doing of building work that is the subject of the compliance declaration (i.e. builder's warranty cover).
- the absence of prescribed minimum limits of indemnity, exclusions and scope of cover in the Draft Regulation means that practitioners will be able to obtain cover that will likely comply with the proposed mandatory insurance requirements.

This commentary is based on our assessment of the Draft Regulation. Wotton + Kearney will provide further commentary when the final version of the regulation is available, which is likely to be in late January/early February 2021. For more information, visit our [Resource hub](#) on the legislative reform of the building and construction industry in NSW.

## NEED TO KNOW MORE?

For more information please contact us.



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