



Department of
Building and Housing
Te Tari Kaupapa Whare

Consultation paper

Private Building Consent Authority 'Adequate Means' and Civil Liability Insurance Proposals

July 2007





Foreword

The Government is implementing a series of reforms to improve consumer protection and public confidence in the building control sector. Key aspects of the improvement process are accreditation and registration of building consent authorities. Accreditation and registration will help to ensure that vital building consenting and inspection processes are carried out professionally, competently and are quality assured.

Collectively these initiatives help to ensure:

- improvements in the competencies and performance of all who participate in the building sector – including designers, constructors and regulators
- better quality buildings and outcomes for all consumers.

A key requirement of the Building Act 2004 is that a private organisation cannot be registered as a building consent authority until the Department of Building and Housing (the Department) is satisfied that the organisation has adequate means to cover any civil liabilities that may arise in the performance of the organisation's functions as a building consent authority.¹

The Building Act 2004 allows insurance policies and other effective consumer protection arrangements to be taken into account when considering whether a private building consent authority will have such adequate means.

This consultation paper outlines:

- the broad context in which the Department must consider adequate means
- generally how the Department could approach adequate means assessments
- proposals for minimum terms and conditions for insurance policies that would be set by regulations made under the Building Act 2004.

The Building Act 2004 and the proposals in this paper show that effective consumer protection

is a high priority for the Government and the Department. In addition to meeting other registration criteria and standards, private organisations must satisfy the Department that they have the required 'adequate means' before they can be registered as a building consent authority.

The prescription of terms and conditions for insurance policies, and the assessment of private organisations' means as part of the registration process, will provide a further safeguard to ensure buildings and homes perform well, and that we have the right people undertaking the critical consent, inspection and approval parts of the building process.

In considering the proposals in this paper, however, please note that insurance industry representatives have already advised the Department that, at least within the short and medium terms, private organisations are unlikely to be able to purchase insurance cover that meets the proposed minimum terms and conditions.

Your feedback on the proposals summarised in this consultation paper is very welcome. Your feedback will be considered prior to regulations being made, and should be submitted by 21 September 2007.

Please also note that, in accordance with a recent government directive, the consultation paper includes a draft regulatory impact statement (Appendix D). The draft statement includes a concise summary of the policy issues and objectives, options considered and the impacts of the preferred option. Feedback on the draft regulatory impact statement is also very welcome.



Bruce Girdwood
**Deputy Chief Executive
Sector Capability**

¹ A private organisation includes an organisation, that is not a territorial or regional authority, that is empowered under the Building Act 2004 to undertake the functions of a building consent authority (eg, issuing building consents, undertaking building inspections and issuing related certificates and approvals).

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The structure of this paper

PURPOSE

In the *Purpose* section you will find information about the purpose of this paper and an indication of some key elements of the Department's proposals.

INTRODUCTION

In the *Introduction* section you will find information about the broad context in which the Department must consider 'adequate means' in relation to the registration of private organisations as building consent authorities.

BACKGROUND

In the *Background* section you will find information about the role of insurance in promoting good building outcomes and the 2004–2005 private building certifier insurance review.

PROPOSALS

The *Proposals* section provides details of the Department's proposals to set minimum terms and conditions for private building consent authorities' civil liability insurance policies. There is a series of specific questions the Department would like you to answer.

SUBMISSIONS

The *Submissions* section explains how to make a submission. A submission form is included for you to complete and return to the Department.

APPENDIX A: A RISK MANAGEMENT FRAMEWORK

Appendix A sets out a generic framework for considering risk management methods potentially available to a private building consent authority.

APPENDIX B: ASSESSMENT OF ADEQUATE MEANS

In Appendix B you will find summary information about:

- consumer protection arrangements that might be used instead of, or in conjunction with, insurance
- early work on a methodology for assessing the effectiveness of such arrangements.

APPENDIX C: EXAMPLES OF OVERSEAS INSURANCE COVER REQUIREMENTS

In Appendix C you will find summary information about a range of overseas insurance cover requirements to assist you to assess the merits of the Department's proposals, particularly in terms of the required minimum levels of indemnity cover.

APPENDIX D: DRAFT REGULATORY IMPACT STATEMENT

In Appendix D you will find a draft regulatory impact statement.

Purpose

This paper describes and seeks your feedback on:

- the context in which the Department must consider 'adequate means' in relation to the registration of private organisations as building consent authorities
- proposals to set minimum terms and conditions for civil liability insurance policies for private building consent authorities
- the draft regulatory impact statement (Appendix D).

The Department's proposals are intended to ensure that insurance cover purchased by private building consent authorities is adequate in terms of:

- the likely number and value of claims arising out of a private building consent authority's performance of its functions under the Building Act 2004
- the availability of cover for the full period of time within which claims may be made.

Accordingly, amongst other things, the Department proposes that private building consent authority civil liability insurance would be required to:

- specify minimum levels of indemnity cover based on the value of building projects
- provide cover for claims arising in the year the policy applies (annual 'claims made' cover)
- provide 10 years' forward cover for claims arising out of building control work undertaken during the year that the policy applies ('claims incurred' cover which would continue to apply even if the private building consent authority ceased operating during that 10-year period)
- provide run-off cover purchased in advance for claims made in future years arising out of building control work undertaken in past years (ie, retrospective forward cover).

Introduction: The context for 'adequate means'

VISION AND MEDIUM-TERM GOALS

The Department of Building and Housing is committed to the vision of 'ensuring that the people of New Zealand have access to quality homes and buildings that meet their needs and reflect our New Zealand environment'.

The Department has the role of regulating the building sector and setting quality and performance requirements for buildings so that:

- buildings and homes perform well in the New Zealand environment
- the building, construction and housing sectors are vibrant and have skilled professionals
- homes and buildings meet the changing needs of New Zealanders
- building owners, tenants and users have confidence in building control systems.

The vision and medium-term goals summarised above reflect the importance of building, construction and housing to the New Zealand economy, and sustainable resource management, for all New Zealanders as they live their lives and go about their daily business.

Therefore, implementation of the Building Act 2004 over the next few years is a key priority for the Department.

WHY PRIVATE BUILDING CONSENT AUTHORITIES MUST HAVE 'ADEQUATE MEANS'

As part of the overall process of establishing and maintaining effective building control systems in New Zealand, the Building Act 2004 requires building consent authorities (which may include organisations other than territorial and regional authorities – ie, private building consent authorities) to be accredited and registered.²

Section 192 of the Building Act 2004 requires the Chief Executive of the Department to be satisfied that private building consent authorities have 'adequate means' to cover any civil liabilities that may arise in the performance of their building consent authority functions.

The Act does not require territorial and regional authorities to demonstrate that they have adequate means. This is because, in the event that a territorial or regional authority is found to have been negligent in carrying out its building consent authority functions, there is an expectation that every territorial and regional authority:

- will be able to meet its consequent civil liabilities
- act responsibly in attending to such liabilities.

This expectation is based on factors such as:

- the long-term existence of territorial and regional authorities
- the resources that are available to such authorities
- the ability of territorial and regional authorities to meet expenses through rates and other revenue streams they have direct control over
- the direct accountability of territorial and regional authorities to their communities of interest.

The long-term existence and viability of private building consent authorities is much less certain. Accordingly, the Building Act 2004 requires special consideration of the range and mix of arrangements made to protect consumers who use the services of such 'private' building consent authorities.

² The Act requires territorial authorities and regional authorities, by November 2007, to be accredited and registered as building consent authorities or to have made arrangements for another building consent authority to carry out their building consent authority functions.

INTERPRETATION OF 'ADEQUATE MEANS' AND RELATED TERMS

The Department has interpreted the term 'adequate' as 'sufficient' or 'satisfactory', and the term 'means' as including a wide range of types of property or financial instruments. The Department does not consider that 'adequate means' would require a private building consent authority to have the means to deal with every single potential liability that might arise. Rather, 'adequate means' must at least cover all 'likely' civil liabilities for that particular building consent authority.

Therefore, the Chief Executive must determine the 'likely' liability of the building consent authority and the means available to the building consent authority to cover that liability.

The following comments about the quantification of what may be 'likely' were included in advice the Department obtained in 2005.³

While the definition of likely is still imprecise and open to interpretation, it is useful to discuss the constraints around the range of possible interpretations:

- *likely is less than potential or maximum possible*
- *likely is at least average, best estimate or expected.*

The first step in estimating likely liabilities would be to estimate the two bounds of likely:

- *maximum possible could be the total value of all buildings for which certificates have been issued in the 10-year responsibility period*
- *expected could be derived from a combination of; industry statistics on building failures and court judgements, the building consent authority's own claims history, and projected insurance premiums.*

Some inferences that can be drawn out of this are:

- *there will be a probability of the building consent authority not being able to meet the loss*
- *because insurance premiums are based on the average or expected loss, the likely loss will be greater than an insurance premium for the same cover.*

Question 1: Do you agree with this interpretation of 'adequate means'? Please explain the reasons for your answer.

OBJECTIVES TO INFORM JUDGEMENTS ABOUT ADEQUATE MEANS AS A REGISTRATION CRITERION

The Department will need to use a systematic process to determine whether or not a private building consent authority's means are adequate to cover civil liabilities.⁴ The varying circumstances and nature of the organisations seeking to be registered as building consent authorities will, however, require the Department to exercise a degree of judgement about what means are, or are not, adequate.⁵

To ensure the Department's judgements are soundly based, the Department would make those judgements with regard to the following objectives.

The objectives of requiring private building consent authorities to have 'adequate means' to cover any civil liabilities include ensuring, as far as practicable, that:

- consumers are continuously well-protected from financial and other losses that may arise from the actions or inaction of a private building consent authority

³ PricewaterhouseCoopers, Building Consent Agencies Assessment of "Adequate Means": Stage 2 – Implementation Framework (August 2005).

⁴ The process is referred to later in this paper as an 'assessment methodology'.

⁵ It is possible that private building consent authorities would range from small organisations seeking registration with a very limited scope through to large national or multi-national corporations that wish to carry out all the functions of a building consent authority.

- the consumer protection arrangements maintained by private building consent authorities provide a level of protection that approaches, but is not necessarily equivalent to, the level of protection consumers acquire by using building consent authority services provided by a territorial or regional authority
- the terms and conditions of consumer protection arrangements used by private building consent authorities serve as an incentive for those private authorities to:
 - maintain and strengthen the consumer protection arrangements
 - otherwise ensure the establishment and use of effective risk reduction and risk management arrangements.

Question 2: Are there other objective statements the Department could usefully have regard to in determining ‘adequate means’? If so, please list the statement(s) and explain how the statement(s) will assist with determining ‘adequate means’.

BUILDING CONSENT AUTHORITY CIVIL LIABILITY RISKS

Section 393 of the Building Act 2004 states that no claim arising out of the performance of a building consent authority function under the Act may be brought after 10 years or more from the date of the act or omission on which the proceedings are based.

Of all the potential civil liabilities that a building consent authority may face, the Department considers that the most likely liability is that arising from negligence.

Many factors will have a bearing on levels of risk and the future civil liabilities of private building consent authorities. For example, legislative

changes (or interpretation of legislation by the Courts) relating generally to consumer protection or the incorporation and management of companies.

The implementation of the Building Act 2004 is, however, expected to reduce the likelihood of a systemic failure such as the one that led to the establishment of the Weathertight Homes Resolution Service. In addition to the requirement to accredit and register building consent authorities, the introduction of licensing for building practitioners, product certification and changes to the New Zealand Building Code are examples of major changes that have potential to reduce building consent authorities’ exposure to liability risks.

The Department has also initiated work that will lead to further detailed consideration of policy options such as homeowner warranty schemes.

The ability of other parties to pay under joint and several liability⁶ will continue to be a significant consideration for all building consent authorities and their insurers.

Question 3: Are there other significant factors that may increase or reduce risks and/or building consent authority civil liability? If so, please list the factors and explain the significance of each factor.

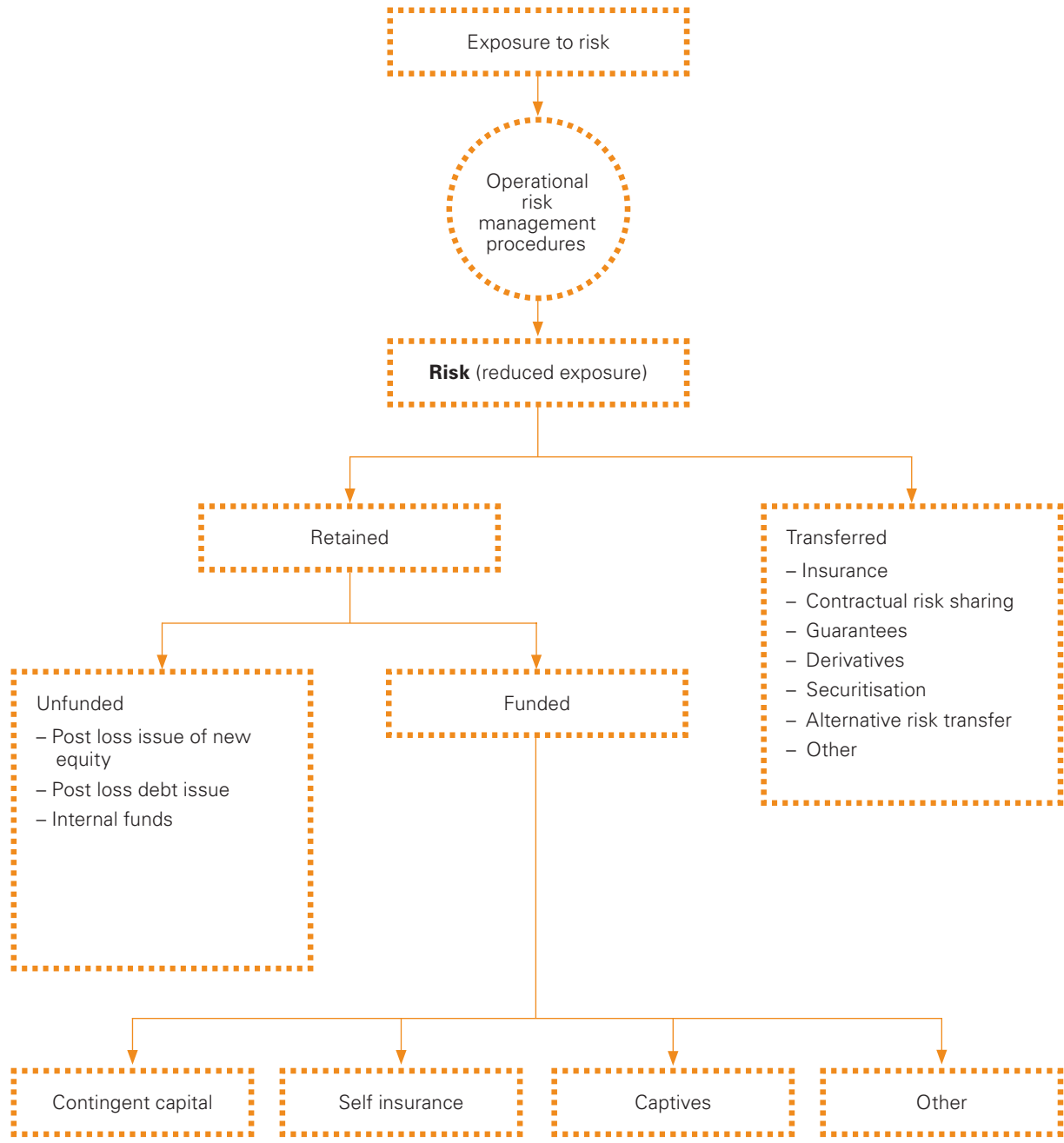
LIABILITY RISK MANAGEMENT

The risk management practices used by a building consent authority will have a significant bearing on the building consent authority’s liability risk.

The diagram opposite sets out a generic risk management framework. Appendix A provides specific comments on the application of the framework set out in the diagram and the risk management methods that are potentially available to a private building consent authority.

⁶ The New Zealand system of ‘joint and several’ liability, where one party can be liable for the total amount of the damage to which their wrongful act or omission contributed, increases the liability for one party where there are other parties who are uninsured or have limited capital resources. This has been described as the ‘deep pockets’ syndrome.

Risk management framework



Background: Insurance as a contribution to the management of civil liabilities

THE ROLE OF INSURANCE IN PROMOTING GOOD BUILDING OUTCOMES

Insurers are vitally concerned with encouraging and facilitating effective risk management. While there are limits on the effects of insurance, insurance can influence behaviour by providing incentives and signals. Insurance premiums reflect a balance between signalling risks and providing incentives to better manage or avoid risks, and maintaining the benefits of risk pooling for insurers.⁷

Insurance has been recognised internationally as contributing to:

- ensuring building control authorities can meet their share of liability in the event of a claim for damages
- improving consumer protection
- promoting good building outcomes (through the application of insurance disciplines).

Insurance providers are motivated to create incentives for building control authorities to work professionally, ensure that building control staff are fully competent, and to use effective quality assurance practices.⁸ Consequent performance improvements help to reduce the incidence of building failures and associated claims for damages.

Similar insurance-based incentives are evident internationally through the use of builders' and home warranty insurance and professional indemnity insurance for a variety of building practitioners. While not required by New Zealand building legislation, in some jurisdictions one or both of these forms of insurance is mandatory.

THE PRIVATE BUILDING CERTIFIER INSURANCE REVIEW (2004–2005)

During 2004 and 2005 a review of private building certifier insurance was completed by the former Building Industry Authority⁹ and the Department. The review related to the approval, under the Building Act 1991, of a scheme of insurance for building certifier liabilities arising from the issuing of certificates under sections 43 and 56 of that Act.¹⁰

Stage One: The former Building Industry Authority review

The initial stage of the review was undertaken in 2004 by the former Building Industry Authority. The Authority was aware that building certifiers were experiencing the following difficulties complying with the approved scheme of insurance.

- Restrictive policy terms and conditions
- Problems with availability of the required cover
- Insurers retrospectively declining to continue to cover certain risks
- Problems with procuring run-off cover

In June 2004, the former Building Industry Authority published a consultation paper that outlined options ranging between strengthening the *Performance Specification for Insurance Cover for Building Certifiers*, maintaining the specification, or lowering the specification to align with the cover that was available in the insurance market. Submissions were made by building certifiers and territorial authorities.

⁷ Australian Government Productivity Commission, *Reform of Building Regulation: Productivity Commission Research Report* (November 2004).

⁸ Incentives include setting insurance excesses, eligibility criteria and premiums in a way that recognises the relative risks posed by the insured parties.

⁹ The Department of Building and Housing's predecessor in these matters.

¹⁰ The scheme of insurance *Performance Specification for Insurance Cover for Building Certifiers* was approved by the former Building Industry Authority on 13 December 1994.

¹¹ The Building Act 2004, which replaced the 1991 Act, was enacted during the time this consultation was taking place.

The former Building Industry Authority considered the consultation feedback and concluded that the level of consumer protection established by the Building Act 1991 should be strengthened rather than lowered. The former Building Industry Authority approved a new performance specification that would require:

- cover for claims arising in the year the policy applies (a typical annual 'claims made' policy)
- 10 years' forward cover for claims arising out of a certificate issued during the year the policy applies (a 'claims incurred' policy)
- run-off cover purchased in advance (referred to by the former Building Industry Authority as 'retrospective forward cover') for claims made in future years arising out of certificates issued in past years.

In approving the new specification, the former Building Industry Authority agreed that a second round of consultation should be undertaken before implementing the new specification.

The former Building Industry Authority also noted that:

- cover was not on offer from insurers in the short to medium term that would meet the requirements of the specification
- the amendments to the specification would, almost inevitably, lead to the closure of all remaining building certifier businesses.

Stage Two: The Department of Building and Housing review

In January 2005, having considered the former Building Industry Authority decisions and information, the Department:

- initiated the second round of consultation on the revised performance specification¹²
- held parallel discussions with building certifiers about the closure of some businesses and possible future arrangements for others in association with territorial authorities.¹³

The Department received only six substantive submissions on the proposed new performance specification, including submissions from the Ministry of Consumer Affairs and the Weathertight Homes Resolution Service (operated then by the Department of Internal Affairs) about consumer protection issues.

The final review report¹⁴ concluded that:

- the two consultation rounds had given ample opportunity for the building sector to come to grips with the insurance issue
- closure of the review had to be based clearly on Parliament's expectations of consumer protection established by the Building Act 1991
- little could be done to alleviate the profound feeling of inequity on the part of building certifiers
- as no fresh, viable solutions had been proposed, the Department could bring the matter to a close by proceeding to implement the new performance specification.

¹² Department of Building and Housing, *Proposed Changes to the Building Certifier Insurance Performance Specification* (January 2005).

¹³ Two of the largest building certifier businesses had ceased to operate in the latter part of 2004.

¹⁴ DK Hunn, Project Manager, *Building Certifiers' Insurance Review Final Report* (March 2005).

The final review report also included observations to the effect that:

- insurers, building certifiers and others consider that:
 - professional indemnity insurance is not particularly useful as a consumer protection mechanism (claims under professional indemnity policies tend to be vigorously defended by insurers and, as far as legally possible, payouts will be avoided or minimised)
 - a home warranty scheme similar to schemes operating in the United Kingdom, Australia and Canada would be a more effective consumer protection mechanism – although New Zealand’s adherence to the regime of joint and several liability would reduce the potential benefits of such a scheme
- in bringing the review of the insurance scheme under the Building Act 1991 to a conclusion, the Department must also decide how to apply the lessons from the review to the development of ‘adequate means’ requirements under the Building Act 2004.

¹⁵ The United Kingdom and British Columbia (Canada), however, also have joint and several liability.

Proposals

REGULATIONS TO SET MINIMUM TERMS AND CONDITIONS FOR PRIVATE BUILDING CONSENT AUTHORITY CIVIL LIABILITY INSURANCE POLICIES

The Department proposes that regulations be made under section 402 of the Building Act 2004 to set minimum terms and conditions for civil liability insurance policies for building consent authorities other than territorial and regional authorities.

The proposals arise from section 192 of the Act (reproduced in full below). Sub-section 2, paragraph (a) (highlighted in bold) is particularly relevant.

192 Criteria for registration—

- (1) Before entering a person's name in the register of building consent authorities, the Chief Executive must be satisfied that—
 - (a) the person holds a current accreditation from a building consent accreditation body appointed under section 248; and
 - (b) the person meets the prescribed criteria and standards for registration; and
 - (c) in the case of a person who wishes to be registered as a building consent authority but who is not a territorial authority or a regional authority, the person has adequate means to cover any civil liabilities that may arise in the performance of the functions of a building consent authority.
- (2) In considering whether a person has adequate means to cover any civil liabilities under subsection (1)(c), the Chief Executive may have regard to whether the person—
 - (a) holds an insurance policy that meets the minimum terms and conditions prescribed by regulations made under section 402; or**
 - (b) holds an insurance policy under a scheme of insurance approved by regulations made under section 402; or
 - (c) has put in place any arrangements that provide for effective consumer protection (for example, by giving a bond or having a guarantor).

MATTERS OUTSIDE THE SCOPE OF THESE PROPOSALS

Approval of a 'scheme of insurance'

The Department is not proposing to approve 'a scheme of insurance' – as referred to in paragraph (b), sub-section 2 of section 192. The Department considers that the initiation of such a scheme is the prerogative of private enterprise – for example, prospective private building consent authorities and/or insurers.

If the Department receives proposals for a scheme of insurance, the Department would then consider the merits of the scheme and the appropriateness of arranging for the scheme to be 'approved'.

Building consent authorities needn't rely solely on insurance to demonstrate 'adequate means'. Other consumer protection arrangements could be used instead of, or in conjunction with, insurance (ie, whether or not insurance is either provided as part of an approved scheme, or is compliant with minimum terms and conditions prescribed by regulations under the Act).¹⁶

A methodology for assessing adequate means

In addition to the proposals in this paper, the Department will develop a methodology for assessing means that might be used by private organisations instead of, or in conjunction with, insurance. The outcomes from earlier consultation on building consent authority registration standards and criteria will also help to inform the Department's work on finalising the assessment methodology.

Appendix B to this paper provides summary information about potential consumer protection arrangements and early work on an assessment methodology.

¹⁶ Examples of other consumer protection arrangements are: a 'self-insurance' fund – possibly in association with other similar companies; or contingent capital arrangements, such as bonds – possibly with a third party that agrees to provide debt capital on predefined terms.

It is likely that the assessment methodology would include consideration by a range of specialist advisors engaged by the Department from the fields of insurance, law, finance/accounting, and risk management of matters such as:

- the likely risk exposure of the organisation – for example, risks associated with the scope and volume of building control work that will be undertaken; and the value of the buildings the work relates to
- the organisation's risk management and risk-transfer or sharing (eg, by way of contracts and insurance cover) arrangements – some of which will also be addressed as part of the accreditation process as a prerequisite to registration
- the organisation's retained liability and the capital the organisation has available to support the likely liability
- the adequacy of the applicant's insurance relative to the requirements of regulations made under the Building Act 2004
- whether 'adequate means' is assured for the full responsibility period.

To increase the chances of registration being granted, the Department assumes that private organisations seeking registration as a building consent authority would also engage specialist advisors to prepare supporting information showing they have adequate means.

TAKING ACCOUNT OF THE 2004–2005 INSURANCE REVIEW

The Department considers that the outcomes from the 2004–2005 private building certifier insurance review and the performance specification reaffirmed in January 2005 are a very sound basis for the development of minimum terms and conditions for building consent authority civil liability insurance.

The reasons for holding this view include:

- the well-established consumer protection expectations that were confirmed by the review
- the history of joint and several liability in New Zealand.

Accordingly, even though such insurance is unlikely to be available in the foreseeable future and building consent authorities would not be able to rely on insurance to demonstrate 'adequate means', the Department is not proposing to revisit the conclusions of the review that such insurance should include:

- 10 years' forward cover for claims arising out of a certificate issued during the year the policy applies
- run-off cover purchased in advance for claims made in future years arising out of certificates issued in past years.

Unless the context demands otherwise, proposals derive directly from the performance specification proposed in the January 2005 publication *Proposed Changes to the Building Certifier Insurance Performance Specification*. If the proposals differ from the 2005 proposals, the differences are due to more up-to-date information received by the Department.¹⁷

The proposals relate to:

- the purpose of the insurance cover
- limits on the scope of the insurance cover
- the nature of the insurance cover
- continuity of cover
- the effect on building consent authority registration if cover lapses
- authorised insurers and intermediaries and rating requirements

¹⁷ The Department received additional information in the course of discussions with representatives of the Insurance Council of New Zealand, other government agencies and representatives of a number of Australian State agencies. Discussions were also held with individuals who previously operated as, or were employed by, private building certifiers under the Building Act 1991.

- matters that must be included in the insurance policy
- conditions that may be included in the insurance policy
- matters that may be excluded by the insurance policy.

PROPOSED MINIMUM TERMS AND CONDITIONS FOR INSURANCE

Purpose of the insurance cover

The Department proposes that the purpose of the insurance cover is to ensure that, unless a private building consent authority has otherwise demonstrated that the authority has 'adequate means', the authority:

- will have insurance to meet claims for civil liabilities in respect of losses arising out of the private building consent authority carrying out its functions under the Building Act 2004
- as far as is reasonably practicable, that indemnity will be available to enable such claims to be met, whenever the claim arises.

Limits on the scope of the insurance cover

The Department is not proposing that the insurance cover would protect a private building consent authority against any other civil or criminal claims. Therefore the coverage would not extend to indemnity for liabilities that arise from the conduct of any professional practice or business other than as a building consent authority under the Building Act 2004.

Nature of the insurance cover

The Department proposes that private building consent authority civil liability insurance would be required to provide:

- cover for claims arising in the year the policy applies (annual 'claims made' cover)
- 10 years' forward cover for claims arising out of building control work undertaken during the year that the policy applies ('claims incurred' cover which would continue to apply even if the private building consent authority ceased operating during that 10-year period)
- where applicable, run-off cover purchased in advance for claims made in future years arising out of building control work undertaken in past years (ie, retrospective forward cover).¹⁸

This proposal is different from normal professional indemnity insurance. Normally such insurance is simply provided on a 'claims made' basis to cover claims first made during the period of insurance (in effect one year's premium buys cover for claims made during that year).

The Department is aware that 10-year forward cover and run-off cover is not likely to be available for the foreseeable future. If, however, cover was allowed for less than 10 years, then consumers of private building consent authority services would have substantially less protection than the consumers of territorial or regional authority building consent authority services.

Without protection for the full 10-year period within which a claim for damages may be made, the potential losses for consumers may be large. Accordingly, it is not appropriate to exacerbate the risk of such losses by allowing insurance cover for less than 10 years.

¹⁸ The requirement to purchase retrospective cover would only apply where building consent authority functions performed in the last 10 years were not already covered by some other form of 'adequate means', including a pre-existing policy of insurance that meets the prescribed minimum terms and conditions for insurance. This retrospective cover would be unable to be cancelled, and would have to meet the prescribed minimum terms and conditions for insurance. With retrospective cover in place, liabilities in respect of functions performed in each future year would be covered by the annual renewal, for that year, of the policy.

Continuity of the insurance cover

The Department proposes that the insurance cover would have to be continuous and not able to be cancelled by the insurer unless:

- the insurer gives not less than 60 working days' notice in writing to the Chief Executive of its intention to cancel the particular policy
- the insurer gives not less than 60 working days' notice in writing to the building consent authority, to the address last notified to the insurer, of the cancellation of the policy¹⁹
- liabilities resulting from building consent authority functions performed prior to the date of cancellation, by either the insurer or the insured, remain covered for the remainder of the 10-year forward cover period.

The Department also proposes that, in the event of a request for cancellation by the insured, the insurers could not give effect to that cancellation until 60 working days after notice to the Chief Executive of the insured's intention to cancel the policy.

The Department considers that a period of 60 working days is the minimum amount of time that would be necessary to enable the Department to consult with the private building consent authority and for the authority to otherwise demonstrate that it has 'adequate means'. Failure by the authority to demonstrate 'adequate means' within that time would be a failure to meet the standards and criteria for registration (see the following section for information about the consequences of such failure).

The effect on building consent authority registration if insurance cover lapses

Policies of professional indemnity insurance are normally underwritten on an annually renewable basis. Accordingly, while not a matter for these proposals, the Chief Executive would need to arrange annual checking of the continuity and suitability of private building consent authority insurance and other consumer protection arrangements.

The annual checks could be part of a routine assessment to confirm that the private building consent authority continues to meet all the standards and criteria for registration. The timing of the check could also be coordinated with the annual renewal of the insurance policy.

The consequences, specified in section 197 of the Act, of failure to meet standards and criteria for registration are:

- initially, suspension of the building consent authority's registration; and then
- revocation of the building consent authority's registration if the building consent authority does not satisfy the Chief Executive within 12 months after the suspension (or any further period that the Chief Executive may determine) that the building consent authority meets the standards and criteria for registration.

¹⁹ The term 'working day' is defined in section 7 of the Building Act 2004. The use of working days is preferred over calendar days as the working day approach eliminates the effect of public holidays and the extended summer holiday period.

Authorised insurers and intermediaries and insurance ratings

The Department proposes that policies could only be issued:

- by an insurer authorised to underwrite for the class of insurance under the Insurance Companies Deposits Act 1953, or
- through an intermediary authorised to arrange for this class of insurance under the Insurance Companies Deposits Act 1953.²⁰

In developing these proposals, the Department has noted mixed views about the value to consumers of insurance ratings.²¹ Accordingly, the Department is not proposing that insurers be required to obtain or declare a rating in respect of civil liability cover for private building consent authorities. The Department is, however, interested in any feedback that stakeholders might wish to provide on the merits, or otherwise, of insurance ratings.

Matters that must be included in the insurance policy

Sum insured

The Department proposes that, unless otherwise approved by the Chief Executive of the Department, all civil liability insurance policies for private building consent authorities would be required to include a sum insured not less than the sums specified in the following table.²²

TOTAL VALUE OF BUILDING PROJECTS THE BUILDING CONSENT AUTHORITY FUNCTIONS RELATE TO	SUM INSURED FOR ANY ONE CLAIM	SUM INSURED IN THE AGGREGATE FOR ALL CLAIMS
Less than \$500,000	\$300,000	\$600,000
\$500,000 or more, but less than \$1,000,000	\$500,000	\$1,000,000
\$1,000,000 or more, but less than \$5,000,000	\$800,000	\$1,600,000
\$5,000,000 or more	\$800,000 plus \$150,000 for every \$1,000,000 or part thereof over \$5,000,000 of building project value	Twice the relevant sum insured for any one claim

²⁰ The Insurance Companies Deposits Act 1953 is administered by the Ministry of Economic Development. Amongst other things, the Act defines the terms 'insurance' and 'insurance business'. Insurance companies operating in New Zealand must lodge substantial financial deposits with the Public Trust.

²¹ A rating is an assessment of an insurer's ability to pay present and future claims. A rating is usually represented by a letter, number and/or symbol and forms part of a rating scale (eg, AA, B or C). The Insurance Companies (Ratings and Inspections) Act 1994 specifies when insurers must obtain a rating. Further information on ratings and the relevant legislation is available from the Insurance Council of New Zealand or the Ministry of Economic Development.

²² The sum insured would be the maximum amount of liability of the building consent authority for which the building consent authority is indemnified by the policy. As indicated in Appendix C, the proposed sums are broadly comparable with sums required overseas.

The Department proposes that the circumstances in which the Chief Executive may approve a sum assured less than the sums specified in the table on the previous page would be where the Chief Executive is satisfied that the actual level of risk warrants a reduction in the level of cover. The ability to approve a reduced level of cover would recognise that, as noted earlier in this paper, ongoing implementation of the Building Act 2004 is likely to impact on liability issues and associated risks, and there will be an opportunity to assess relative levels of risk.

For example, the Building Act 2004 introduced building practitioner licensing, which will be implemented between 2009 and 2011.

Details of licensing are still being finalised. Under the current proposals, from 2010 all 'significant building projects' must have a Design Lead who integrates and coordinates the building design, and a Site Lead who coordinates and oversees construction. All 'restricted building work' elements of a significant building project must be undertaken or supervised by a person with a specialist or trade licence.

The following three types of building projects are 'significant building projects', and will require licensed building practitioners.

- Construction of new buildings for occupation as workplaces or places of residence
- Projects to change the use of a building where the end use is a building occupied by people
- Major alterations or extensions to an existing occupied building

It is also currently proposed that there will be 13 licence classes including: three design licences (levels one, two and three); three site licences (levels one, two and three); and seven trade and specialist licences comprising carpentry, brick and block-laying, roofing and external plaster, steel structure, concrete structure, and building services.

The three levels of design and site licences reflect the following three categories of building complexity.

Category 1: Conventional timber-framed or masonry detached or semi-detached residential dwellings, of limited complexity, of low or medium risk envelope design.

Category 2: Moderately complex commercial or residential buildings.

Category 3: Buildings that have a high risk to occupants, high community importance or a category 1 classification under the Historic Places Act 1993.

If a private building consent authority elected to only carry out work associated with category 1 (ie, conventional, residential etc) buildings, then it is likely that the assessed risk for that authority would be less than for another authority working in all three categories (ie, where the total value of the work undertaken by each authority was identical).

As noted earlier in this paper, other relevant changes that are likely to influence future risk assessments are:

- product certification by product certification bodies
- accreditation of building consent authorities
- the future availability of home warranty cover and the nature of such cover.²³

²³ As noted earlier in this paper, the Department is considering issues and options related to home warranty insurance. The Department has also noted recent developments in this area in Australia and in other comparable jurisdictions.

Other matters that must be included

In addition to the sum insured, the Department proposes that all civil liability insurance policies for private building consent authorities would be required to include:

- a specification of the insurer's liability for any costs and expenses associated with defending or settling any claim that is incurred with the consent of the insurer
- unless otherwise approved by the Chief Executive of the Department of Building and Housing, a self-insured deductible or excess under the policy that is no more than \$20,000 for each and every claim²⁴
- a provision that, if during the time that a policy exists the building consent authority gives written notice to the insurer of any occurrence that may subsequently give rise to a claim against the building consent authority, then any such claim or claims which may subsequently be made against the building consent authority shall, for the purposes of the policy, be deemed to have been made during the time that the policy existed
- a provision that when any person having a claim against the building consent authority which would be covered by the policy is prevented from bringing proceedings against the building consent authority because the building consent authority has –
 - died
 - disappeared
 - become bankrupt, gone into receivership or liquidation; or
 - for any other reason, become unavailable to respond to the claim –then, if that person notifies the insurer of the claim as soon as is reasonably practicable, that person:

- shall be a 'beneficiary' of the policy for the purposes of the Contracts (Privity) Act 1982
- shall be entitled to receive from the insurer any sum which that person would otherwise have been entitled to receive by way of the indemnity available to the building consent authority in respect of that claim.

Conditions that may be included in the insurance policy

The Department proposes that civil liability insurance policies for private building consent authorities would be able to include conditions that:

- prevent the aggregation of cover where there is more than one collectable policy of insurance indemnifying the building consent authority against the same liability (any such condition shall include a rateable contribution clause)
- prevent the building consent authority admitting liability or settling any claim or incurring costs and expenses without the written consent of the insurer (provided that such consent is not unreasonably withheld)
- entitle the insurer to take over and conduct in the name of the building consent authority the defence or settlement of any claim
- limit, in respect of any one claim, the insurer's liability for costs and expenses of defending or settling any claim to \$100,000 or 20 percent of the limit of indemnity, whichever is the greater
- require the building consent authority to give reasonable cooperation to the insurer in respect of the defence or settlement of any claim and to use due diligence to mitigate any loss
- require the building consent authority, as a precedent to the right to be indemnified under the policy, to give prompt notice in writing of any claim made against the building consent authority

²⁴ The Department has noted an insurance industry concern about the sustainability of cover if, in practice, such a deductible or excess proves difficult to collect.

- require the building consent authority to notify the insurer of material changes in the risk including mergers, voluntary bankruptcy, receivership or liquidation or other similar events
- require the building consent authority to provide information by stated dates to the insurer by way of periodic reports or other means, including evidence of the building consent authority functions performed (including consent issue dates, code compliance certificate numbers, value of work certified etc)
- enable the premium to be initially on a provisional basis subject to any adjustments.
- liabilities to pay fines, or punitive or exemplary damages
- claims arising out of:
 - circumstances notified under any previous policy of insurance
 - circumstances noted on the proposal form for the current period of insurance or any previous proposal form
 - alleged or actual infringement of copyright, patent or trademark.

Matters that may be excluded by the insurance policy

The Department proposes that civil liability insurance policies for private building consent authorities would be able to exclude:

- claims arising from:
 - allegations of defamation
 - ionising radiations or contamination by radioactivity from any nuclear fuel or from any nuclear waste from the combustion of nuclear fuel
 - any physical chattel manufactured, treated, assembled or processed by the building consent authority
 - acts of war, terrorism, insurrection, riot or similar events
- claims caused or contributed to by dishonest, fraudulent, criminal or malicious acts or omissions of the building consent authority
- claims where the building consent authority has failed to inform the insurer within a reasonable period of receiving any intimation or notice of an impending claim or of any circumstances known to the building consent authority as likely to give rise to a claim against the building consent authority

Question 4: Do you agree with the proposed minimum terms and conditions for private building consent authority civil liability insurance policies? Please explain the reasons for your answer in relation to each of the following points.

- The purpose of the insurance cover
- The nature of the insurance cover
- Continuity of the insurance cover
- Authorised insurers and intermediaries, and rating requirements
- Matters that must be included in the insurance policy
- Conditions that may be included in the insurance policy
- Matters that may be excluded by the insurance policy

Question 5: Are there any other comments you wish to make about the proposals in this paper? If so, please indicate clearly which particular aspect of the proposal your comment is about.

Submissions

The Department invites you to submit feedback on proposals to set minimum terms and conditions for civil liability insurance policies for private building consent authorities.

When you have filled in the submission form on the following pages, please send the form to:

BCA Accreditation and Registration Project
Consent Authority Capability and Performance
Group
Department of Building and Housing
PO Box 10 729
Wellington

An electronic version of this paper, including the submission form, is available from the Department's website (www.dbh.govt.nz).

Your submission will become publicly available information. Please indicate clearly if your comments are commercially sensitive or if, for some other reason, you do not consider that they should be disclosed. Any request for non-disclosure would be considered in terms of the Official Information Act 1982 and the Privacy Act 1993.

For more information:

- go to www.dbh.govt.nz
- call freephone 0800 242 243.

Please return your submission to the Department by **21 September 2007**.

Private building consent authority adequate means and civil liability insurance submission form

To be sent to:

BCA Accreditation and Registration Project
Consent Authority Capability and Performance Group
Department of Building and Housing
PO Box 10 729
Wellington

PRIVATE BUILDING CONSENT AUTHORITY ADEQUATE MEANS AND CIVIL LIABILITY INSURANCE SUBMISSION FORM

Name of person preparing submission:

Position:

Organisation:

Contact details:

- telephone
- email
- postal address

This submission form is intended to help you make a submission on private building consent authority 'adequate means' proposals and proposals to set minimum terms and conditions for civil liability insurance policies for private building consent authorities.

Please fill out the questions that are relevant to you. You may also send additional feedback if you choose.

For more information please contact the Department on 0800 242 243 or refer to www.dbh.govt.nz

Please return this form to the Department by **21 September 2007**.

Question 1: Do you agree with the interpretation of 'adequate means' set out in the consultation paper? Please explain the reasons for your answer.

Question 2: Are there objective statements additional to those in the consultation paper the Department could usefully have regard to in determining 'adequate means'? If so, please list the statement(s) and explain how the statement(s) will assist with determining 'adequate means'.

**PRIVATE BUILDING CONSENT AUTHORITY ADEQUATE MEANS AND CIVIL LIABILITY INSURANCE
SUBMISSION FORM (continued)**

Question 3: Are there significant factors additional to those in the consultation paper that may increase or reduce risks and/or building consent authority civil liability? If so, please list the factors and explain the significance of each factor.

Question 4: Do you agree with the proposed minimum terms and conditions for private building consent authority civil liability insurance policies? Please explain the reasons for your answer in relation to each of the following points.

- The purpose of the insurance cover
- The nature of the insurance cover
- Continuity of the insurance cover
- Authorised insurers and intermediaries, and rating requirements
- Matters that must be included in the insurance policy
- Conditions that may be included in the insurance policy
- Matters that may be excluded by the insurance policy

Question 5: Are there any other comments you wish to make about the proposals in this paper? If so, please indicate clearly which particular aspect of the proposal your comment is about.

Appendix A: A risk management framework²⁵

A key factor in assessing the likely liability is the risk management practices of the building consent authority. In order to assess the total risk management package, it is useful to consider a generic risk management methodology. The generic framework considers all methods potentially available to an organisation. Not all of the options would necessarily be available to a building consent authority in New Zealand.

The diagram opposite sets out the framework, with comments on the specific application to a building consent authority.

Exposure to risk

The first consideration is the potential exposure to risk. This will depend on the number and value of building consents or code compliance certificates that have been issued. The risk extends for the period of 10 years from the time of certification. All buildings certified in the last 10 years as well as planned activity over the next period (eg, year) need to be considered.

In addition to the specific civil liabilities resulting from performing the duties of a building consent authority, any other significant risks should be considered, to the extent that they will reduce the means available to cover the specific liabilities being considered by the Department.

Operational risk management procedures

The next step to consider is the operational risk management procedures. This information should be available from the accreditation process, and is likely to cover the skills, experience, qualifications, procedures, scope of accreditation and any other relevant items.

Risk

A building consent authority is liable, for 10 years from the date the certificate is issued, for any civil liability claim for an act or omission by the building consent authority. The value of the risk under consideration is the value of future liability claims awarded against the building consent authority.

The most likely scenarios include:

- a certificate is issued to a building that does not comply with the Building Code
- there is a failure in some aspect of the building
- subsequent inspection reveals that there is non-compliance with the Building Code
- there is negligence in the process of inspecting the building and issuing the code compliance certificate.

There may be other likely scenarios where the building consent authority incurs a liability. All likely scenarios or risks should be considered, but it should not be necessary to consider every conceivable risk.

Joint and several liability adds an extra risk if any of the contributing parties have contributed to the liability but are unable to pay their contribution.

Transferred risk

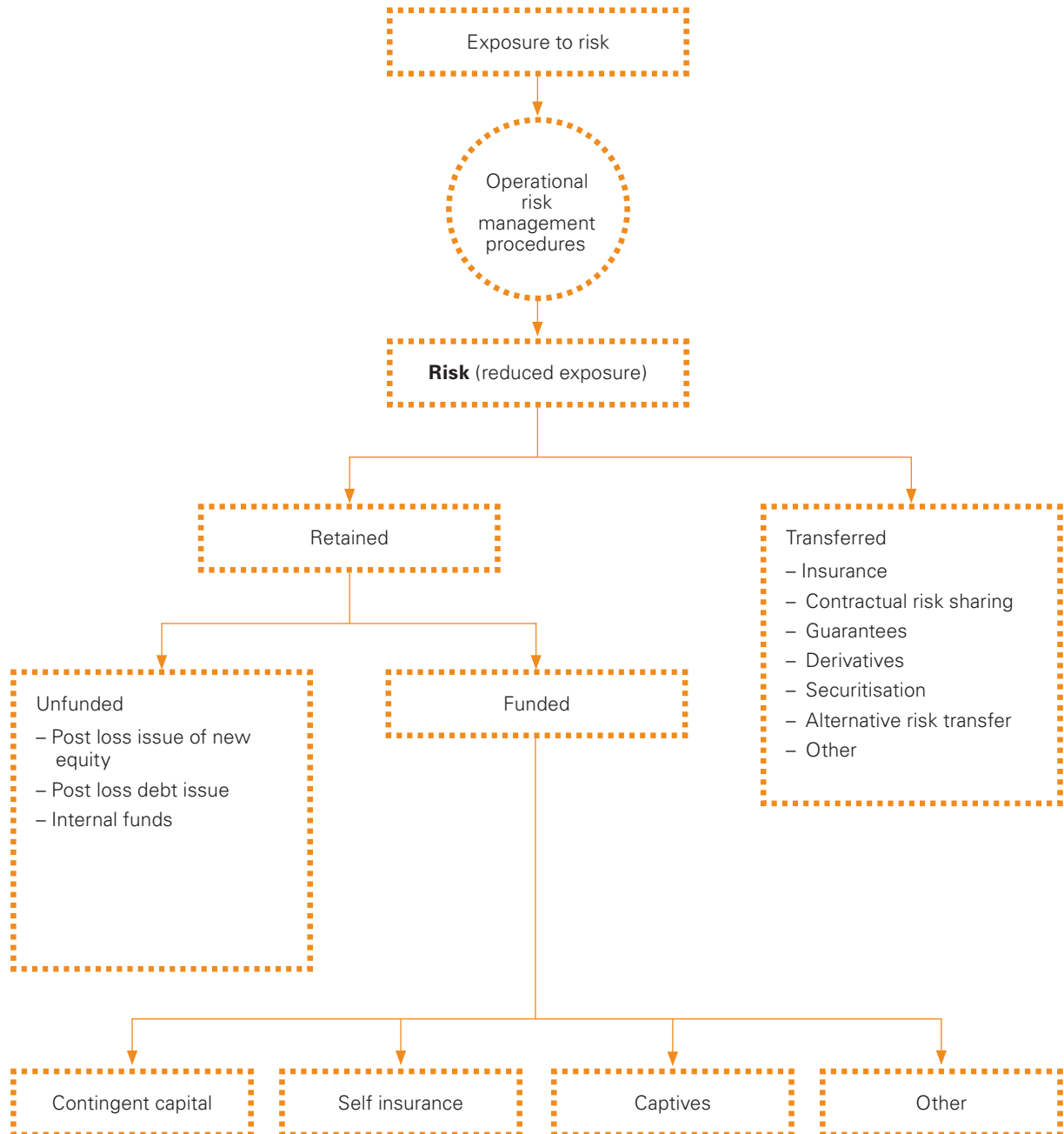
Risk can be transferred to a third party through a variety of mechanisms, including insurance.

While ultimately the risk to be considered under the Building Act is the public liability claim, any risk transfer that is based on the event that gives rise to the liability claim should be considered. An example of this would be a contract with a builder guaranteeing that the builder rectifies any building defects. This may be backed up by building warranty insurance to cover any remaining risks, including the bankruptcy risk of the builder.

It would be expected that the building consent authority also have professional indemnity insurance covering civil liabilities resulting from negligence.

²⁵ The content of this Appendix has been extracted from advice provided to the Department of Building and Housing by PricewaterhouseCoopers in August 2005.

Risk management framework



Retained risk

Retained risks are defined as all risks that have not been transferred. Consideration should be given to all the details of risk transfer contracts and policies including:

- the definition of risks transferred
- the duration for which the risk has been transferred
- exclusions
- excesses or deductibles and maximums.

The retained risk should consider the full term of the liability and include allowance for:

- non-renewal of risk sharing contracts that do not cover the full term of the liability (eg, annual contracts)
- default risk of counterparties.

The retained risk is the basis for determining the likely liabilities for which adequate means must be shown. There are a variety of financial assets and instruments that can be used to provide the adequate means, however all methods will involve capital or access to additional capital in some form.

Funded liabilities

The liability for the retained risk can either be funded or unfunded. The decision on whether to fund the liability will depend on the nature of the liability. In general, small frequent liabilities would tend to be funded, whereas larger, less frequent and more uncertain liabilities may not be funded. An insurance company is required to fund all of its liabilities; the insurance accounting standards will provide guidance on how much additional margin is required in addition to the best estimate.

A key distinction for funded risk is that the arrangements are put in place before the event, or loss happens. In order to fund a liability, the expected value of the liability needs to be estimated in some way. This will necessitate the implementation of processes and methodology to estimate and then monitor the value of the expected liability.

There are a number of possible methods for funding the liability, some of which are discussed below.

Self-insurance

An internal insurance fund is established on insurance principles to cover the expected retained losses. The self-insurance fund might be pooled with other similar companies.

Captives

Self-insurance may also be undertaken through a captive, which is a subsidiary company set up and managed as an insurance company. The cashflows to the subsidiary will be initial capital, premiums and claims. If a captive is used, then the assessment should be on a 'look through' basis considering the capital of the captive as well. If the captive does not have sufficient capital then additional capital will be required elsewhere.

Contingent capital

This may take several forms, but one example would be an arrangement with a third party to provide debt capital on predefined terms, if a predefined event were to happen. The provider of the capital is likely to require a fee up front that would reflect the likelihood of the loan being taken up and the subsequent risk of default. The loan might, for example, be triggered if liability claims reached a certain threshold. Another example could be a letter of credit from a bank.

The difference from insurance is that the building consent authority would still have to repay the capital. The third party's risk is the risk of the building consent authority being unable to pay the loan rather than the original liability risk.

Unfunded liabilities

An unfunded risk is where no prior arrangement has been made for funding that risk. It is what remains after allowing for transferred risk and funded retained risk.

The default position, if no other procedures have been put in place, is for all the risk to be unfunded. A building consent authority may not be able to, or choose not to fund any of the liabilities, but if this is the case, the remaining unfunded liabilities will be difficult to evaluate.

The unfunded liability will include the additional margins not already funded or transferred, needed to provide the required level of sufficiency.

The unfunded liability has to be met from the remaining reserves and capital of the company, or from additional capital.

The capital reserves of the company will be evaluated from the net assets adjusted for any additional liabilities, or funded amounts already considered.

The additional capital could include borrowing capital from the bank, or a capital injection. This additional capital should only be counted towards the adequate means if there is some guarantee in place that it will be available. If there is a guarantee of availability then the amount and terms on which the capital is provided should be considered.

Sustainability

All of the components discussed above have to be sustainable for the full 10-year responsibility period of the liability. If any of the components are not sustainable then the risk will default into the unfunded liability. The sustainability of this will depend on the continuing existence of the building consent authority for 10 years after ceasing operations as a building consent authority.

The risk management plan should address the arrangements for ensuring this capital continues to be available.

Summary

The risk management framework set out above is not intended to be comprehensive, or for all parts to be achievable. The framework is included as a guide so that the various possible mechanisms that might be used can be categorised and their effectiveness evaluated.

The risk management framework is also intended as a guide to the extent that a building consent authority would be expected to plan, implement and monitor its risk management strategy. The onus should be on the building consent authority to undertake this work and present the documentation to the Department for assessment. It is likely that they will require professional and legal advice to do this.

This work has to be done on realistic assumptions and to a sufficient standard to enable the Department to assess the likely liability with any confidence. Otherwise the required adequate means may have to default to the full value of all buildings certified.

Appendix B: Assessment of adequate means²⁶

The assessment of adequate means will require that the Department makes an assessment of:

- the risk management arrangements of the building consent authority
- the likely retained liability
- the capital available to support the likely liability
- whether 'adequate means' is assured for the full responsibility period.

The risk management methodology discussed in the previous section²⁷ identifies the key elements that need to be considered. The sections below provide some guidance on what needs to be considered by the Department when reviewing each component.

Exposure to risk

To assess exposure, it will be necessary to consider statistics on the number and value of all buildings (if any) for which certificates have been issued in the last 10 years, plus the projected statistics for the next year from the building consent authority's business plans. The likely liability will generally run off over the 10-year period, so it is important to keep records of each year's certificates separately to estimate the likely liability. Initially, there will be no history to consider unless one of the existing private certifiers applies.²⁸

The exposure may also depend on the location and type of buildings to be certified and the scope of certification.

Operational risk management procedures

The operational risk management procedures will generally concentrate on reducing the likelihood of any errors or negligence occurring, and hence reducing the likely frequency of claims.

The other way the liability can be reduced is by reducing the maximum claim amount and/or the average claim amount. Examples of this would be any liability cap (limitation on the maximum liability) that is legally and effectively able to be included in contracts.

The assessment of operational risk management will be part of the accreditation process. It is beyond the scope of this paper to consider this, but the implications on risk of the operational risk management procedures need to be taken into account.

The Department should also consider any client acceptance procedures or criteria the building consent authority has in place, as these can potentially reduce risk.

Risk

To understand the risks, it may be useful to construct a table of all likely liabilities the building consent authority may face and the likely maximum amount and duration of each of these liabilities. There is the additional risk added by joint and several liability. A jointly liable party may not be in a position to pay their contribution to the loss, increasing the share for the building consent authority.

Transferred risk

Full details of all contracts or arrangements that are in place to transfer risk will be required.

Professional indemnity insurance

Insurance will still remain an important risk management tool for the building consent authority. It is unlikely that the known limitations of the insurance cover available will change in the foreseeable future. Consequently, the insurance cover will need to be considered on a case-by-case basis.

²⁶ The content of this Appendix has been extracted from advice provided to the Department of Building and Housing by PricewaterhouseCoopers in August 2005.

²⁷ Appendix A.

²⁸ Depending on when litigation begins and how long it takes to be resolved, liability could extend beyond the 10-year limitation in the Building Act 2004.

The review of the insurance cover will need to consider both the current insurance contract available, plus the ability of the building consent authority to continue to obtain this cover for the full 10-year run-off period.

The review of the current insurance will consider all relevant information including:

- the rating of the insurance company providing the cover
- the definition of liability, generally a professional negligence definition
- any other civil liabilities covered
- the term and nature of the insurance (the current market provides yearly renewable cover on a claims-made basis)
- the maximum amount covered and the reinstatement of cover provisions
- policy conditions
- exclusions
- amount of excess
- premiums.

The uninsured liability for the current period must be considered elsewhere in the assessment. As a guide the uninsured component is any event for which a claim is made (assuming the insurance is on a claims-made basis) in the period that falls outside the policy definitions or is subject to an exclusion, or any amount over the maximum insured, plus the excess.

The next consideration is the renewability of the insurance for the particular building consent authority. This must consider both the insurance market's capacity to continue to offer the insurance and the building consent authority's continued capacity to purchase the insurance.

If insurance is a significant component of the building consent authority's risk management strategy, then a major risk to the maintenance of adequate means is the non-renewal of insurance during the 10-year responsibility period.

This risk has been well documented and discussed in the review of the insurance scheme for private building certifiers undertaken by the former Building Industry Authority in 2004, including the PwC report on the review.²⁹

The renewability of the insurance in practice will depend on the maintenance of good risk management practices and the continuation of the building consent authority in business. Poor claims experience will also reduce the ability to renew insurance. If a building consent authority were to get into difficulties with emerging liability claims against it, it is unlikely that the insurance as currently available would by itself prevent the failure of the company.

Other risk transfer

The Department would need to examine full details of any risk-sharing arrangement with a third party. This will include the terms of the arrangement, the duration of the arrangement and the scope of the arrangement.

It is important to consider any circumstances where the risk-sharing arrangement may break down, and whether this causes the liability to fall to the building consent authority. An example of this would be if the other party to the risk-sharing were to go out of business. Similarly, if the term of the arrangement is less than the full responsibility period, then the building consent authority may effectively retain the risk for the remainder of the period.

Any other arrangements to back the risk-sharing arrangement should also be considered. For example, if the risk-sharing was a warranty by the builder to fix any defects, then additional arrangements may be needed to cover the builder going out of business, or to indemnify the building consent authority from any recovery of costs in the event of negligence.

²⁹ PricewaterhouseCoopers *Review of Building Certifier Insurance* (July 2004).

RISK	COMPONENT	SECONDARY RISKS	MAXIMUM	DURATION
Negligence	Total		Building value	10 years
	Insured		500,000	1 year
	Net retained		50,000 plus (claim – 500,000)	
		Non-renewal of insurance	Building value	9 years

Retained risk

The table based on all likely risks, maximums and durations can then be adjusted for all the risk-sharing arrangements to give a picture of the retained risks. The table above is an example of one risk split by total risk, transferred risk and the net retained risk.

Funded liabilities

It is not necessarily a requirement that the building consent authority fund their retained liabilities. However, if some of the liabilities are to be funded, it demonstrates a serious commitment to the risk management strategy, and is likely to make the assessment of adequate means considerably easier.

When assessing the funding arrangements, the Department will need to consider:

- the risk being funded
- the type of arrangement for funding
- whether there are any charges, covenants or restrictions over the assets backing the funded liability
- any arrangements to separate the fund from day-to-day business activities
- the extent and pace of funding, for example is it fully funded or does it include any additional margins
- monitoring procedures in place
- data and assumptions underlying the funding calculations

- collateral data such as industry experience or insurance premiums
- the nature of the assets or other instruments backing the fund.

Unfunded liabilities

The first part of this final stage is assessing the remaining assets, capital and access to additional capital.

The building consent authority will have provided all the financial information, and details of all financial assets and instruments. If the building consent authority is proposing to raise additional capital, or invoke a guarantee or other arrangement to cover unfunded liabilities as they arise, then the details of these arrangements must be considered. The extra capital may not be required until the building consent authority is already suffering adverse financial results, in which case the capital is likely to cease to be available.

The next stage is assessing the remaining unfunded liabilities. There is likely to be little information available here. For this analysis, it may be more appropriate to combine the unfunded and the funded liabilities and consider all the retained liability together.³⁰

³⁰ The August 2005 advice included further discussion on retained liability.

Sustainability

The assessment will need to carefully consider the sustainability of any arrangements. The 10-year responsibility demands this and the main problems in the past have resulted from a lack of sustainability of arrangements. Principally, these were the difficulties in renewing the professional indemnity insurance without exclusions and the loss of all insurance on ceasing business.

The assessment should consider, for example, the effect on the run-off liability of insurance being cancelled.

There will need to be mechanisms in place to continue to provide for likely liabilities on ceasing business or winding up the company. Similarly, controls may be needed around the paying of dividends or return of capital that resulted in the adequate means capital position being breached.

Appendix C: Examples of overseas insurance cover requirements

The Department has reviewed requirements from a number of overseas jurisdictions. The requirements summarised below indicate the 'sums insured' the Department is proposing are broadly comparable. A direct comparison is difficult, however, due to significant differences in legal frameworks and building control practices.

AUSTRALIA

A recent Australian Procurement and Construction Council Inc (APCC) publication *Professional Indemnity Insurance Guidelines in the Building and Construction Industry*, using a risk-based assessment model, suggested amounts of insurance cover ranging between AU\$2 and 10 million for a range of project and service risks.

The level of cover suggested by the APCC is based on several factors including:

- levels accepted or recommended by some government agencies
- recognising the finite amount of insurance availability and the need to allocate it responsibly
- the balance between the cost of insurance and the required level of insurance for each project.

Victoria

Section 135 of the Building Act 1993 (Victoria) enables the responsible Minister to require, by order published in the Government Gazette, that 'building practitioners' be covered by insurance. The Minister may also specify the kinds and amount of insurance that must be held.

The May 2005 *Building Practitioners' Insurance Ministerial Order* requires 'building surveyors' and 'building inspectors' to have a professional indemnity insurance policy with the following indemnity limits.³¹

- (1) where the cost of the defence of claims (Defence Costs) are included in the limit of indemnity – not less than \$1.5 million for any one claim, and in the aggregate for all claims during any one period of insurance; or
- (2) where Defence Costs are not included in the limit of indemnity:
 - (a) not less than \$1 million for any one claim, and in the aggregate for all claims during any one period of insurance, not including Defence Costs; and
 - (b) not less than \$500,000 for any one claim, and in the aggregate for all claims during any one period of insurance, in respect of Defence Costs.

Before a building surveyor enters into an agreement under section 215 of the Building Act 1993 (Victoria) to undertake work for a council, the limit of indemnity under the relevant policy of professional indemnity insurance must be not less than \$5 million for any one claim and in aggregate during any one period of insurance.

Australian Capital Territory (ACT)

The Construction Occupations (Licensing) Regulations 2004 (ACT) specify the following as part of the eligibility criteria for licensing of 'building surveyors'.³²

A person is adequately insured if the person has professional indemnity insurance that provides—

- (a) indemnity against claims for breach of professional duty as a building certifier; and
- (b) a minimum limit of indemnity of \$1,000,000 for any 1 claim; and
- (c) a minimum limit of indemnity of \$1,000,000 for the total of all claims against the insured made in the period of cover; and

³¹ http://www.buildingcommission.com.au/resources/documents/Building_Practitioners_Insurance_MO_12May05.pdf

³² <http://www.legislation.act.gov.au/sl/2004-36/current/pdf/2004-36.pdf>

(d) in addition to the indemnities mentioned in paragraphs (b) and (c), a minimum limit of indemnity for the costs and expenses of defending or settling a claim of 20% of the limit of indemnity for the claim.

Queensland

The Standard Building Regulation 1993 (Queensland) requires a 'private certifier' to have professional indemnity insurance that provides for the following.³³

- (a) a minimum limit of indemnity of \$1 million for any 1 claim and in the aggregate during any 1 period of insurance that may arise from the conduct of the practice or business as a private certifier;*
- (b) in addition to the limit of indemnity mentioned in paragraph (a)—indemnity for costs and expenses incurred with the consent of the insurer of defending or settling a claim;*
- (c) indemnity for breaches of professional duty as a private certifier arising from an act, error or omission of the private certifier after the day the private certifier was first licensed as a private certifier;*
- (d) at least 1 automatic reinstatement of indemnity;*
- (e) indemnity for negligent building certifying work (other than for claims for fraudulent or illegal acts or omissions);*
- (f) if the certifying work is being undertaken by an employee of a firm or corporation—indemnity to former principals, partners and directors of the firm or corporation who were, but no longer are, licensed private certifiers.*

New South Wales (NSW)

The *Environmental Planning and Assessment Regulation 2000* specifies the following as the 'limit of indemnity as to compensation'.³⁴

- (1) An approved professional indemnity contract may limit the indemnity provided to an insured (being an individual), with respect to all claims made by the insured under the contract in any one year, to an amount of at least \$1,000,000.*
- (2) For an insured that is a company, an approved professional indemnity contract must indemnify the company, with respect to all claims made by the company under the contract in any one year, for not less than the amount calculated by multiplying \$1,000,000 by:
 - (a) the number of accredited certifiers who are directors or employees of the company as at the date on which the contract is issued, or*
 - (b) if the contract is the fourth or subsequent contract issued to the company, whether by the same or by another insurer, the average number of accredited certifiers who have been directors or employees of the company at any one time during the previous 3 years.**
- (3) For an insured that is a partnership, an approved professional indemnity contract must indemnify the partnership, with respect to all claims made by the partnership in any one year under the contract, for not less than the amount calculated by multiplying \$1,000,000 by:
 - (a) the number or accredited certifiers who are partners or employees of the partnership as at the date on which the contract is issued, or**

³³ <http://www.legislation.qld.gov.au/LEGISLTN/CURRENT/B/BuildingStanR93.pdf>

³⁴ <http://www.legislation.nsw.gov.au>

- (b) if the contract is the fourth or subsequent contract issued to the partnership, whether by the same or by another insurer, the average number of accredited certifiers who have been partners or employees of the partnership at any one time during the previous 3 years.
- (4) Nothing in subclause (2) or (3) requires the indemnity provided by an approved professional indemnity contract, with respect to all claims made by a company or partnership in any one year under the contract, to be for an amount greater than \$10,000,000.
- (5) An approved professional indemnity contract must contain at least one automatic reinstatement of the indemnity provided by it.

CANADA

Ontario

The Ontario building code (2006), which came into force in December 2006, requires the following insurance cover for registered code agencies and persons.³⁵

(1) The insurance policy,...

- (f) shall specify a limit of indemnity for any one claim and in the aggregate during any one period of insurance that is not less than,
- (i) in the case of persons registered under Article 3.2.4.2,
- (A) \$1,000,000 per claim and \$2,000,000 in the aggregate, if the person billed \$100,000 or more in fees in the 12 months immediately before the issuance of the policy,
- (B) \$500,000 per claim and \$1,000,000 in the aggregate, if the person billed more than \$50,000 and less than \$100,000 in fees in the 12 months immediately before the issuance of the policy,

- (C) \$250,000 per claim and \$500,000 in the aggregate, if the person billed \$50,000 or less in fees in the 12 months immediately before the issuance of the policy, or
- (D) the limits of indemnity for any one claim and in the aggregate that are set out in Sub-subclause (A), (B) or (C), as determined by reference to the person's estimated fees billings for the 12-month period immediately after the issuance of the policy, if the person has been registered less than one year before the issuance of the policy, and
- (ii) in the case of a registered code agency registered under Article 3.4.3.2., \$1,000,000 per claim and \$2,000,000 in the aggregate, except that those limits shall apply exclusively to the exercise of the powers and performance of the duties of a registered code agency under the Act and shall be in addition to any insurance applicable to any other activities carried on by the registered code agency,
- (g) shall provide that any costs and expenses necessarily incurred by the insurer in the investigation, defence or settlement of claims under the policy shall not be part of the limit of indemnity set out in Clause (f) unless the limit of indemnity from any one claim exceeds \$2,000,000,
- (h) shall not provide that the insured shall be responsible for the first portion of any sum that the insured becomes legally liable to pay in respect of a claim made against him, her or it in respect of any one claim or occurrence in an amount exceeding the lesser of,
- (i) \$70,000, and
- (ii) 5% of,

³⁵ http://www.e-laws.gov.on.ca/DBLaws/Source/Regs/English/2006/R06350e_e.htm

- (A) *the amount of fees billed by the insured in the 12 months immediately before the issuance of the policy, or*
- (B) *the amount of the insured's estimated fees billings for the 12-month period immediately after the issuance of the policy, if the insured has been registered under Article 3.2.4.2. less than one year before the issuance of the policy,*
- (i) *shall provide that it cannot be cancelled by the insured unless,*
 - (i) *the insured immediately replaces the policy with another policy that satisfies the requirements of this Article,*
 - (ii) *the insurer has given notice in writing of the proposed cancellation to the director, and*
 - (iii) *the notice described in Subclause (ii) was received by the director at least 30 days before the day the policy is cancelled,*
- (j) *shall provide that it cannot be cancelled by the insurer unless,*
 - (i) *it is cancelled for non-payment of a premium,*
 - (ii) *the insurer has given notice in writing of the proposed cancellation to the director, and*
 - (iii) *the notice described in Subclause (ii) was sent to the director at least 30 days before the day the policy is cancelled,*
- (k) *shall provide for the continuation of coverage if the insured is adjudged a bankrupt, insolvent, incompetent or dies during the period of insurance, and*
- (l) *may provide that coverage be subject to such exclusions and conditions and otherwise on such terms as are consistent with normal insurance industry practice from time to time.*

ENGLAND

The Building Act 1984 (England) includes provisions relating to building control by 'approved inspectors'. Approved inspectors must have professional indemnity insurance approved by the Secretary of State. Advice from the Office of the Deputy Prime Minister indicates that the following *Criterion for schemes of insurance for Approved Inspectors pursuant to section 47(6) of the Building Act 1984* was current at 31 October 2005.³⁶

a) Professional Indemnity cover

Schemes must provide for professional indemnity insurance covering the approved inspector for losses arising from claims on him/it in respect of negligence, or alleged negligence, in the performance of his/its duties as an approved inspector.

The following minimum limits apply to such cover:

- i) for claims against the approved inspector in respect of personal injury (including illness, disease and death) an aggregate limit of £5m per claim (all claims attributable to one occurrence shall be treated as one claim)³⁷
- ii) for other claims against the approved inspector, a limit of £1m per claim (all claims attributable to one occurrence shall be treated as one claim)

subject to a minimum aggregate limit of £15m for all claims against the approved inspector in respect of his or its work carried out in any one period of 12 months.

b) Defence costs

Cover is to extend to the approved inspector's defence costs, which are to be treated on a 'costs in addition basis', (ie, such costs will not be taken into account for the per claim limits, though they will count towards the aggregate limit of £15m).

³⁶ http://www.communities.gov.uk/pub/280/BuildingControloftheWarrantyLinkRuleandholidayhomesbyApprovedInspectors_id1161280.pdf

³⁷ Note that the Injury Prevention, Rehabilitation, and Compensation Act 2001 would prevent many personal injury claims in New Zealand.

c) Automatic run-off cover

In relation to

- (i) any personal injury claims; and
- (ii) non-injury claims brought by an owner-occupier in relation to his only or main residence, other than under the law of contract,

cover must be provided in respect of claims notified to the insurer within 10 years of the date of completion of the approved inspector's work in respect of the relevant building project, whether that date is that of acceptance of a final certificate, or of some other event marking the practical termination of the approved inspector's involvement in the project.

The minimum per claim limits set out in (a)(i) and (ii) above apply in respect of this cover, as does the minimum aggregate limit of £15m.

d) Index linking

Not required.

e) Excess

Not more than £5,000 per claim.

f) Voiding of cover

In line with commercial practice, reasonable provisions for voiding of cover will be allowed.

Appendix D: Draft regulatory impact statement

Executive summary

Under the Building Act 2004 (the Act), the Department of Building and Housing (the Department) must be satisfied that private building consent authorities have 'adequate means' (in particular by way of insurance policies) to meet the authorities' civil liabilities. Until regulations are made under the Act, there will be uncertainty about minimum terms and conditions for insurance policies and how insurance may contribute to ensuring 'adequate means'. Beyond providing the desired certainty and assisting the effective and efficient implementation of the registration scheme established by the Act, the impact of the proposed regulations will not add significantly to the overriding impact of requirement in the Act relating to 'adequate means'.

Status quo and the problem

The Act introduced a suite of measures designed to improve the control of, and encourage better practice and performance in, building design, regulatory building control, and building construction. One of these measures is an accreditation and registration scheme for building consent authorities. Building consent authorities are primarily territorial and regional authorities, but the Act also provides for accreditation and registration of private organisations (private building consent authorities). Under the Act, building consent authorities must be registered in order to undertake building control functions (sections 192–198 refer).

To be registered as a building consent authority, a private organisation must satisfy the Department that the organisation is accredited, meets criteria for registration prescribed in regulations (if any), and has 'adequate means' to cover any civil liabilities that may arise in the performance of building consent authority functions. In considering whether an organisation has 'adequate means', section 192 of the Act provides that the Department may, amongst other things, have regard to whether the organisation holds an insurance policy that meets minimum terms and conditions prescribed by regulations made under section 402 of the Act.

Status quo is not feasible as the registration scheme cannot be implemented effectively due to uncertainty about minimum terms and conditions for insurance policies.

Section 402(1)(r) of the Act enables the making of regulations prescribing minimum terms and conditions of an insurance policy for the purposes of section 192(2)(a). There are currently no such regulations. Without regulations prescribing minimum terms and conditions for insurance policies, private organisations that may be considering applying for registration as building consent authorities, insurers and the Department will have no certainty about whether any particular insurance policy constitutes 'adequate means' for the purposes of the Act.

Objectives

The public policy objectives are to:

- provide certainty for private organisations and insurers about the insurance policy requirements that must be met if policies are to satisfy the Department about 'adequate means'
- ensure, unless 'adequate means' has otherwise been demonstrated, that private building consent authorities have sufficient insurance cover to meet claims for civil liabilities in respect of losses arising out of the carrying out functions under the Act, whenever the claim arises.

Alternative options

The Department considered the alternative option of simply setting minimum terms and conditions for insurance policies as a matter of Department policy (ie, as part of the wider methodology that would need to be established by the Department to assess 'adequate means').

As the Department would need to make assessments on a case-by-case basis, the alternative option would enable greater flexibility in assessing individual registration applications and more regular updating of the requirements.

This option is not preferred, however, as flexibility is more likely to lead to inconsistent decision-making, create uncertainty about what the requirements actually are, and create a much higher risk of applicants or insurers attempting to unduly influence or challenge the outcome of 'adequate means' assessments.

Preferred Option: Regulations prescribing minimum terms and conditions for insurance policies

The preferred option is regulations prescribing clear and definitive minimum terms and conditions for insurance policies, as summarised below.

Private building consent authority civil liability insurance would be required to provide:

- cover for claims arising in the year the policy applies (annual 'claims made' cover)
- 10 years' forward cover for claims arising out of building control work undertaken during the year that the policy applies ('claims incurred' cover which would continue to apply even if the private building consent authority ceased operating during that 10-year period)
- where applicable, run-off cover purchased in advance for claims made in future years arising out of building control work undertaken in past years (ie, retrospective forward cover).

If cover was allowed for less than 10 years, consumers of private building consent authority services would have substantially less protection than the consumers of territorial or regional authority building consent authority services. Without protection for the full 10-year period within which a claim for damages may be made, the potential losses for consumers may be large.

The insurance cover would be required to be continuous and not able to be cancelled by the insurer without prior notice (60 working days' notice is proposed). Notice would be required to enable the Department to consult with the private building consent authority and for the authority to otherwise demonstrate that it has 'adequate means'. Failure by the authority to demonstrate 'adequate means' within that time would be a failure to meet the standards and criteria for registration.

All civil liability insurance policies for private building consent authorities would be required to include a sum insured not less than the sums specified in the following table. The sum insured would be the maximum amount of liability of the building consent authority for which the building consent authority is indemnified by the policy.

TOTAL VALUE OF BUILDING PROJECTS THE BUILDING CONSENT AUTHORITY FUNCTIONS RELATE TO	SUM INSURED FOR ANY ONE CLAIM	SUM INSURED IN THE AGGREGATE FOR ALL CLAIMS
Less than \$500,000	\$300,000	\$600,000
\$500,000 or more, but less than \$1,000,000	\$500,000	\$1,000,000
\$1,000,000 or more, but less than \$5,000,000	\$800,000	\$1,600,000
\$5,000,000 or more	\$800,000 plus \$150,000 for every \$1,000,000 or part thereof over \$5,000,000 of building project value	Twice the relevant sum insured for any one claim

The Department would also be able to approve a sum insured less than the sums specified in the table above, where satisfied that the actual level of risk warrants a reduction in the level of cover. The ability to approve a reduced level of cover would recognise that ongoing implementation of the Act is likely to impact on liability issues and associated risks, and there will be an opportunity to assess relative levels of risk.

Changes that have potential to influence future risk assessments, and probably also the future availability of insurance cover for private building consent authorities, are:

- licensing of building practitioners
- product certification by product certification bodies
- accreditation of building consent authorities
- the future availability of home warranty cover and the nature of such cover.

In addition to the sum insured, insurance policies would be required to include:

- insurer's liability for the costs and expenses of defending or settling any claim which is incurred with the consent of the insurer
- a self-insured deductible or excess under the policy that is no more than \$20,000 for each and every claim.

Civil liability insurance policies for private building consent authorities would be able to include standard insurance conditions and exclusions, for example in relation to:

- preventing the aggregation of cover; or admitting liability, settling claims or incurring costs and expenses without the written consent of the insurer
- the building consent authority giving reasonable cooperation to the insurer, and prompt notice of any claim made and of material changes in the risk
- the provision of information
- setting and reviewing premiums

- claims arising from allegations of defamation, ionising radiations and acts of war or similar events
- claims caused or contributed to by dishonest, fraudulent, criminal or malicious acts or omissions of the building consent authority
- limiting liabilities to pay fines, punitive or exemplary damages.

The following summarises the impacts (benefits and costs) of the preferred option.

Government

Central government

Certainty about the minimum terms and conditions for insurance policies will assist the effective and efficient implementation of the registration scheme established by the Act, and limit risks to the Department in undertaking 'adequate means' assessments.

Local government

Ensuring that private building consent authorities have sufficient, ongoing insurance cover will reduce the risk of local government being exposed to claims after a private building consent authority has ceased trading.

Private building consent authorities

For the foreseeable future, private building consent authorities are unlikely to be registered – ie, because private applicants are unlikely to be able to meet the requirement of section 192 of the Act that they satisfy the Department that they have adequate means to cover civil liabilities (eg, through insurance, a bond or guarantor).

Society

Future insurance costs (which are unknown) are likely to be passed on in the form of fees charged to building consent applicants. Even with significant insurance costs, consent fees would likely remain a small component of the overall cost of significant building works. It is unlikely that development would be stifled or that significantly more illegal work would occur.

The actual cost for building consent applicants will also depend on matters such as the profit margins and fee-setting approach of each private building consent authority. Consent fees set by local authorities are also likely to influence the level of fees set by private authorities. For example, it is estimated that, in 2005, territorial authorities collected \$110 million in building consent fees (ie, 1% of the \$11 billion value of new buildings that year).

There are no incremental compliance costs to businesses arising from the proposal.

Implementation and review

Subject to Parliamentary processes, the Department intends that the regulations would come into force in the first half of 2008 (ie, due to the high priority given to accreditation and registration of territorial and regional authorities to meet the 30 November 2007 deadline imposed by the Act).

The Department will provide information to prospective applicants about the requirements of the Act relating to adequate means, minimum terms and conditions for insurance prescribed by the regulations, and other aspects of the Department's assessment methodology.

Enforcement will occur through the assessment of registration applications and checks made in the course of monitoring assessments of registered private building consent authorities (if any).

Monitoring assessments are required at least once every 3 years (section 196 of the Act refers).

Consultation

Stakeholder consultation

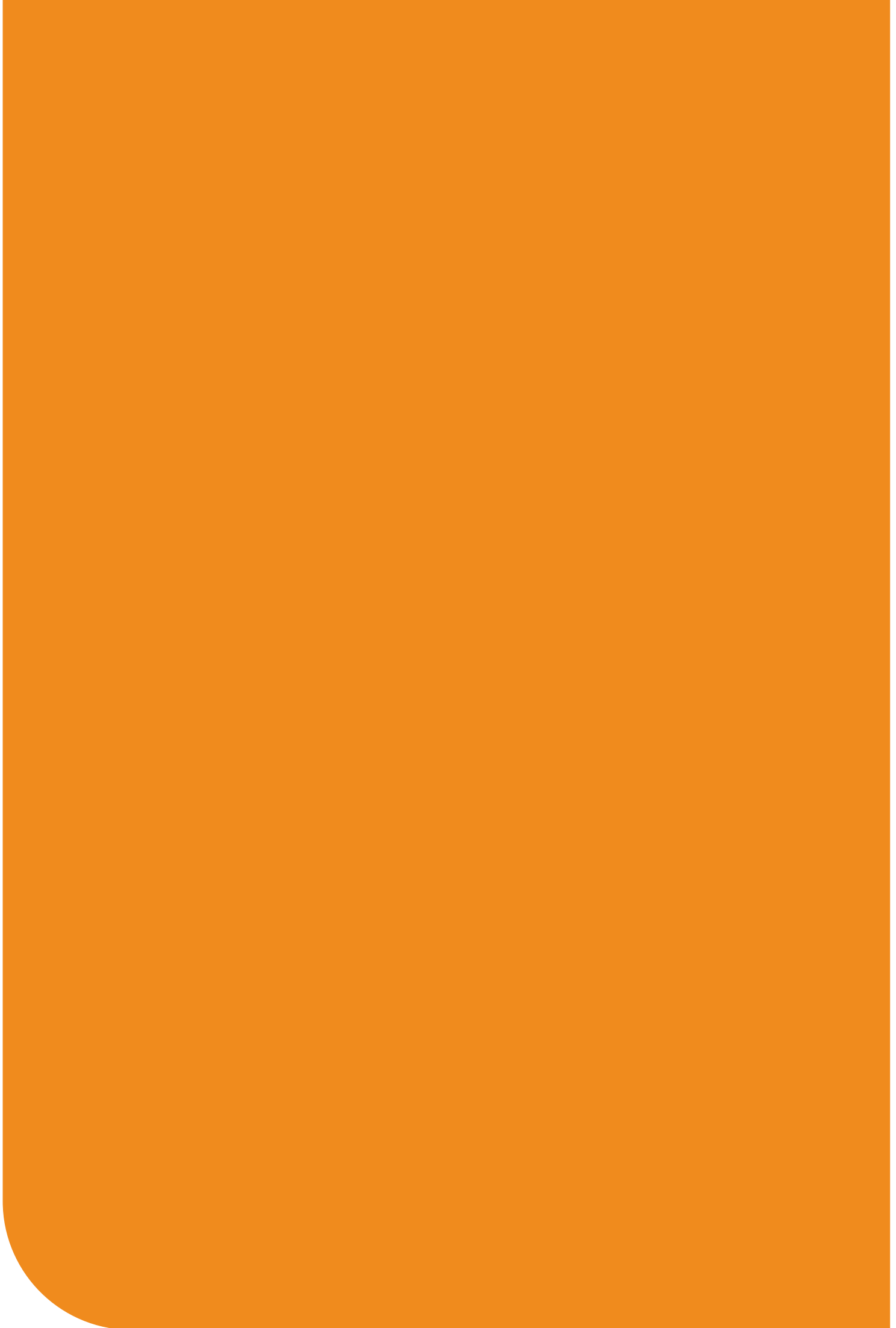
In finalising the proposals in the consultation paper, the Department sought the views of officials in overseas jurisdictions operating similar schemes and a number of people that had previously operated as private building certifiers. Feedback was clear that, despite the likelihood that compliant insurance cover was unlikely to be available in New Zealand in the foreseeable future, the proposals were appropriate to ensure an adequate standard of consumer protection.

Consultation with representatives of the Insurance Council of New Zealand, including the Council's Chief Executive and Liability Committee (which includes representatives of many Australasian insurers) confirmed that, in the current New Zealand environment, the 10-year forward cover and run-off cover is not likely to be available in the foreseeable future.

Government agency consultation

The following government agencies have been consulted on these proposals: Department of Internal Affairs, Department of Prime Minister and Cabinet, Ministry of Consumer Affairs, Ministry of Economic Development, and The Treasury. Comments received have been incorporated as appropriate.





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