INSURANCE COUNCIL OF AUSTRALIA

Hon N. L. Roxon MP
Attorney General
PO Box 6022
Parliament House
CANBERRA ACT 2600

2 March 2012

Dear Attorney General

ACCESS TO CREDIT REPAYMENT HISTORY INFORMATION

The Insurance Council of Australia (***Insurance Council***)[1] appreciated the meeting that Mr Anning (Insurance Council) and Ms O'Loughlin (QBE LMI) had with your adviser, Ms Lorna Clarke, on 24 February 2012 to discuss our concern that the Credit Reporting Exposure Draft (the Exposure Draft) unnecessarily restricts the ability of lenders mortgage insurance (LMI) providers to access credit repayment history information. We would like to emphasise that the Insurance Council supports the Government's proposed reforms to allow credit repayment history information to be included in an individual's credit information file as part of more comprehensive credit reporting.

This submission is made on behalf of the Insurance Council's three LMI provider members: Genworth, QBE LMI and Westpac LMI. These are three of the four largest LMI providers in Australia.[2]

As was explained at the meeting, section 135 of the Exposure Draft needs to be amended so that a credit provider is **not** precluded from disclosing repayment history information to a LMI provider and once the information is disclosed, a LMI provider is permitted to use that information. (See Attachment A for an explanation of the relevant provisions in the Exposure Draft).

LMI Providers' Use of Credit Information

LMI providers place significant reliance on credit reporting information when:

- Determining whether or not to underwrite the original credit risk of a particular borrower - LMI providers have no direct contact with the consumer, either during the establishment or duration of the home loan credit contract. Application information provided by the credit provider and/or an independent credit report from a credit reporting agency are fundamental for an LMI provider to assess whether or not to underwrite a credit risk.

  It should be noted that LMI is most frequently required by the lenders for high Loan to Valuation Ratio (LVR) loans where underwriting by the very nature of the loan is riskier. The more information that the LMI provider has on the borrower the better able they are

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[1] The Insurance Council of Australia is the representative body of the general insurance industry in Australia. Our members represent more than 90 percent of total premium income written by private sector general insurers. Insurance Council members, both insurers and reinsurers, are a significant part of the financial services system. September 2011 Australian Prudential Regulation Authority statistics show that the private sector insurance industry generates gross written premium of $35.1 billion per annum and has total assets of $113.9 billion. The industry employs approx 60,000 people and on average pays out about $104 million in claims each working day.

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

[2] From the points it raised with the Senate Committee on Finance and Administration, we understand that the fourth, ANZ LMI, shares the Insurance Council's concerns.

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to assess the risk accurately and provide cover to the benefit of those such as such as first home buyers and young professionals that are good credit risks;

- Loan Variations - During the life of a loan, it is often necessary for the LMI provider to obtain up to date credit information, such as when assessing hardship or loan variation applications;

- Conducting risk assessment and management involving securitisation, credit scoring, portfolio analysis, reporting and fraud prevention;

- Arranging insurance and reinsurance.

Typically, the LMI provider will establish and agree underwriting criteria with lenders to enable it to determine if particular loans are acceptable risks. LMI providers therefore require access to the same range of information as the lender in order to assess the level of risk.

The Privacy Act 1998 specifically allows credit information to be disclosed to mortgage insurers (or LMI providers) by both credit reporting agencies (section 18K) and credit providers (section 18N).

Furthermore, in the Government's First Stage Response to the ALRC report, in response to recommendation 57-1, the Government stated:

> *The Government agrees that the current drafting in Part IIIA of the Privacy Act in relation to the way that credit providers and credit reporting agencies can use and disclose credit reporting information is overly complicated and confusing.* ***The Government is committed to redrafting the use and disclosure provisions to continue to allow the current practices of credit reporting agencies, credit providers, mortgage and trade insurers and debt collectors****. These permitted uses and disclosures will be outlined in a clearer and more consistent way[3]. (emphasis added)*

Consequences of the Exposure Draft

Currently, LMI providers when assessing an application for LMI utilise the same information as that used by the lender to assess the application for credit. We are concerned that the effect of removing the ability of LMI providers to access the full suite of information has not been fully considered.

LMI providers at the moment can access all the information that the lender has on a potential borrower. In some circumstances LMIs see all the lender information, including the loan application. Alternatively, where a delegated underwriting authority is in place, LMIs may not see the lender information at the time of application but have the right to audit customer files, at which point they can see all the lender information. Some LMIs conduct such audits on a monthly basis.

All lenders provide arrears data to the LMI providers on a monthly basis. This information is fundamental for LMI providers and is integral in the operation of the LMI business under the current prudential regulatory regime. This includes understanding and provisioning for the risk of the portfolio, holding appropriate capital as required under APRA's prudential standards, the use and application of scoring tools to determine risk appetite and exposure. LMI providers would not be able to operate without repayment data from lenders.

[3] Australian Government (2009) First Stage Response to ALRC Privacy Report, October 2009, p115

It is also important to note that LMI providers use credit reports and assessments to underwrite the risk on loans. In effect, LMI providers are taking on the same risk as the lender when they make a decision to provide LMI. If there is asymmetrical information between the lender and LMI, it may result in increased risk flowing into the LMI portfolio which may not become evident for a period of several years when claims begin to emerge. However, LMI providers charge a single premium up front for the LMI, which provides cover for the life of the loan. Access to credit reporting information is therefore crucial for LMI providers to enable them to accurately and sensibly assess risk. There is strong sentiment within members that the potential increase in risk they would face without independent access to the same credit reporting data sets as the lender could not be managed commercially and the very basis of their business would need to be reconsidered.

LMI providers, if they are prepared to manage the greater risk, will need to price accordingly. This will not only be commercially sensible but also expected by the prudential regulator, APRA, which monitors closely how licensed insurers manage the full range of risks that they face. The prospect of taking on a greater level of risk will also make LMI providers reluctant to agree to loan variations, including those relating to financial hardship of the borrower.

An increase in the cost of LMI or a lack of flexibility around loan variations at a time when there is already widespread concern about mortgage affordability would be a regrettable outcome. This is especially the case when the root cause, denial of access to full credit reporting information, would serve no purpose. LMI providers have had long term access to credit reporting data under the current regulatory regime without us being aware of any concerns being raised about their use of the data.

LMI Providers and Responsible Lending

We understand that the Government is seeking to encourage informed and prudent lending practices. The Government response to the Australian Law Reform Commission's (ALRC's) Privacy Report noted that "the Government agrees with the ALRC's view that the predictive value of this extra data set will lead to more informed lending practices, which in turn will result in greater efficiency and effectiveness in consumer credit lending"[4].

LMI providers currently exert market discipline and encourage prudent lending practices in the Australian mortgage market. LMI provides an important 'second set off eyes' for this industry. Limiting access to information in credit reports limits the industry's ability to perform this function and therefore does not align with the Government's stated policy intention.
When the Government foreshadowed restrictions on access to repayment history in its response to the ALRC's recommendations for a new privacy regime, we understood the rationale to be the protection of consumers from the irresponsible pushing of credit. Consequently, use of repayment information was tied to the existence of responsible lending obligations. However, this caution need not apply to an LMI provider's assessment of whether to provide mortgage insurance. (See Attachment B for an explanation of the role of LMI providers and its relationship to the Credit Licensing Regime.) In accordance with APRA regulation, LMI providers are monoline insurers and they cannot use credit reporting data in connection with other any business.

Conclusion

The Insurance Council and its LMI provider members strongly urge the Commonwealth Government to allow LMI providers to have access to the same credit reporting information as

[4] Australian Government (2009) First Stage Response to ALRC Privacy Report, October 2009, p106

credit providers, including repayment performance history. LMI providers should be able to access this information directly from credit reporting agencies as well as from credit providers. We suggest this could be achieved by adding mortgage insurers to the class of recipients to which subsection 135(4) does not apply as follows:

Section 135(5)

(5)Subsection (4) does not apply if:

(a) the recipient of the credit eligibility information is:

(i) another credit provider who is a licensee; or
(ii) a mortgage insurer ; or

(b) the credit provider discloses the credit eligibility information under paragraph (3)(d) to an enforcement body; or

(c) the credit provider discloses the credit eligibility information under paragraph (3) (e) or (f).

If you or one of your officers would like to discuss this issue, please contact the Insurance Council's General Manager Policy – Regulation, Mr John Anning, on 02 9253 5121 or janning@insurancecouncil.com.au.

Yours sincerely

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ATTACHMENT A

THE EXPOSURE DRAFT AND THE SENATE STANDING COMMITTEE ON FINANCE AND PUBLIC ADMINISTRATION REPORT

Subsection 135(1) of the Credit Reporting Exposure Draft deals with use or disclosure of credit eligibility information and provides that a credit provider who holds credit eligibility information must not use or disclosure the information other than in line with the exceptions provided for in the section. Subsection 3 contains the following exceptions:

> *135(3) Subsection (1) does not apply to the disclosure of credit eligibility information about the individual if:*
>
> *(a) the disclosure is a permitted CP disclosure in relation to the individual; or*
>
> *(b) the disclosure is to a related body corporate of the credit provider; or*
>
> *(c) the disclosure is to a person:*
> *(i) who manages credit provided by the credit provider for use in managing that credit; and*
>
> *(ii) who is not acting as an agent of the provider; or*
>
> *(d) both of the following apply:*
> *(i) the credit provider believes on reasonable grounds that the individual has committed a serious credit infringement;*
> *(ii) the provider discloses the information to another credit provider or an enforcement body; or*
>
> *(e) both of the following apply:*
> *(i) the disclosure is for the purposes of a recognised external dispute resolution scheme;*
> *(ii) a credit provider or credit reporting agency is a member of the scheme; or*
>
> *(f) the disclosure is required or authorised by or under an Australian law, or an order of a court or tribunal; or*
>
> *(g) the disclosure is a disclosure prescribed by the regulations.*
>
> ***(4) However, if the credit eligibility information about the individual is, or was derived from, repayment history information about the individual, the credit provider must not disclose the information under subsection (3).***
>
> *Civil penalty: 2,000 penalty units.*

Subsection 135(4) therefore clearly precludes a credit provider from disclosing repayment history information to a LMI provider.

The issue was briefly discussed in the report on the Exposure Draft released by the Senate Committee on Finance and Public Administration. In relation to section 135 of the Exposure Draft, the Committee stated that:

7.32 The committee does not consider that section 135 requires amendment to allow for the disclosure of credit eligibility information derived from repayment history information. The Government was clear in its intention to limit access to repayment history. As to problems with embedded data, the committee considers this to be a data management issue and not one which should impact on the credit reporting system. Similarly, the committee does not consider that management of their portfolios by mortgage insurers or debt collectors is a matter for the credit reporting system. [5]

We submit that the Committee failed to give sufficient consideration to the issue.

[5] Senate Finance and Public Administration Legislation Committee (2011) Exposure Drafts of Australian Privacy Principles Amendment Legislation Part 2 – Credit Reporting, October 2011, p133

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ATTACHMENT B

LMI PROVIDERS AND CREDIT ACTIVITIES

LMIs are required to hold a credit licence and are therefore subject to the following general conduct obligations under the *National Consumer Credit Protection Act* 2009[6] (the NCCP Act):

- engage in credit activities efficiently, honestly and fairly;
- comply with relevant laws;
- comply with any conditions of the credit licence;
- manage conflicts of interest;
- must have an internal dispute resolution procedure that complies with ASIC standards;
- must ensure representatives comply with the credit legislation;
- must ensure representatives are adequately trained and are competent to engage in the credit activities authorised by our licence; and
- have adequate arrangements for compensating persons for loss or damage suffered because of a contravention of the NCCP Act by the licensee or its representative

It is important to remember that LMI is a business to business insurance product. LMI providers have no direct contact with the consumer in either the establishment or the ongoing management of the home loan credit contract. LMI providers work directly with lending institutions through the establishment and management of the mortgage and not with the borrower.

The LMI provider moves into a direct role with the consumer (the borrower) only after:

- there has been a default on the home loan
- the lender has taken possession
- the property has been sold
- the LMI has paid the shortfall to the lender; and
- the lender has assigned to the LMI (or the LMI provider is subrogated for the lender in relation to) any ongoing rights of the lender against the consumer for the personal debt still outstanding under the home loan contract.

If the borrower defaults on the mortgage and the LMI provider pays out on the insurance to the original credit provider, the LMI provider stands in the shoes of the credit provider in regards to their rights and obligations under the mortgage. It is for this reason that LMI

[6] National Consumer Credit Protection Act 2009 Section 47

providers need to have a credit licence. It is illogical that an LMI provider is expected to take on the legal position of a party that had access to more information about the borrower at the time that the mortgage was provided.

At this point, the nature of the direct arrangement between the LMI and the borrower then more readily resembles a debt recovery arrangement and is not the management of a credit contract with a borrower. Where a default occurs and once the LMI provider has paid the lender's claim, the LMI provider will contact the borrower to ascertain the borrower's financial position in order to assess whether any recovery action is worthwhile.

Recoveries by LMI providers against borrowers for the outstanding personal debt are a very small part of the LMI business. It is not the practice of the LMI providers to pursue borrowers in this situation unless it is clear that the borrower has additional assets (for example if the home loan was for investment purposes).