INSURANCE COUNCIL OF AUSTRALIA

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Dear Ms Gallo

NATIONAL CREDIT REFORM: GREEN PAPER

The Insurance Council of Australia Limited[1] (Insurance Council) welcomes the opportunity to expand upon the comments made in its submission of 6 August 2010 on the Green Paper, "National Credit Reform, Enhancing confidence and fairness in Australia's credit law" that the Government released on 9 July.

As with its initial views, this submission concerns the interests of the those members of the Insurance Council that provide Lenders' Mortgage Insurance (LMI) and focuses on Chapter Seven of the Green Paper dealing with "Enhancements to the National Consumer Credit Protection Regime". Of the possible enhancements to consumer remedies discussed in Chapter Seven of the Green Paper, the Insurance Council wishes to comment on those affecting:

- the hardship variation provisions; and
- a stay of enforcement proceedings.

Hardship variation provisions

Q1: Should the range of variations under hardship provisions be expanded?

The Insurance Council endorses the benefits for all concerned of credit providers and borrowers working together to overcome a borrower's temporary financial difficulties such that borrowers are able to remain in their homes and to ultimately meet their obligations under the loan.

Furthermore, in working with the lending institution to manage the loan before default, the Insurance Council's LMI provider members are strongly supportive of the lender exploring the feasibility of any additional measures consistent with the lender's obligations under the Code of Banking Practice, the Mutual Banking Code of Practice, or the agreement between the Federal Treasurer and the four major banks to assist borrowers in financial difficulty. As a matter of practice, it is in everyone's interests to explore all feasible opportunities to assist a borrower in these circumstances.

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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. December 2009 Australian Prudential Regulation Authority statistics show that the private sector insurance industry generates gross premium revenue of $32.9 billion per annum and has total assets of $94.2 billion. The industry employs approx 60,000 people and on average pays out about $95 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).

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It should be borne in mind that the three options listed in subsection 72(2) are the most practicable variations to be made to a credit contract and it is relatively straight forward for a lender to assess their implications and likelihood of success. It is therefore feasible for the lender to comply with the requirement to respond to a hardship variation request within 21 days (subsection 72(3)).

Requests for variations outside subsection 72(2) may be more difficult to evaluate and may also be so unrealistic that the lender should not be compelled to consider them. For example, our LMI members have advised some requests from borrowers are "lifestyle" requests and are not genuine hardship situations. Consequently, it would be inappropriate to require the lender to respond within 21 days, and also inappropriate to provide statutory recourse to a court or external dispute resolution scheme (EDR) for review when a credit provider declines to consider the request to vary the contract outside subsection 72(2).

Also, an unintended consequence of broadening the range of variations may be to actually create moral hazard by delaying or exacerbating the situation if the best scenario for the borrower may in fact be selling the home rather than delaying the inevitable and losing more equity in the process.

For the reasons set out above, the Insurance Council considers that the existing specific hardship provisions contained in subsection 72(2) of the National Credit Code (the Code), supplemented by the ability under the Code for the parties to change the credit contract by agreement, provide satisfactory scope for resolving a borrower's temporary financial difficulties. Consequently, the Insurance Council submits that there is no need to expand upon the range of variations listed in the Code.

Q2: If, so, what additional types of variations should be available?
Not applicable in view of response to Q1.

Q3: Should there be any monetary threshold above which a statutory right to apply for a hardship variation does not exist?
It is industry practice for LMI providers to consider all hardship variation requests regardless of the loan size. Consequently, the Insurance Council would have no immediate concerns if the monetary threshold was removed. However, lenders could reasonably expect that borrowers of larger loans, more than $500,000 or investors, are more sophisticated than others and better equipped to manage their affairs. The key concern would be if more sophisticated borrowers who can pay but choose not to pay, use the hardship process as a tactic to delay default proceedings.

Q4: If so:

- ***What proportion of consumers do not have a statutory right under the existing $500,000 threshold?***
- ***Should the threshold be subject to regular indexation?***

Not applicable in view of response to Q3.

Q5: What are the implications for lenders, that is, prudential concerns or compliance costs
While there are obvious benefits to enabling a borrower to overcome their temporary financial difficulties and so meet their credit contract obligations, where the borrower's financial difficulties are of an ongoing nature, varying the contract will not provide meaningful relief and most likely worsen the ultimate outcome for the borrower. Their backlog of missed repayments will continue to mount without improving their capacity to pay. The probability of

them being left with little equity, or even a debt, after sale of the mortgaged property will be that much higher.

The introduction of requirements to consider hardship variations outside of the most practicable options in subsection 72(2) and the associated possibility of judicial or EDR review would significantly postpone resolution of the difficulties by sale of the mortgaged property, and so exacerbate the losses to the lender in terms of interest foregone. Where the lender has taken out LMI, the LMI provider is obliged to reimburse the lender for these losses if not recouped from the sale of the mortgaged property. The LMI provider then has a right of recourse to the borrower to recoup its losses and as such it is possible that the borrower will ultimately bear the cost of delaying the sale of their property.

Evidenced by the current approach for consumers to try all possible options for variation (for example see sample letter at http://www.cclcnsw.org.au/sample-letters/request-for-hardship-variation/), the take up of any new right to request a credit contract variation is likely to be widespread. This may impact on the loss exposure of the LMI providers and may impact pricing, capital requirements and have other unintended consequences. .

As previously outlined, the Insurance Council is also concerned that mandating a broader range of hardship variations may result in borrowers making applications that are not consistent with their circumstances. Lenders and LMI providers will incur additional costs in investigating and responding to potentially inappropriate variation requests that are also likely to take longer than the required 21 days.

Stay of enforcement proceedings

Q6: Should it be compulsory to consider a hardship variation before commencing default proceedings? If so, should there be any exceptions to this rule.

The option to make an application for hardship is already available to borrowers. The Code also contains provisions which ensure that borrowers are aware of their rights to apply for hardship (e.g. the requirement to issue Form 12 with default notices).

The Insurance Council strongly submits that it should not be compulsory to consider a hardship variation before commencing default proceedings. While a stay of proceedings is logical when a hardship variation request has been made (see answer to Q7), it is unnecessary to delay commencement of proceedings. If prior consideration is required, commencement would be delayed not only by the 21 days within which a response to the variation is to be made but also the period for judicial or EDR review. This could be used by vexatious borrowers as a lengthy delaying tactic that is likely to be in no one's interests.

Q7: Should there be an automatic stay of proceedings where a request for hardship variation has been made? If so, should there be any exceptions to this rule?

The Insurance Council considers that a stay of proceedings would be reasonable for the 21 day period that the lender has to consider the hardship variation. However, to prolong the stay until the outcome of judicial/EDR review has been reached creates the potential for an unlimited timeframe. This will expose the lender and in turn the LMI provider to additional costs and potential losses by postponing resolution of the problem mortgage, which ultimately will not be in the interests of the borrower.

Q8: Should there be any specific provisions in respect of payment of legal costs incurred by the lender before any stay of proceedings?

The Insurance Council sees no reason to alter the usual court rules that a borrower subject to successful default proceedings would be liable for legal costs incurred by the lender before a request for a stay of proceedings is made and while this request is being considered. While a stay of proceedings is on foot, the Insurance Council considers it is reasonable that the lender be responsible for the legal costs they may incur during the 21 days they have to respond to the hardship variation request.

Q9: Should the credit provider be prevented from listing a default while considering a hardship variation?

In the Insurance Council's view, the lender should not be prevented from listing a default while considering a hardship variation. It would be inconsistent with the Government's focus on responsible lending and positive credit reporting for a prospective lender to be unaware of the borrower's current situation and therefore the very real possibility of default.

If you require any further information, please contact Mr Anning on (02) 9253 5121 or janning@insurancecouncil.com.au.

Yours sincerely

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