The Secretariat, Joint Forum
Bank for International Settlements
CH-4002
Basel
Switzerland

Email: baselcommittee@bis.org

1 May 2013

Dear Sir/Madam

MORTGAGE INSURANCE: MARKET STRUCTURE, UNDERWRITING CYCLE AND POLICY IMPLICATIONS

The Insurance Council of Australia[1] (Insurance Council) welcomes the opportunity to respond to the Joint Forum consultation paper "Mortgage Insurance: market structure, underwriting cycle and policy implications" (the Consultation Paper). We do this on behalf of our members that are licensed to provide Lenders' Mortgage Insurance (LMI) Australia.

LMI enhances the underlying efficiency of the market for housing loans. It improves access to home ownership, contributes to the smoothing of the effects of economic cycles (primarily because its underlying risk preparedness is very long term), increases competition among lenders by providing credit enhancement to securitisation programs and reduces barriers to entry for homeowners in the lending market.

From a system stability perspective, the LMI providers, as general insurers regulated by the Australian Prudential Regulation Authority, are required to hold significant capital thereby providing an additional independent layer of capital that assists in diversifying risk across lenders, across time and across geography. LMI is a valuable ingredient and has played a significant role in ensuring a stable and competitive residential mortgage market in the Australian housing sector.

We are pleased to read and agree with the comments in the Consultation Paper that suggest that mortgage insurance may constitute a positive part of a safe mortgage system and where

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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 2012 Australian Prudential Regulation Authority statistics show that the private sector insurance industry generates gross written premium of $38.7 billion per annum and has total assets of $115.8 billion. The industry employs approx 60,000 people and on average pays out about $102 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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wrongly or poorly used it may well mask risk. Despite what we view as a sometimes negative view of mortgage insurance, the Consultation Paper is a very useful summary of mortgage insurance as it is regulated in a number of jurisdictions.

The Australian MI industry has been subject to a rigorous regulatory regime enforced by a vigilant regulator for some time. For this reason, we cannot agree with the impression created by the Consultation Paper of more regulation being necessarily better in order to forestall early any adverse consequences of MI for the overall economy. It should be remembered that if the use of MI is discouraged by too onerous regulation, lenders may resort to less efficient and riskier means of managing their mortgage risk. For example, lenders may attempt to manage default risk by risk based pricing, that is higher interest rates for those borrowers deemed to be at higher risk of default.

In relation to specific recommendations, the Insurance Council would like to make the following comments:

1. ***Policymakers should consider requiring that mortgage originators and mortgage insurers align their interests***
   It is difficult to evaluate this recommendation because the Consultation Paper does not explain what actions should be considered to produce the desired alignment of interests. Insurance Council members consider that, in Australia at least, there is already an alignment of the interests of the lender and insurer in wanting a realistic assessment of the borrower's creditworthiness. We also consider that there is alignment between the insurer and the borrower in that neither party wants to see foreclosure.

   One option that could be explored is mandating mortgage insurance for high Loan to Valuation Ratio loans as is the case in several jurisdiction including Canada and Hong Kong. This can be a valuable tool for ensuring alignment of interests as the lender must have access to mortgage insurance and thereby must agree with the mortgage insurance provider on underwriting criteria and loan performance management. This alignment works to enhance credit quality generally in the higher risk loans.
6. ***Supervisors should apply the FSB Principles for Sound Residential Mortgage Underwriting Practices to mortgage insurers noting that proper supervisory implementation necessitates both insurance and banking expertise.***
   Insurance Council members are concerned that application of the FSB Principles would require that both the lender and the insurer in practice assess the credit worthiness of the borrower. This would be an inefficient duplication of effort when the same outcome could be achieved by ensuring that strict agreed underwriting standards were observed by both the lender and the insurer with mandatory MI for high LTVR loans.

If you require further information in relation to this submission, please contact Mr John Anning, Insurance Council's General Manager Policy – Regulation Directorate at janning@insurancecouncil.com.au.

Yours sincerely

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