INSURANCE COUNCIL OF AUSTRALIA

12 May 2011

Mr Christian Mikula
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Email: christian.mikula@treasury.com.au

Dear Mr Mikula

CREDIT LICENCE CONDITIONS – RECORD KEEPING

The Insurance Council of Australia (***Insurance Council***)[1], the representative body of the general insurance industry in Australia, would like to raise a practical issue that has arisen in the context of its members that provide Lenders' Mortgage Insurance (LMI) obtaining credit licences.

SUMMARY

The Insurance Council and its LMI members seek an exemption for LMI providers from the provisions of section 132(2) of the *National Consumer Credit Protection Act 2009* (the Act' – see relevant extracts at Attachment A).

The reasons for seeking the exemption are:

1. The original credit provider (being the person that undertook the credit assessment) remains subject to obligations imposed by section 132(2) of the Act, notwithstanding any rights of recovery obtained by an LMI provider.
2. There is a real risk to LMI providers that they may comply with their credit licence conditions but nevertheless be, unfairly, subject to strict liability civil and/or criminal penalties under section 132 of the Act. The risk arises because the original credit provider may not provide the credit assessment to an LMI provider within the statutory time limit (or at all) so as to enable the LMI provider to comply with a request under section 132(2).
3. In the event that the LMI provider was unable, through no fault of its own, to deliver the credit assessment to the consumer, the consumer would be entitled to make a formal complaint or bring an action against the LMI provider for non-compliance with section 132(2). These actions would require an LMI provider to cease all recovery

[1] The Insurance Council of Australia's 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 2010 Australian Prudential Regulation Authority statistics show that the private sector insurance industry generates gross written premium of $33.4 billion per annum and has total assets of $101.7 billion. The industry employs approx 60,000 people and on average pays out about $87 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).

action while the matter was being investigated. Depending upon the circumstances, this could seriously impact upon the LMI provider's ability to recover from the borrower the money paid to the lender under the LMI policy.

4. As the LMI provider would not be the original credit provider, it will not necessarily know the date of the credit contract and therefore it may be unable to determine the applicable timeframe under section 132(2)(c) and (d) of the Act.

Initial Regulatory Consultation

As you may be aware, during development of the consumer credit regime in 2009, Treasury recognised the shortcomings of a 'one size fits all' approach to licensing and agreed that different levels of licensing would apply depending on different business models. The approach could be characterised as it is not what you are but rather what you do in terms of the credit process. (For your information, Attachment B is a submission we provided following a meeting with Treasury and ASIC on 13 May 2009. Amongst other things, it explains the operation of LMI.)

During the process of our LMI members obtaining a credit licence, ASIC has sought to impose a record keeping obligation in line with the obligation that assignees of a credit contract would have under section 132(2) of the Act to provide a copy of the credit assessment to the consumer if requested.

However, in recognition of the specific role of the LMI provider as a credit provider, ASIC has prepared an amended licence condition (see Attachment C) that would give the LMI provider the option of complying with the condition by having in place written arrangements with the original credit provider or a previous assignee that would enable the LMI provider to obtain a written copy of the assessment or relevant records.

Continuing Obligation of the Original Credit Provider to provide the Credit Assessment

While appreciative of the consideration that ASIC has given this issue, the Insurance Council submits that there is no need for a record keeping condition as part of the credit licence for a LMI provider. LMI operates differently to other situations (for example purchase of a debt) where the original credit contract is no longer on foot.

LMI providers are not involved in any way in the provision of credit to consumers and have no direct involvement with the borrower in relation to the creation or ongoing management of the home loan credit contract.

An LMI provider only acquires the lender's right to recover the outstanding loan debt after the LMI provider has paid the lender's claim in respect of the shortfall suffered by the lender upon default by the borrower. In such circumstances the original contract remains in operation between the borrower and lender. Consequently, there is no need in terms of consumer protection for an additional obligation to be imposed on LMI providers requiring the supply of the credit assessment under section 132(2). This obligation can and should be satisfied by the lender.

In addition, it is likely in practice to be the case that consumers will ask for credit assessments when the loan first enters default or when possession proceedings are commenced or are likely rather than at a much later time after such events have occurred and a claim has been paid by an LMI provider. In those circumstances, the imposition of the

requirements under section 132(2) on LMI providers appears to contribute little to the object of providing information to consumers.

Strict Liability Civil and Criminal Penalties
Section 132(2) of the Act allows for the imposition of a strict liability civil penalty for a contravention of that section. Further, section 132(5) and (6) allows for the imposition of a strict liability criminal penalty for a contravention of section 132(2).

Subjecting LMI providers to the requirements of section 132(2) unfairly exposes them to both civil and criminal penalties.

As an LMI provider is not the original credit provider, it does not conduct the credit assessment required under the Act. Therefore when a request is received by an LMI provider from a consumer for such an assessment it would be necessary for the LMI provider to approach the original credit provider for a copy of the credit assessment. In making the request of the original credit provider, the LMI provider has no control of whether the original credit provider provides the assessment within such a period of time (or at all) that allows the LMI provider to comply with the timeframes set out in section 132(2).

It is pertinent to note that our LMI members have generally found that lenders are slow to react to any requests made by the LMI provider once the LMI policy is paid out.

Under ASIC's proposed credit licence condition, the LMI provider would not be in breach of the record keeping condition of its amended licence if it makes a request and the original credit provider or previous assignee did not deliver the assessment to the LMI provider within the prescribed time limit, and the LMI provider in turn was unable to provide it to the consumer within the time limit prescribed under section 132(2). Nevertheless, a failure to supply the assessment within the time limit prescribed by section 132(2) may result in a civil and/or criminal penalty being imposed on the LMI provider.

In this context, we note that both the civil and criminal penalties under section 132 are strict liability offences and therefore effectively there is no defence available based on the reasonableness of the LMI provider's actions in seeking the credit assessment from the original credit provider.

In our view, the potential to be subject to a strict liability civil and/or criminal penalty is inappropriate and contrary to legal norms where the potential offender has not committed any wrongful act. As noted above, an LMI provider has no control over whether it can comply with section 132(2) (as it does not conduct the credit assessment and they cannot ensure that the original credit provider supplies the credit assessment within the prescribed timeframe or at all).

Moral hazard
Furthermore, the Insurance Council has concerns about the moral hazard created if the LMI provider were unable to comply with section 132(2). In the event that the LMI provider were unable, through no fault of its own, to deliver the credit assessment to the consumer, the consumer would be entitled to make a formal complaint or bring an action against the LMI provider for non-compliance with section 132(2). These actions would require an LMI provider to cease all recovery action while the matter was being investigated.

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Date of the original credit contract
As noted above, an LMI provider is not a party to the credit contract and it is usually the case that they do not know the date which the contract was entered into as this information is not necessary to an insurer of a loan.

This may give rise to a practical problem when receiving a request under section 132(2) as an LMI provider will not know whether the request needs to be answered within the timeframe set out in section 132(2)(c) or (d). This uncertainty is not desirable in light of the penalties noted above.

Consultation with ASIC
The Insurance Council and its members discussed this issue with Ms Fleur Grey and Mr Chris Green of ASIC on 13 April. They understood the special circumstances applying to LMI and were open to considering exempting LMI providers from compliance with sec 132(2) through sec 109 of the Act (an exemption could also be achieved through a regulation under sec 110 but this is likely to be more difficult to achieve). However, they advised the issue was a question of policy that should be considered in the first instance by Treasury. They therefore recommended that the Insurance Council put the issue to Treasury to seek its approval for provision of an exemption. We would appreciate your response to this proposal.

Offer of a meeting
We would be pleased to arrange a meeting for you with the Insurance Council's LMI Committee if you would like to discuss this issue in more detail.

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

Yours sincerely

Robert Whelan
Executive Director & CEO

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ATTACHMENT A

EXTRACTS OF NATIONAL CONSUMER CREDIT PROTECTION ACT 2009

10 Assignees of credit providers, lessors, mortgagees and beneficiaries of a guarantee

(1) For the purposes of this Act (other than the National Credit Code), a person is a credit provider, lessor, mortgagee or beneficiary of a guarantee whether the person is:

(a) the original credit provider, lessor, mortgagee or beneficiary of a guarantee under a credit contract, consumer lease, mortgage or guarantee; or

(b) a person to whom the rights of a credit provider, lessor, mortgagee or beneficiary of a guarantee under a credit contract, consumer lease, mortgage or guarantee have been assigned or passed by law.

132 Giving the consumer the assessment

Requirement to give assessment if requested

(1) If, before entering the credit contract or increasing the credit limit, the consumer requests the licensee for a copy of the assessment, the licensee must give the consumer a written copy of the assessment before entering the contract or increasing the credit limit.

Note: The licensee is not required to give the consumer a copy of the assessment if the contract is not entered or the credit limit is not increased.

Civil penalty: 2,000 penalty units.

(2) If, during the period that:

(a) starts on the day (the ***credit day***) the credit contract is entered or the credit limit is increased; and

(b) ends 7 years after that day;

the consumer requests the licensee for a copy of the assessment, the licensee must give the consumer a written copy of the assessment:

(c) if the request is made within 2 years of the credit day—before the end of 7 business days after the day the licensee receives the request; and

(d) otherwise—before the end of 21 business days after the day the licensee receives the request.

Civil penalty: 2,000 penalty units.

(5) A person commits an offence if:

(a) the person is subject to a requirement under subsection (1), (2) or (4); and

(b) the person engages in conduct; and

(c) the conduct contravenes the requirement.

Criminal penalty: 50 penalty units.

(6) Subsection (5) is an offence of strict liability.

109 Exemptions and modifications by ASIC

Exemptions and modifications

(1) ASIC may:
  (a) exempt:
    (i) a person; or
    (ii) a person and all of the person's credit representatives;
  from all or specified provisions to which this Part applies; or
  (b) exempt a credit activity that is engaged in in relation to a specified credit contract, mortgage, guarantee or consumer lease from all or specified provisions to which this Part applies; or
  (c) declare that provisions to which this Part applies apply in relation to a person, or a credit activity referred to in paragraph (1)(b), as if specified provisions were omitted, modified or varied as specified in the declaration.

(2) An exemption or declaration under subsection(1) is not a legislative instrument.

(3) ASIC may, by legislative instrument:
  (a) exempt a class of persons from all or specified provisions to which this Part applies; or
  (b) exempt a credit activity (other than a credit activity referred to in paragraph (1)(b)) from all or specified provisions to which this Part applies; or
  (c) exempt a class of credit activities from all or specified provisions to which this Part applies; or
  (d) declare that provisions to which this Part applies apply in relation to a credit activity (other than a credit activity referred to in paragraph (1)(b)), or a class of persons or credit activities, as if specified provisions were omitted, modified or varied as specified in the declaration.

Conditions on exemptions

(4) An exemption may apply unconditionally or subject to specified conditions. A person to whom a condition specified in an exemption applies must comply with the condition. The court may order the person to comply with the condition in a specified way. Only ASIC may apply to the court for the order.

Publication of exemptions and declarations

(5) An exemption or declaration under subsection (1) must be in writing and ASIC must publish notice of it on its website.

Special rules in relation to offences

(6) If conduct (including an omission) of a person would not have constituted an offence if a particular declaration under paragraph (1)(c) or (3)(d) had not been made, that conduct does not constitute an offence unless, before the conduct occurred:

(a) the text of the declaration was published by ASIC on its website; or

(b) ASIC gave written notice setting out the text of the declaration to the person;

(in addition to complying with the requirements of the *Legislative Instruments Act 2003* if the declaration is made under subsection (3)).

(7) In a prosecution for an offence to which subsection (6) applies, the prosecution must prove that paragraph (6)(a) or (b) was complied with before the conduct occurred.

110 Exemptions and modifications by the regulations

The regulations may:

(a) exempt a person or class of persons from all or specified provisions to which this Part applies; or

(b) exempt a credit activity or a class of credit activities from all or specified provisions to which this Part applies; or

(c) provide that the provisions to which this Part applies apply as if specified provisions were omitted, modified or varied as specified in the regulations.

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Via email: Alix.Gallo@treasury.gov.au

22 May 2009

Dear Ms Gallo

INSURANCE COUNCIL SUBMISSION: NATIONAL CONSUMER CREDIT REFORM PACKAGE

The Insurance Council of Australia (Insurance Council)[1] welcomes the opportunity to provide input into the Federal Government's public exposure draft of the National Consumer Code (NCC) contained in the National Consumer Credit Protection Bill 2009 (Cth) (the Bill) released on 27 April 2009. This submission[2] concentrates on issues of concern to our members that provide Lenders' Mortgage Insurance (LMI).

As discussed at our meeting on 13 May 2009 with Treasury and ASIC, Insurance Council, in principle, strongly supports the goals and objectives of the Bill under the supervision and administration of a single national regulator. In particular, Insurance Council welcomes the establishment of a national credit licensing regime for all participants in the mortgage lending industry and the increased focus on responsible lending practices. Reform is needed to: protect borrowers from assuming unsustainable credit, address gaps in the regulatory framework and tackle inconsistent practices across the mortgage industry while setting minimum standards.

Insurance Council has appreciated the ability to provide ongoing feedback to both Treasury and ASIC officials through the consultation process and would welcome the opportunity to be represented on future Treasury working groups regarding the second phase of the consumer credit regime.

As discussed at our meeting on 13 May, our member LMI companies Genworth and QBE LMI would welcome the opportunity to provide a confidential half day workshop, as suggested by Treasury and ASIC. We believe this workshop would be useful to provide ASIC and Treasury with further insight on current market and industry lending practices which may assist in the finalisation and implementation of the regime.

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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 2008 Australian Prudential Regulation Authority statistics show that the private sector insurance industry generates gross premium revenue of $30.0 billion per annum and has assets of $84.0 billion. The industry employs approx 60,000 people and on average pays out about $100 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] The Professional Indemnity Insurance (PII) which will be required as a licence condition for credit providers and advisers is also an important issue for the Insurance Council and those of our members that provide PII. However, the substance of these requirements will be set out in ASIC guidance and Insurance Council looks forward to a continuation of the dialogue which Treasury and ASIC has with Insurance Council's PII Committee on this matter.

This submission is focused on the following key areas:
1. An overview of the LMI industry in Australia;
2. Specific issues relating to the application of the Bill to the LMI industry;
3. General industry commentary and observations; and
4. Conclusion.

1. Overview of the LMI Industry

1.1 Lenders mortgage insurance in Australia

LMI was introduced into Australia in 1965 to enable first home buyers[3] to "bridge the deposit gap" which was at that time, and still is, a significant impediment to achieving homeownership.

Over the last 40 years LMI has played an important role in enabling home buyers with low deposits (less than 20%) to enter the housing market thus providing greater access to home ownership. Approximately, more than 1 in every 4 residential mortgages are currently insured by an LMI provider.

The LMI industry has extensive data that has been compiled over the last 40 years in respect of Australian residential mortgages.

LMI providers in Australia are in the unique position in that they have broad oversight of mortgage lending practices in Australia. LMI providers have a whole of market view given the breadth of the LMI customer base which includes numerous authorised deposit taking institutions (ADIs), non-bank lenders, and mortgage managers, originators, brokers and valuers. It can be seen that LMIs operate in a market segment vital to the effective provision of credit.

LMI providers exert market discipline and have encouraged prudent lending practices in the Australian mortgage market throughout the last 40 years. LMI provides an important "second set of eyes" for this industry.[4] This is demonstrated in a number of ways including:

- providing information and expertise to the market and customers;
- providing parameters of "acceptable risk" by setting credit policy and practice boundaries;
- providing a 'second set of eyes" on loan applications and customers' overall credit operations (policy and practice) for residential mortgages;
- providing post quality assurance reviews;
- working with customers to address and improve compliance issues;
- working with customers to address and improve default and claims management; and
- dis-accrediting particular market participants who do not engage in responsible lending practices.

There is a strong commercial incentive for the LMIs to maintain prudent lending practices in Australia, given the 100% nature of the product coverage.

1.2 LMI and consumers

It is important to understand that LMI is a *business to business* insurance product that protects the **lender** in the event of a borrower credit default on a residential mortgage loan. If the secured property is required to be sold as a result of the credit default and the net sale proceeds do not cover the outstanding loan balance, LMI covers the **lender** for the shortfall.

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[3] A demographic which is currently targeted by the Government with the First Home Owners Grant and First Home Owners Boost.

[4] LMI provides cover against certain losses created by mortgage defaults resulting from economic factors or the borrower's credit risk, generally provides 100% cover, involves single upfront premiums, provides cover throughout economic cycles (e.g. the policy is written for the life of the insured mortgage which can be a period of up to 30 years), provides an additional level of management of credit risk

An LMI provider approaches the underwriting of credit risk on residential housing loans from a portfolio perspective and as an insurer (not as a lender). The contractual arrangements (insurance policies) are entered into by the LMI provider with the lending institutions (although often the lending institution will pass the cost onto the borrower). Typically, the LMI provider will also establish and agree underwriting criteria with lenders to enable it to determine if particular loans are acceptable risks.

Importantly, the LMI provider has no role and therefore no contact with the consumer in the establishment nor the ongoing management of the home loan credit contract. LMI providers work directly with the lending institutions through the establishment and during the 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 provider has paid the shortfall to the lender; and
- the lender has assigned to the LMI provider (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.

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. 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.

Also as discussed at our meeting, 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). Currently the LMI providers recover less than 5% of any claims paid from borrowers.

1.3 Regulation and capital requirements of LMI in Australia

The provision of LMI in Australia is already highly regulated. LMI is a general insurance product offered in Australia by providers operating under a monoline licence. It operates under the Insurance Contracts Act 1984 and is regulated by the Australian Prudential Regulation Authority (APRA).

LMI is recognised as a 'catastrophe' insurance line (i.e. large credit losses are created by future events linked to economic factors). As such, APRA has specific requirements that relate to LMI providers including requiring mortgage insurers to hold significant amounts of capital to cover losses to manage and weather the storm of economic cycles, particularly during periods of economic downturn such as recessions.

Insurance Council submits, given the breath and depth of data and knowledge of its LMI members, that going forward Insurance Council and its members participate in Treasury and ASIC working groups responsible for reviewing the implementation of the consumer credit regime and development of relevant ASIC Regulatory Guides.

2. Specific issues relating to the application of the Regime to LMI

2.1 Licensing of the LMI industry

The licensing provisions of the Bill apply to those "engaging in a credit activity". This includes:

- those who perform the obligations, or exercise the rights, of a credit provider (whether under a credit contract or a related mortgage or guarantee); and
- those who are assignees of the rights of a credit provider.

Insurance Council's interpretation of the definition of "engaging in a credit activity" is that an LMI provider that takes an assignment of a credit contract (or stands in the shoes of the credit provider under the doctrine of subrogation) in these circumstances will be "engaging in credit activities" and from that point onwards will need to be registered/licensed.

As outlined above, the contact the LMI provider would have with the borrower in these circumstances is quite limited (and similar in nature to that of debt recovery).

On our understanding of the Bill however, this will mean the LMI providers will need to comply with the general obligations of a licensee under the regime. This clearly would have unintended consequences as the regime is essentially focused on the interaction of the credit provider and the borrower in relation to the formation and management of the credit contract. We assume the unwarranted regulation of LMI providers is not the intent of the legislation and urgently seek clarification on this matter.

From our discussions with Treasury and ASIC, we understand that there is a recognition of the shortcomings of a 'one size fits all' approach to licensing and that different levels of licensing will apply depending on different business models. The approach, as we understand it, is not "what you are" but rather "what you do" in terms of the credit process.

Consequently, we do not expect that LMI providers would need to be licensed at any other time in the loan cycle.

We also assume that the supervisory power of ASIC in relation to LMI will be limited to the regulated activities. APRA already has a significant regulatory oversight role in relation to an LMI provider's operations.

The Insurance Council submits that:

- **the limited role the LMI providers have with borrowers should be recognised under the regime (either by way of specific licence conditions or by regulation);**
- **the general obligations that apply to licensees under the regime should be limited to the credit activities that an LMI actually undertakes (which essentially will be debt recovery);**
- **ASIC's supervisory power in relation to LMI providers should be limited to the restricted credit activity operations the LMI performs with consumers (particularly given that the LMI providers are already APRA regulated); and**
- **it is correct to provide, as the draft regime proposes, appropriate exemptions for APRA regulated entities.**

Set out in Appendix A is commentary on additional practical issues in relation to the application of the Bill to LMI providers.

3. General industry commentary and observations

3.1 "Unsuitable" loans and capacity to repay

Under the credit legislation, credit providers and credit assistance providers must not provide or arrange a loan:

- that is unsuitable for the consumer's needs; or
- that the consumer does not have capacity to repay.

In order to achieve the clarity essential to the effective operation of these provisions, Insurance Council strongly supports the creation of appropriate standards of behaviour for the mortgage industry and the development of responsible lending obligations. Insurance Council is however concerned at anecdotal evidence available in the industry that seems to indicate a view by lenders that high loan to value (LTV) loans or low doc loans as "higher risk" loans are automatically going to be considered "unsuitable" loans.

High LTV[5] mortgage loans do not of their nature mean they are "unsuitable loans". Rather the key test is serviceability of the loan and the credit worthiness of the borrower in the longer term and throughout economic cycles. For many first home buyers the difficulty of entering the market is the down payment required as opposed to actually repaying the loan. Many first home buyers fall into the high LTV category.

Similarly, a low doc loan for a bone-fide self employed borrower may be the only option available to enable that borrower to access the housing market.

The broad application of the concept of "unsuitability" to a particular product rather than to a particular loan for a particular consumer would be problematic. Insurance Council would strongly encourage Treasury to provide further guidance on this issue.

Insurance Council would also encourage Treasury and ASIC to undertake a further review and assessment of appropriate serviceability tests/credit provider's assessment processes to ensure the borrower's ability to repay a loan.

3.2 Suspect behaviour notification to ASIC

As indicated at our meeting, the LMI providers maintain a "watch list" of those participants in the industry who have demonstrated suspect behaviour in relation to the establishment of mortgage loans. This enables the LMI provider to consider more carefully applications that involve these participants. If the behaviour is serious enough, this also provides evidence to enable the LMI provider to determine not to deal with such participants.

These lists are proprietary to the individual LMI provider and the information, for privacy and other legal reasons, can not be shared amongst other market participants. Action by one LMI provider does not prevent suspect players reinventing themselves (generally using different company structures) and re-entering the market.

This is an opportunity to establish a mechanism for the industry to alert the regulator to suspect market participants, enabling their behaviour to be monitored by the regulator and so raise the bar for industry standards. This provision would be an expansion/enhancement of the current provision whereby a licensee is required to notify ASIC of certain significant contraventions of the credit legislation.

[5] Definitions vary across countries but, in general, we can define a HLTV residential mortgage loan as a loan with and LTV greater than 80%.

Insurance Council would support a new section in the legislation which clearly establishes the ability for confidential notification to the regulator, ASIC, if a licensee in the industry believes in good faith that there has been a pattern of less than satisfactory mortgage lending practice by a participant. Legislative protection for such notification would be necessary to enable the effective operation of such a provision.

3.3 Responsible lending obligations

Under the Bill, credit providers and licensees providing credit assistance will be obliged to make reasonable enquiries before entering into or increasing the limit on a credit contract about a consumer's requirements and objectives and financial situation and to take reasonable steps to verify the consumer's financial situation.

Insurance Council submits that it would be helpful for Treasury or ASIC to provide further clarity as to what constitutes "reasonable enquiries" and "reasonable steps". We also believe the industry would benefit from further clarity on what constitutes an "unsuitable loan" perhaps increased focus in the context of serviceability tests regarding the consumer's capacity to repay.

The Insurance Council on behalf of the LMI providers would be pleased to provide input to assist Treasury and ASIC's further consideration of this issue and the preparation of regulatory guidance.

3.4 Responsible management of loans

Phase one of the legislation clearly focuses on the establishment of the credit contract. As discussed at our meeting, the legislation is less explicit on the obligations of licensees in relation to the ongoing management of the loan. At our meeting you indicated further consideration would be given to this in the second phase of implementing the consumer credit reforms.

Managing arrears, hardship cases and foreclosures are a key component of responsible lending practices and are areas which have been considered as requiring improvement, globally such as by the FSA in the UK. A theme in such international reform is the obligation upon the lender to make direct contact with the borrower.

With unemployment already rising, the recent Federal Budget forecasting unemployment to reach 8.5 per cent by 2010-2011 and the OECD and World Bank's view that globally unemployment will go beyond 10 per cent, **we strongly encourage Treasury to consider the benefits of applying responsible lending practices when borrowers are delinquent**. The LMI sector has often found that approximately 95 per cent of hardship cases can be cured as often the default occurs as a result of relatively short term causes such as for example, unemployment, maternity leave, illness and divorce.

ASIC's recent report examining how lenders and mortgage brokers respond to borrowers experiencing financial difficulties provides useful background information for considering this question.

Insurance Council's LMI provider members would welcome the opportunity to share their experience of dealing with cases of financial hardship and would be happy to provide input on industry best practice when the second phase of the regulatory regime is being developed. A serious problem in dealing early with financial hardship is the reluctance of consumers to contact their specific lender to discuss mortgage stress until the situation is out of control.

Insurance Council recommends that ways of addressing the reluctance of consumers to discuss mortgage stress with their lender be seriously considered and our LMI members would be pleased to again contribute ideas from their practical experience.

Responsible management of loans also needs to recognise that there are cases when the best scenario for the borrower in financial difficulties may in fact be selling the home rather than delaying the inevitable and losing more equity in the process. Insurance Council and our LMI members would be pleased to discuss appropriate guidance on this matter.

3.5 Positive credit reporting

As Treasury is aware, borrowers commonly experience mortgage stress because they have entered into additional unsecured credit arrangements after the mortgage loan has been established. With the current restrictions on access to credit data, it is difficult for lenders to know accurately the extent of the borrower's indebtedness.

As recommended in the ALRC report, Insurance Council submits that introduction of positive credit reporting in Australia would be extremely beneficial to all parties involved.

3.6 Securitisation

The new credit legislation will apply to entities involved in securitised lending (including trustees). Insurance Council considers that entities involved in securitised lending will have a number of issues with the application of the new credit legislation to entities involved in securitised lending which will create substantial difficulties for them in complying with some aspects of the credit legislation. These issues are of concern to LMI providers as we issue insurance in relation to securitised loans.

Insurance Council recommends that the Government consult closely with participants in securitised lending to resolve these issues before the credit legislation is finalised.

3.7 Transition arrangements

Insurance Council considers that there is a need for adequate transitional arrangements to ensure the successful implementation of the new regime and looks forward to further clarification in various ASIC Regulatory Guides on various practical aspects of the legislation.

In particular, from the material which has been released to date, it is uncertain what transitional arrangements will apply to loans that are currently unregulated. We understand that further transitional provisions will be drafted and released which may address this point.

As discussed at our 13 May meeting, the NCC will regulate consumer credit for investment purposes, in contrast to the Uniform Consumer Credit Code (UCCC) which does not. If the transitional arrangements do not satisfactorily address this issue, any change to an essential term of an investment property loan could give rise, at general law, to a new contract and if, at the time that deemed new contract is entered into, investment is a regulated purpose, then the relevant credit provider should document the arrangement as varied using a new, NCC compliant, credit contract. It is therefore essential that the transitional provisions specifically address this situation to provide clarity for participants in the industry.

Insurance Council recommends that consideration be given to the inclusion of a provision similar to section 37 of the UCCC to address transitional issues.

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4. Conclusion

In conclusion, Insurance Council welcomes the introduction of the NCC and appreciates the opportunity to provide industry input and share our data, experience and industry knowledge with Treasury and ASIC in the development of the new credit regime.

We will be in contact shortly with ASIC to arrange a mutually convenient time for the proposed workshop with ASIC.

If Treasury or ASIC require further input on any of the matters raised in this submission please contact Mr John Anning, Insurance Council's General Manager, Policy Regulation Directorate, on (02) 9253 5121 or janning@insurancecouncil.com.au..

Yours sincerely

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INSURANCE COUNCIL OF AUSTRALIA

APPENDIX A

SPECIFIC PRACTICAL ISSUES ON THE APPLICATION OF THE CONSUMER CREDIT REGIME TO THE LMI INDUSTRY

1. Streamlined licensed process

Given that LMI providers are prudentially regulated by APRA, and APRA will already have considered a number of the matters that ASIC will need to consider in determining whether to grant a credit licence, a streamlined application process should be made available to the LMI sector in the same way that streamlining is proposed for ADIs.

2. Conflicts of interest

LIC 170 (1) requires a licensee to have in place adequate arrangements to ensure that clients of the licensee are not disadvantaged by any conflict of interest that may arise wholly or partly in relation to credit activities engaged in by the licensee or by its representatives.

Given the LMI insurer's "client" is the credit provider, this obligation is not appropriate when applied to LMIs.

We submit that this obligation should only apply to licensees whose clients are debtors or potential debtors (or guarantors or mortgagors).

3. Training of licensee's representatives

The legislation obliges a licensee to ensure that its (the licensee's) representatives are adequately trained and are competent to engage in the credit activities authorised by the licence. We interpret this obligation using the broad term "representatives" rather than the narrower meaning of "Authorised Representative" and are concerned this would mean that an LMI insurer will need to train its entire staff and other representatives who engage in credit activities. This would be problematic as it is unnecessary and inappropriate to train all staff in relation to the relevant credit activities, nor is it reasonable to require that all employees and directors of related entities be trained.

We submit that the obligation in LIC170 (1)(g) should be qualified so it only applies for staff or representatives who are engaging in a relevant credit activity and the training should apply only in relation to that activity (so, for example, finance or underwriting staff do not need to be trained at all and claims staff need only to be trained to the extent that their role has a direct impact on a relevant credit activity). It may be that the word "adequately" is meant to imply this but this needs to be clarified. We accept that directors of the licensee should understand in general terms the requirements of the legislation and how they impact on the business, but we submit that they do not need "how to" training in relation to the relevant activities carried out by the licensee.

Further, we submit that directors and employees of related entities who are not involved in providing services on behalf of a licensee should not be required to be trained at all, (for example directors and employees of a US parent of an LMI Insurer should not be required to be trained in relation to all the credit activities authorised by the licence).

4. External dispute resolution schemes

An LMI provider will need to be a member of an external dispute resolution (EDR) scheme. Consistent with the arguments above about the inappropriateness of LMI providers undertaking all the licensing obligations of a credit provider, we submit that it should be clarified that an LMI provider needs only to belong to an EDR scheme in relation to the limited credit activities that it undertakes.

APPENDIX A

SPECIFIC PRACTICAL ISSUES ON THE APPLICATION OF THE CONSUMER CREDIT REGIME TO THE LMI INDUSTRY

We submit that LMI providers should not be obliged to deal with complaints made about conduct of the relevant credit provider prior to the LMI Insurer taking an assignment of, or being subrogated to, the rights of the credit provider.

5. Advertisements

From 2 years after commencement a licensee must quote its licence number on documents prescribed by regulations in which it identifies itself.

Due to the limited role the LMI provider has in relation to the consumer, there does not seem to be any good policy reason for an LMI provider's licence number to be quoted on its advertisements (the requirement appears to apply to *any* advertisements).

Any LMI advertisements are directed at credit providers rather than consumers/borrowers.

6. Consumer credit guides

A credit provider needs to give a credit guide to a consumer:

- as soon as practicable when it becomes apparent to the credit provider that it is likely to enter into a credit contract with the consumer; or
- as soon as practicable after it has been assigned any rights or obligations of a credit provider under a credit contract.

As the first instance will not apply to an LMI Insurer, we understand an LMI Insurer will only need to provide a credit guide to a particular debtor when the LMI Insurer has taken an assignment of that debtor's credit contract. The information in the LMI credit guide should also be limited to the credit activities the LMI provider actually undertakes. Insurance Council would appreciate confirmation of these understandings.

Insurance Council supports the view of Treasury in our recent meeting that additional disclosure from the LMI industry at the establishment of the loan would be confusing for consumers and therefore is not necessary.

Record-keeping requirements
(*This condition is imposed on all licensees.*)
The licensee must either:
(a) keep a record of all material that forms the basis of an assessment of whether a credit contract or consumer lease will be unsuitable for a consumer in a form that will enable the licensee to give the consumer a written copy of the assessment if a request is made under section 120, 132, 143 or 155 of the Act; or

(b) if the licensee is a credit provider or lessor, but, for a particular credit contract or consumer lease, is not the original credit provider or lessor–either:

(i) obtain a written copy of the assessment of whether the credit contract or consumer lease will be unsuitable for the consumer from the original credit provider or a person (a previous assignee) to whom the rights of the original credit provider or lessor have previously been assigned or passed by law, and keep a written copy of the assessment; or

(ii) have in place written arrangements with the original credit provider or lessor, or a previous assignee, that require the original credit provider or lessor, or the previous assignee, to:

(A) keep a record of all material that forms the basis of an assessment of whether a credit contract or consumer lease will be unsuitable for a consumer in a form that will enable the licensee to give the consumer a written copy of the assessment if a request is made under section 132 or 155 of the Act; and
(B) upon request by the licensee, provide the licensee with a written copy of the assessment, or suitable information to enable the licensee to prepare a written copy of the assessment, within a period of time that will enable the licensee to give the consumer a written copy of the assessment if a request is made under section 132 or 155 of the Act.