INSURANCE COUNCIL OF AUSTRALIA

Mr Chris Connolly
Independent Reviewer
Credit Reporting Code of Conduct

By email: **codeofconduct@arca.net.au**

9 July 2012

Dear Mr Connolly

THE CREDIT REPORTING (CR) CODE OF CONDUCT INDEPENDENT REVIEW

I refer to recent discussions that the Insurance Council of Australia[1] (Insurance Council) and the Lenders Mortgage Insurance (LMI) Committee held with you on 17 May 2012. The Insurance Council appreciates the briefing you provided on the Code review process and the opportunity to comment on aspects of the Issues Paper.

Role and value of LMI

LMI plays an important role in the Australian residential mortgage market. LMI was originally introduced into Australia in 1965 to enable first home buyers to "bridge the deposit gap" which was at that time, and still is, a significant impediment to achieving home ownership. LMI protects a lender in the event of a borrower credit default on a residential mortgage loan. If the security property is required to be sold as a result of the credit default and the sale proceeds do not cover the outstanding loan balance, LMI covers the lender for the loss. This mechanism has given confidence to lenders, allowing them to compete in the marketplace, and it provides a capacity for the lender to stand by the loan in the event of consumer default, allowing time for the borrower to rectify the loan and resume mortgage repayments.

The LMI industry has extensive data in the area of residential mortgage defaults and understands the unique long term cyclical nature of this risk. LMI providers exert market discipline and have encouraged prudent lending practices in the Australian mortgage market throughout the last 40 years. This is demonstrated in a number of ways including:

- providing information and expertise to the market and customers (lenders);
- providing parameters of "acceptable risk" by setting credit policy and practice boundaries;

[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. March 2012 Australian Prudential Regulation Authority statistics show that the private sector insurance industry generates gross written premium of $36.6 billion per annum and has total assets of $115.9 billion. The industry employs approx 60,000 people and on average pays out about $111 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).

- providing a "second set of eyes" on loan applications and customers' overall credit operations and 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.

Residential mortgage risk is long term risk that is generally cyclical in nature. Large credit loss periods arising from residential mortgage risk are generally created by events that are correlated to economic factors (e.g. increases in unemployment, increases in interest rates, reductions in nominal house prices and recessions). Low arrears and defaults occur in times when these factors all work in a positive direction. However, when these factors work in a negative fashion, these factors tend to affect many properties simultaneously in a geographic region (e.g. city, state or in some circumstances, the entire country).

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 and reduces barriers to entry into the lending market.

From a stability perspective, the independent LMI providers in Australia hold significant capital that provides an additional independent layer of capital that assists in diversifying risk across lenders, time and geography. LMI is a valuable ingredient and has played a significant role in ensuring a stable and competitive residential mortgage market in Australia during the last 40 years. That capacity is critical at times when the financial system and the residential mortgage component of the system are under stress. The global financial crisis has demonstrated once again that residential mortgage risk is cyclical and borrowers are now extremely sensitive to fluctuations in interest rates and the health of the economy. Ultimately, it is the consumer that bears the brunt and the cost of such systemic dysfunction.

The principle of reciprocity

In the Issues Paper, ARCA states it strongly believes that credit reporting information must be shared on the principle that credit providers must contribute all of their chosen level of data (negative, full or partial comprehensive) to receive all data at the same level in return. The Issues Paper further notes that if a credit provider has only a ‘limited’ product range and they supply data in accordance with the data standard for a particular tier, they will receive back in credit reporting data across all products at that same tier level. In this form, reciprocity is a significant concern to LMI providers.

The Insurance Council provided input into the Issues Paper, which can be found at paragraph 2.6.2: As noted in our contribution to the Issues Paper, LMI providers have very limited credit information to contribute. In cases of default, it is likely that such information has already been reported by the lender.

We suggest that the principle of reciprocity should be modified to allow access to all credit information/credit eligibility information (within the limitations of the legislation) provided the credit provider, LMI provider etc contribute all relevant information they hold.

In the alternative, we submit it is necessary to include a specific carve out from the reciprocity principle for LMI providers in the Code. This approach does not appear to conflict with any proposed legislative requirement. We note the Explanatory Memorandum states the CR code must bind all credit reporting bodies and must set out which credit providers or other entities (for example, mortgage insurers and trade insurers) are bound. Furthermore, a CR code may be expressed to apply differently in relation to classes of entities that are subject to Part IIIA and specified classes of credit information, credit reporting information or credit eligibility information. It follows that the Code could provide for differential treatment for lenders mortgage insurers.

Serious credit infringements

We note that both the Privacy Amendment (Enhancing Privacy Protection) Bill 2012 and ARCA propose to include specification of the minimum requirements that must be met prior to listing a serious credit infringement. We support this approach. Specifically, the Code should flesh out terms in the proposed definition, including guidance on what constitutes taking such steps as are reasonable in the circumstances and last contact with the individual.

Code Compliance

We note that the Issues Paper was based on the first Exposure Draft of the Bill. It is now necessary to consider code compliance in light of the Privacy Amendment (Enhancing Privacy Protection) Bill 2012 (the Bill) as introduced into Parliament. Schedule 3 of the Bill replaces the provisions dealing with privacy codes and the Credit Reporting Code of Conduct with a new Part IIIB dealing with a code of practice about credit reporting (called the CR Code).

Division 3 of Part IIIB sets out how a CR Code will be developed and registered and what it must include. Given the significant role played by the Commissioner in this process, we agree with ARCA that a single regulator, namely the Commissioner, should be responsible for ensuring compliance with aspects of the Code.

EDR and Complaints management

We note the focus to date has been on credit providers and credit reporting agencies. In the Issues Paper, ARCA proposes requiring both credit providers and credit reporting agencies to develop processes to holistically deal with consumer complaints. Whilst we have no comment on potential complaints management processes at this stage, we wish to reiterate that LMI is a business to business product and should therefore not be captured under any such processes.

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