INSURANCE COUNCIL OF AUSTRALIA

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13 May 2013

Dear Sir/Madam

CHANGES TO DISCLOSURE REQUIREMENTS UNDER THE NATIONAL CONSUMER PROTECTION ACT 2009

The Insurance Council of Australia (Insurance Council) appreciates the opportunity to comment on the Discussion Paper "Changes to Disclosure Requirements under the National Consumer Protection Act 2009 (the Discussion Paper) which Treasury released on 8 April 2012. This submission relates to the introduction of an Information Statement (IS) for Lenders' Mortgage Insurance (LMI) discussed in Attachment B of the Discussion Paper.

The Insurance Council strongly supports introduction of the LMI IS as a simple and effective means of helping borrowers understand how LMI works. Our members consider that the IS is a better option to promote understanding of LMI than an additional statement in the loan contract which could be easily overlooked.

We address below the four questions posed in the Discussion Paper and have marked in Attachment A specific suggestions to improve the IS (Attachment B gives a version of the IS which incorporates the Insurance Council suggestions). However, we would like to emphasise three points:

- The draft states "The LMI premium is payable when you, the borrower, enter the loan". This is misleading and potentially confusing for consumers, as it would be interpreted that the borrower is paying for the LMI directly which is a common misconception held by borrowers. The purpose of the IS should be to concisely correct such misconceptions rather than to enable misunderstandings to continue. We encourage Treasury to adopt wording, which clearly explains that LMI is payable by the lender but the cost is usually passed on to the borrower.
- The current draft states "The LMI insurer will pay your lender the difference between the amount outstanding and the sale price". We suggest that it would be more accurate to state the LMI insurer will pay the lender an amount in accordance with the LMI policy.
- The draft encourages the borrower to contact the LMI insurer for more information about LMI. LMI providers have no direct contact with the borrower at the time a loan

is taken out. It would be better to direct the borrower to their lender, rather than to the LMI insurer.

Insurance Council Answers to Questions for Stakeholders

1. It is proposed that credit providers would be obliged to give the debtor the Information Statement, and that it would be badged as a document of the credit provider, as it would include their name and Australian Credit Licence number. Given this, should the Statement replace the references to 'the lender' with either 'us' or the name of the credit provider (as appropriate)?

The Insurance Council suggests that the credit provider should be able to choose the option which suits its business model.

2. The Information Statement refers to the borrower paying an LMI premium. Will it always be the case that the premium is deducted from the amount of credit, or do some credit providers have business models in which the cost is not paid in this way? If the latter, how should this type of arrangement be disclosed in the Information Statement?

The IS should be amended as suggested in Attachment A to clearly explain that the cost of LMI is payable by the lender but is usually passed on to the borrower.

3. The draft encourages a borrower to contact the LMI insurer if they want more information about LMI. Stakeholders' views are sought on whether it would be better to direct the borrower to their lender, given that it is unusual for LMI providers to have such direct contact?

It would be better to direct the borrower to their lender, rather than to the LMI insurer. LMI providers have no direct contact with the borrower at the time a loan is taken out.

4. Section 17 does not specifically address disclosure in relation to LMI products currently disclosure is covered by section 17(3)(a)(ii), which requires a credit provider to disclose "the persons, bodies or agents (including the credit provider) to whom it is to be paid and the amounts payable to each of them, but only if both the person, body or agent and the amount are ascertainable." Credit providers may have models where the LMI premium is not deducted from the amount of credit. If this is the case, should there be any new disclosure requirements in relation to the existence of an LMI policy, or is disclosure sufficiently addressed in the Information Statement?

As explained in response to 2) above, the IS should be amended as suggested in Attachment A to clearly explain that the cost of LMI is payable by the lender but is usually passed on to the borrower. The IS would then satisfactorily address the question of disclosure.

<u>Delivery Timing for the IS</u>

In order to maximise the benefit for the borrower of the information in the IS, the Insurance Council recommends that the most appropriate point for the IS to be provided is for it to be mandatory with the loan approval.

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

Robert Whelan
Executive Director & CEO

INSURANCE COUNCIL OF AUSTRALIA

ATTACHMENT A

IS WITH INSURANCE COUNCIL SUGGESTIONS MARKED

IMPORTANT FACTS ABOUT LENDERS' MORTGAGE INSURANCE

What is lenders' mortgage insurance (LMI)?

LMI is insurance that a lender takes out to insure itself against the risk of not recovering the full loan balance should you, the borrower, be unable to meet your loan payments. **It is important to understand that LMI covers the lender, not you (or any guarantor)**.

In other words, LMI:

- Provides consumers with a benefit as it allows **lenders** to provide home loans to those who otherwise meet their lending requirements but who may still be rejected for a loan because they do not have a substantial deposit ~~are seeking to borrow more than 80% of the value of the property~~; and
- Means that if you, the **borrower,** can't meet your loan payments (and all other options are exhausted), and the property is sold, the LMI insurer may pay to the lender any shortfall, ~~if any,~~ on the outstanding amount of the loan as outlined in the LMI policy.

You will still have to repay any shortfall on the amount owing ~~(plus the costs of enforcement)~~ to the LMI insurer, instead of the lender – see the example below.

What is the cost of LMI?

The LMI premium is payable at settlement by the lender, but usually passed on by the lender as a cost to the borrower ~~when you, the borrower, enter into the loan~~. The cost varies depending on the lender, how much is borrowed and the size of the deposit. The premium may be able to be included as part of the loan amount or paid ~~as an~~ upfront on settlement~~cash sum~~. Your lender can provide details of the likely costs after you have applied for the loan. On refinancing, LMI may be payable again (especially if you are increasing your loan amount).

What happens if I default and my property is sold?

If you have problems and cannot make repayments and no other resolution is found, your property may need to be sold to cover the outstanding loan amount. In this situation sometimes the house is sold for less than the amount owing. The LMI insurer may pay your lender an amount in accordance with the LMI policy ~~the difference between the amount outstanding and the sale price~~, and may then ask you, the borrower, to repay this sum~~, plus any enforcement expenses,~~ directly to them.

Example: John borrows $450,000 to buy a home valued at $500,000. As John's deposit is less than the lender's requirements, John pays the cost of the LMI which for him is included in the amount borrowed. John then becomes unemployed and defaults on his repayments. The lender repossesses the home and sells it for only $400,000, leaving a difference of $50,000 plus costs of enforcement of $5,000. The LMI insurer under the policy pays the lender $55,000, and then has the right to require John to repay this amount to them.

Important: If you experience problems making your repayments, you need to contact your lender as soon as possible as you may be able to arrange a payment variation on the grounds of financial hardship.

Comment [JA1]: Referring to the 80% LVR rule would be misleading. Some lenders have different LVR thresholds and this also excludes the Low Doc product, where LMI is usually obtained at a lower LVR such as 60%.

Comment [JA2]: There need not be a "forced sale".

Comment [JA3]: There may be reasons under the policy why the insurer does not pay.

Comment [JA4]: Added for clarity.

Comment [JA5]: Can be deleted as unnecessary and does not apply in all cases.

Comment [JA6]: As above, there may be reasons under the policy why the insurer does not pay.

Comment [JA7]: The "amount in accordance with the LMI policy" (i.e. claim amount) will include enforcement expenses.

Comment [JA8]: In line with above comment, no need to mention enforcement costs.

Is LMI refundable?

LMI may be partially refundable if the loan is terminated early in the life of the loan (usually the first year or two only). Each lender can provide details of their own refund arrangements.

Where can I find out more information about LMI?

You can contact your lender~~, the LMI insurer (your lender can advise their details),~~ or the consumer credit regulator, the Australian Securities and Investments Commission on 1300 300 630, or through their consumer website at www.moneysmart.gov.au.

Comment [JA9]: It would be better to direct the borrower to their lender, rather than to the LMI insurer. LMI providers have no direct contact with the borrower at the time a loan is taken out.

ATTACHMENT B

IS WITH INSURANCE COUNCIL SUGGESTIONS INCORPORATED

IMPORTANT FACTS ABOUT LENDERS' MORTGAGE INSURANCE

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