

LMI PROVIDERS AND CREDIT INFORMATION

We understand that the community expect their personal data to be handled with due care and respect for privacy. However it is crucial that LMI providers have access to the full suite of credit information (including on repayment history) that will be available to lenders under the Bill.

LMI providers' use of credit information

LMI providers place significant reliance on credit reporting information when:

- ❖ Determining whether or not to underwrite the original credit risk of a particular borrower - It should be noted that LMI is most frequently required by the lenders for high Loan to Valuation Ratio (LVR) loans where underwriting by the very nature of the loan is riskier. The more information that the LMI provider has on the borrower the better able they are to assess the risk accurately and provide cover to the benefit of those that are good credit risks such as such as first home buyers and young professionals;
- ❖ Loan Variations - During the life of a loan, it is often necessary for the LMI provider to obtain up to date credit information, such as when assessing hardship or loan variation applications;
- ❖ Conducting risk assessment and management involving securitisation, credit scoring, portfolio analysis, reporting and fraud prevention;
- ❖ Arranging insurance and reinsurance.

When assessing an application for LMI, LMI providers utilise the same information obtained from the credit reporting body as that used by the lender to assess the application for credit. In some circumstances, LMIs also choose to access the information indirectly and see all the information which the lender has, including the loan application. Alternatively, where a delegated underwriting authority is in place, LMIs may not see the lender information at the time of application but have the right to audit customer files, at which point they can see all the lender information. Some LMIs conduct such audits on a monthly basis.

The ability for the LMI provider to verify information obtained through the lender with information sourced directly from the credit reporting agency is essential to the integrity of the LMI provider's assessment of the risk in underwriting the mortgage.

The need for 'direct access' to repayment history information

Currently the *Privacy Act 1998* allows credit information to be disclosed to mortgage insurers (that is, LMI providers) by both credit reporting agencies (section 18K) and credit providers (section 18N).

Section 21G of the Privacy Bill is similar to the current section 18N in that it allows a credit provider to disclose credit eligibility information to a LMI provider, including repayment history information. We welcome the explicit acknowledgment in the Explanatory Memorandum that although repayment history information is only available to credit providers who are subject to responsible lending obligations under the *National Consumer Credit Protection Act 2009*, an exception to this requirement has been made for mortgage insurers to allow them to obtain the information from those credit providers to whom they provide mortgage insurance.

We are concerned that the same exception does not apply to direct disclosure of such information by a credit reporting body to a LMI provider. Section 20E prevents the disclosure of repayment history information by a credit reporting body unless the disclosure is to a credit provider who is a licensee. As a LMI provider never provides credit, a credit reporting body cannot provide such information directly to them.

The reliance LMI providers place on credit reporting information has been outlined above. It is not sufficient that LMI providers can only access repayment history information indirectly from the lender. Direct access via the credit reporting body should be allowed for the following reasons:

❖ Underwriting risk

LMI providers actually take on the risk of a borrower defaulting on a home loan. They therefore place significant reliance on credit reports and credit account information in determining whether or not to underwrite the credit risk of a particular borrower on a residential mortgage.

The ability to directly collect and report about an individual's current accounts is a fundamental part of an LMI provider's underwriting process and is incorporated in their credit scoring systems. Credit account obtained from third parties other than the credit reporting agency is open to manipulation, fraud, errors and omissions. This may give rise to allegations of misrepresentation and potentially claim denials by the LMI providers, which is in no one's interest.

Ensuring the accuracy of information received is critical to the effectiveness of an LMI provider's underwriting process. A complete credit report obtained directly from a credit reporter is the only truly independent item of information that an LMI provider receives in relation to an application for LMI. All other information is provided by the lender, the borrower or an agent of the lender. If LMI providers cannot obtain a complete credit report directly from a credit reporter, then its risk analysis will not be based on truly independent information, and may be compromised.

Furthermore, the lack of independent verification of a borrower's credit history will result in the very basis of LMI being reconsidered. It also raises serious conflict of interest issues if an LMI provider is required to assess an application for LMI based on a credit report which is submitted to it via the insured party.

❖ Existing practice

LMI providers already have in place direct links with credit reporting agencies to ensure the timely provision of the credit report. Having to request such reports from a lender would reduce their responsiveness, which would not ultimately assist the borrower who is the ultimate credit consumer.

❖ Fraud management

Enabling LMI providers to access the full suite of credit information, including repayment history information, from the credit reporting body allows the LMI provider to check this information against the information provided by the lender and provides an opportunity to detect fraud by the borrower.

❖ 'Second set of eyes'

We understand that the Government is seeking to encourage informed and prudent lending practices. The Government response to the Australian Law Reform Commission's (ALRC's) Privacy Report noted that the Government agrees with the ALRC's view that the predictive value of the repayment history information data set will lead to more informed lending practices, which in turn will result in greater efficiency and effectiveness in consumer credit lending. LMI providers currently exert market discipline and encourage prudent lending practices in the Australian mortgage market, providing an important 'second set of eyes' for this industry.

As noted above, in effect LMI providers are taking on the same risk as the lender when they make a decision to provide LMI. It is inconsistent to create a repayment history information data set to enable more informed lending practices but deny access to such information to the 'second set of eyes' in the lending process.

Limiting access to information in credit reports limits the industry's ability to perform this function and therefore does not align with the Government's stated policy intention.

❖ Hardship application

Although it is the role of the lender to accept or deny a hardship application, in reality lenders must liaise with the LMI provider or risk voiding the policy. Direct access to repayment history information will enable LMI providers to more confidently assess whether to agree to repayment flexibility in response to a hardship application by the borrower.

Existing Protections for Consumers

We understand that the Attorney General has made a commitment that access to credit repayment history would be limited to those with a responsible lending obligation. We also understand that limiting access aligns with a key theme of the privacy regime that direct access to personal information should be limited to those that need it. It has been demonstrated above the LMI providers have a genuine need to access this information.

In the Bill, LMI providers have been granted access to repayment history information via a lender without being subject to a responsible lending obligation. We submit that this should

be extended to include repayment history information disclosed by a credit reporting body. Even though LMI providers have dealt directly with credit reporting data under the current regulatory regime for many years, the Insurance Council is not aware of issues having been raised about the misuse of personal information. We ask that the Committee notes the following protections:

❖ **LMI providers are monoline insurers**

LMI providers are licensed by the Australian Prudential Regulation Authority (APRA) to only provide LMI and therefore do not utilise credit information in relation to any other products.

❖ **LMI providers will only be able to use credit reporting information in relation to mortgage insurance**

In the Privacy Bill (under the proposed paragraph (a) of subsection 20E(3)), a credit reporting body will only be able to disclose credit reporting information where the disclosure is a permitted CRB disclosure.

Section 20F contains a table which defines what constitutes a permitted CRB disclosure and relevantly states:

20F Permitted CRB disclosures in relation to individuals

(1) A disclosure by a credit reporting body of credit reporting information about an individual is a **permitted CRB disclosure** in relation to the individual if:

- (a) the disclosure is to an entity that is specified in an item of the table and that has an Australian link; and
- (b) such conditions as are specified for the item are satisfied.

7	<i>a mortgage insurer</i>	<i>the insurer requests the information for a mortgage insurance purpose of the insurer in relation to the individual.</i>
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A mortgage insurance purpose is defined in the Bill as:

mortgage insurance purpose of a mortgage insurer in relation to an individual is the purpose of assessing:

- (a) *whether to provide insurance to, or the risk of providing insurance to, a credit provider in relation to mortgage credit:*
 - (i) *provided by the provider to the individual; or*
 - (ii) *for which an application to the provider has been made by the individual; or*
- (b) *the risk of the individual defaulting on mortgage credit in relation to which the insurer has provided insurance to a credit provider; or*
- (c) *the risk of the individual being unable to meet a liability that might arise under a guarantee provided, or proposed to be provided, in relation to mortgage credit provided by a credit provider to another person.*

Therefore, a LMI provider can only use credit reporting information (including repayment history information) in very limited circumstances for a purpose which we submit is ultimately to the borrower's benefit.

❖ **LMI providers do not engage in direct marketing to consumers**

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. The insured customers are banks, building societies, credit unions and non-bank lenders. Typically, the provision of LMI is negotiated with a lender under a master policy arrangement. This master policy then governs the insurance issued on an individual loan basis. LMI providers have no role and no direct contact with the consumer in the establishment or the ongoing management of the home loan credit contract.

❖ **Consumer consent**

All borrowers provide their consent to the provision of information to LMI providers as part of the loan application process. LMI providers do not see that the individual borrower is disadvantaged by the direct provision of the credit account information to an LMI provider from a credit reporting body during this process. Conversely, an LMI provider may potentially be severely disadvantaged by the current proposal to limit access, which will impact on its ability to assess the risk inherent in the application, its claims payment liability and ultimately premium levels. It is worth noting that the Insurance Council and its members have worked with the Government on its foreshadowed introduction of an LMI Information Sheet which will help explain LMI to borrowers taking out a mortgage.

❖ **LMI providers hold a credit licence**

Whilst it is the case that LMI providers do not directly have responsible lending obligations (as they do not lend to consumers), they are still required to hold an Australian credit licence and are therefore subject to the following general conduct obligations under the *National Consumer Credit Protection Act 2009* (the NCCP Act):

- engage in credit activities efficiently, honestly and fairly;
- comply with relevant laws;
- comply with any conditions of the credit licence;
- manage conflicts of interest;
- must have an internal dispute resolution procedure that complies with ASIC standards;
- must ensure representatives comply with the credit legislation;

- must ensure representatives are adequately trained and are competent to engage in the credit activities authorised by our licence; and
- have adequate arrangements for compensating persons for loss or damage suffered because of a contravention of the NCCP Act by the licensee or its representative

As noted above, LMI providers have also historically encouraged responsible lending practices by its customers (lenders) prior to the implementation of the NCCP Act.

LMI providers are required to hold a credit licence because of the way that LMI operates following payment of a claim to a lender. An LMI provider pays a claim if a borrower cannot repay their home loan and there is a shortfall on the sale proceeds following repossession and sale by the lender. Once an LMI provider pays a claim, it effectively 'stands in the shoes' of the original lender in relation to the mortgage. The LMI provider is also assigned by the lender any rights of the lender against the consumer/borrower in relation to the personal debt still outstanding on the home loan. Given this scenario, it is illogical that an LMI provider is expected to take on the legal position of a lender but is not permitted the same direct access to credit reports in relation to the origination of the home loan and its underwriting of the risk associated with that home loan.

Consequences of denying access to repayment history information

Currently when assessing an application for LMI, LMI providers utilise the full suite of credit information available. We are concerned that the effect of removing the ability of LMI providers to access this information has not been fully considered.

❖ Increased risk

If there is asymmetrical information between the lender and LMI, it may result in increased risk flowing into the LMI portfolio which may not become evident for a period of several years when claims begin to emerge. However, LMI providers charge a single premium up front for the LMI, which provides cover for the life of the loan. Access to independent credit reporting information is therefore crucial for LMI providers to enable them to accurately and sensibly assess risk.

There is strong sentiment amongst LMI providers that the potential increase in risk they would face without independent access to the same credit reporting data sets as the lender could not be managed commercially and the very basis of their business would need to be reconsidered. LMI providers, if they are prepared to manage the greater risk, will need to price accordingly. This will not only be commercially sensible but also expected by the prudential regulator, APRA, which monitors closely how licensed insurers manage the full range of risks that they face. The prospect of taking on a greater level of risk will also make LMI providers reluctant to agree to loan variations, including those relating to financial hardship of the borrower.

A decrease in the availability of LMI or a lack of flexibility around loan variations at a time when there is already widespread concern about mortgage affordability would be a regrettable outcome. This is especially the case when the root cause, denial of access to full credit reporting information, would serve no purpose. LMI providers have had long term access to credit reporting data under the current regulatory regime and we are not aware of any concerns being raised about their use of the data.

❖ **Systems changes will be required**

Currently LMI providers generally rely on information received directly from the credit reporting body. As noted above, where a delegated underwriting authority is in place, LMI providers may not see the lender information at the time of application. We acknowledge that implementation of the new credit reporting regime will require changes to IT systems in order to accommodate the newly available data sets. However as LMI providers currently access credit reports directly from credit reporting agencies, it will be necessary to make systems changes to obtain all information from the lender instead and there will inevitably be timing/delay issues in addition to the risk issues outlined above.

Without direct access, it will be impossible for LMI providers to agree to timing parameters with lenders in relation to the assessment of applications, which may have flow on effects for a lender's business and its ability to process applications in a timely manner. As noted above, the timely receipt and review of a borrower's entire credit report is also integral to, and an essential element of an LMI provider's risk underwriting process.

Additional practical issues in relation to system changes include:

- lenders that don't provide information electronically would need to provide hard copies of the credit reports via email or fax, potentially exposing them to privacy issues;
- LMI providers have, over the course of time, developed credit scoring tools, which are built into the whole credit reporting and lending process. Any change to the way this system currently operates (e.g. if LMI providers cannot obtain credit reports directly), will fundamentally affect how LMI providers assess risk and there may be significant unintended consequences in relation to the operation of mortgage assessments;
- LMI providers deal with a wide range of customers within the lending market, with varying levels of risk appetite, credit sophistication and processes, depending on what segment of the market they operate in and their customer base. Obtaining information from the customer, rather than directly, will significantly weaken the LMI provider's credit assessment process and potentially expose them to higher losses;
- In relation to securitised bulk transactions, LMI providers can currently access credit bureau reports in order to assist in credit assessment of loans insured post origination. In such circumstances, lenders would not have a current credit report at the relevant time.

SCHEDULE 2 CREDIT REPORTING: USE AND DISCLOSURE OF CREDIT REPORTING INFORMATION BY A CREDIT REPORTING BODY TO A MORTGAGE INSURER

Clause 20E sets out the provisions for the use or disclosure of credit reporting information by credit reporting bodies. Clause 20F sets out a table of permitted credit reporting body disclosures in relation to the individual.

Our understanding of the practical implication of this section is as follows:

- A credit reporting body can disclose credit reporting information under paragraph (3)(a) of section 20E where it is a permitted CRB disclosure;
- A disclosure by a credit reporting body to a mortgage insurer is a permitted CRB disclosure under section 20F;
- However disclosures by a credit reporting body under paragraph 3(a) are subject to an additional limitation if the disclosure is credit reporting information that includes, or was derived from repayment history information - as per subclause (4) of section 20E.
- Subclause 4 limits the disclosure of credit reporting information that includes, or was derived from repayment history information unless the recipient is a credit provider who is a licensee.
- **Therefore section 20E does not allow disclosure of repayment history information to an entity other than a credit provider who is a licensee.**

Amendment Sought

We suggest the Government could enable LMI providers to access repayment history by amending subsection 20E(4) in the Bill as follows:

20E Use or disclosure of credit reporting information

Prohibition on use or disclosure

- (1) *If a credit reporting body holds credit reporting information about an individual, the body must not use or disclose the information.*

Civil penalty: 2,000 penalty units.

Permitted uses

- (2) *Subsection (1) does not apply to the use of credit reporting information about the individual if:*

- (a) the credit reporting body uses the information in the course of carrying on the body's credit reporting business; or*

- (b) *the use is required or authorised by or under an Australian law or a court/tribunal order; or*
- (c) *the use is a use prescribed by the regulations.*

Permitted disclosures

- (3) *Subsection (1) does not apply to the disclosure of credit reporting information about the individual if:*
- (a) *the disclosure is a permitted CRB disclosure in relation to the individual; or*
 - (b) *the disclosure is to another credit reporting body that has an Australian link; or*
 - (c) *both of the following apply:*
 - (i) *the disclosure is for the purposes of a recognised external dispute resolution scheme;*
 - (ii) *a credit reporting body or credit provider is a member of the scheme; or*
 - (d) *both of the following apply:*
 - (i) *the disclosure is to an enforcement body;*
 - (ii) *the credit reporting body is satisfied that the body, or another enforcement body, believes on reasonable grounds that the individual has committed a serious credit infringement; or*
 - (e) *the disclosure is required or authorised by or under an Australian law or a court/tribunal order; or*
 - (f) *the disclosure is a disclosure prescribed by the regulations.*
- (4) *However, if the credit reporting information is, or was derived from, repayment history information about the individual, the credit reporting body must not disclose the information under paragraph (3)(a) or (f) unless the recipient of the information is a credit provider who is a licensee **or a mortgage insurer**.*

Civil penalty: 2,000 penalty units.

- (5) *If a credit reporting body discloses credit reporting information under this section, the body must make a written note of that disclosure.*

Civil penalty: 500 penalty units.

Note: Other Acts may provide that the note must not be made (see for example the Australian Crime Commission Act 2002 and the Law Enforcement Integrity Commissioner Act 2006).

No use or disclosure for the purposes of direct marketing

- (6) *This section does not apply to the use or disclosure of credit reporting information for the purposes of direct marketing.*

Note: Section 20G deals with the use or disclosure of credit reporting information for the purposes of direct marketing.

LENDERS MORTGAGE INSURANCE - BACKGROUND INFORMATION

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;
- 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, across time and geography. LMI is a valuable ingredient and has played a significant role in ensuring a stable and competitive residential mortgage in the Australian market 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.