Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Budget Estimates

4 – 6 June 2013

Question: **BET 32**

Topic: **Lenders Mortgage Insurance**

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Senator WILLIAMS asked:

Senator WILLIAMS: Thank goodness we had amendments to some recent legislation because lenders' mortgage insurers were going to be excluded from the credit ratings or credit history. What do you call it when you have a black mark on your credit rating for not paying your power bill or whatever? The government was going to exclude lenders' mortgage insurers from access. They have had access to it for decades. How much more capital is in the APRA regulated system right now because of the LMIs to make sure our financial system is sound?
Dr Laker: I would have to answer the question on notice if you want an amount. The amount of capital in the system as a whole is substantially larger in the banking system than in the other LMI sector. The LMI sector we have always said plays a valuable role in underwriting risk. But there is a limit to how much a sharing of risk can lead to a reduction of capital. I am comfortable when banks are holding the full amount of risk. I know that that then ensures there is adequate capital against the risk of a housing loan default. If the bank chooses to share that, we have readily acknowledged in the frameworks in the past that they get some relief. That relief does not apply for the major players that have authorisation from us to use the advanced Basel II framework because there is a binding floor on their modelling that we have imposed to make sure there is adequate capital in the system as a whole. I know that causes issues for lenders' mortgage insurers.

Answer:

As at 31 December 2012, lenders mortgage insurers held approximately $5 billion[1] in capital. This includes capital held against lenders mortgage insurance (LMI) issued to ADIs using the standardised approach to credit risk, ADIs using the internal ratings-based approach (IRB) to credit risk and to non-APRA regulated entities (such as mortgage-backed securities). Lenders mortgage insurers also hold significant reinsurance that provides additional protection in the event of a severe downturn in the housing market.

As at 31 December 2012, ADIs received capital relief of around $1 billion[2] due to LMI. For the IRB approach banks, APRA presently requires a 20 per cent floor at a portfolio level for loss given default estimates for housing loans. This results in no capital relief for housing loans covered by LMI for banks under the IRB approach to credit risk.

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[1] Source: APRA *General Insurance Company Level Statistics*.
[2] Source: unpublished APRA data.