Guiding Principles

Australian Banking Association

Lenders Mortgage Insurance – Guiding Principles

Purpose

These guiding principles outline measures in place to help customers understand Lenders Mortgage Insurance (LMI), understand the default / LMI claim process, and the consumer protections in the shortfall debt recovery process.

These voluntary principles complement the provisions of the Banking Code of Practice[1] (the Code) set out in Chapter 19 (LMI), Chapter 41 (we will try and help you if you are experiencing financial difficulty), and Chapter 43 (when we are recovering a debt).

The voluntary principles were developed with input and support from member banks. The industry principles do not have legal force or prescribe binding obligations on individual banks.

The ABA encourages members to use these guiding principles to set internal processes, procedures, and policies.

What is LMI?

Lenders Mortgage Insurance (LMI) is taken out by a lender to protect the lender against the risk of not recovering the mortgage balance if a customer cannot fully repay their mortgage.

Typically, lenders take out LMI for mortgages where the amount being borrowed is more than 80% of the property value as there is a higher risk of the mortgage not being fully repaid if the property is sold. A shortfall debt arises where the proceeds from the sale of a property are not enough to fully repay the loan.

The customer is liable for the shortfall debt. Where the bank has LMI and the customer does not repay the shortfall debt to the bank, the bank is entitled to make an LMI claim. The LMI insurer will make an insurance payout to the lender and the insurer then has the right to pursue the customer for the debt shortfall.

LMI reduces the lender's risk of the customer not repaying the shortfall debt, making them more likely to lend to customers with smaller deposits where other requirements are met.

The lender may require the customer to pay for LMI in connection with their loan, in which case the provisions of Chapter 19 of the Code (LMI) will apply.

The cost of LMI insurance usually depends on the mortgage size compared with the assessed property value, whether the property is owner occupied or is an investment, the terms agreed to between the lender and the LMI provider, and the lenders risk assessment of the customer. A customer may reduce or avoid the cost of LMI by having a larger deposit, additional security, or using the First Home Loan Deposit Scheme.

[1] https://www.ausbanking.org.au/campaigns/new-banking-code/

Industry LMI guiding principles

The ABA encourages each bank to have internal policies, processes, and procedures in place to meet the principles outlined in this document.

1. Point of Sale

Where a lender requires a customer to pay for LMI, information should be provided to customers in a fact sheet, in accordance with Chapter 19 of the Code. This includes the key policy features (cl 69), and whether the customer is entitled to a refund, or part refund, of the fee or charge they have paid if the mortgage is repaid or refinanced before the end of the policy (cl71).

In addition, the following information should also be provided to the customer:

a) Having a smaller deposit means there is a smaller buffer against possible adverse movements in the property market, which increases the possibility of a shortfall debt on the sale of the property.

b) The lender may seek to insure against the risk of a shortfall debt by taking out LMI. Without LMI, the lender may decide not to make the loan where other requirements are met.

c) The lender may require the customer to pay for LMI in connection with their loan, in which case the provisions of Chapter 19 of the Code (LMI) will apply.

d) Where a customer refinances, a new LMI policy may be required, with the customer potentially being required to pay the costs.

e) What a shortfall debt is.

f) That LMI protects the lender, not the customer, against a shortfall debt i.e. the insurer pays the bank, and the customer is liable for the shortfall debt. That the shortfall debt may be pursued by the bank, the banks insurer, or a third-party debt collector. Noting these parties are required to have financial hardship policies.

g) Worked examples of how LMI works at point of sale and in a shortfall debt situation.

h) Where the customer can get more information / discuss LMI with the bank, for example an information line and / or webpage details.

i) The information should be easy to understand from a customer's perspective. Consideration should be given to the best way of providing the information to the customer to help ensure they understand it. For example:

   - Through one or a combination of: factsheets, videos, e-learning module, on-line information, use of info graphics, and obtaining customer feedback to ensure understanding and identify ambiguity or areas of confusion.
   - Making communications as clear as possible particularly when the bank is aware that a customer is experiencing vulnerability or has limited English.

2. Default

When a customer defaults on their mortgage it may be a time of confusion and stress for them. This is especially so where it is likely their property will be sold, and a shortfall debt is expected after the sale.

Chapter 41 of the Code (We will try and help you if you are experiencing financial difficulty) requires banks to work with customers to find a sustainable solution to their financial difficulties. The help will depend on the customers individual circumstances and will be provided on a case by case basis.

In addition, banks should:

a) Provide customers who default on their loan with sufficient information about their options (e.g. resume repayments, enter a financial difficulty arrangement, sell their home themselves, or surrender their home for the bank to sell), the implications of each option (including the possible impact on their credit report) so they can make informed decisions. This is usually part of a bank's hardship process.

b) Ensure customers rights (such as the right to seek financial hardship, raise a dispute regarding unsuitability, or dispute the steps taken to sell) are not diminished.

3. Shortfall debt / LMI claim

When a shortfall debt is confirmed ("crystalises") and the bank has LMI, the bank should:

a) Provide the LMI insurer with all relevant information about the customer, and where appropriate, discuss the customer's situation (subject to privacy considerations). For example, this may include vulnerability indicators such as advanced age or serious illness.

b) Where a bank makes or settles a LMI claim take reasonable steps to provide the customer with written information letting them know:

As early as practical:

- That they have submitted or settled an insurance claim with their LMI provider regarding the shortfall debt.
- The name of the insurer.
- Why the insurer is entitled to recover the debt (reminding customers of their responsibilities under the loan contract).

Following settlement of an LMI claim and execution of a deed of assignment:

- That they have settled an insurance claim with their LMI provider regarding the shortfall debt.
- The date the shortfall debt was assigned to the insurer under the deed of assignment between the lender and insurer.
- If they are experiencing financial hardship to inform the insurer, or their representative, so they can work with the customer on options available to support them.
- That the customer retains their right to raise any issues or concerns with the lender in respect of the loan contract. For example, how the mortgage was sold to the customer, or assistance provided to the customer over the course of the mortgage.

4. Consumer protections during the shortfall debt recovery process

Banks should ensure that the LMI providers they work with have adequate consumer protections in place during the shortfall debt recovery process, including:

- Support for customers experiencing vulnerability.
- Support for customers experiencing financial difficulty.
- Are compliant with:
  - *ASIC Regulatory Guide 165: internal and external dispute resolution*[2] and they are members of the Australian Financial Complaints Authority (AFCA) or another external dispute resolution scheme
  - ACCC's and ASIC's joint guidance: *ASIC Regulatory Guide 96: Debt Collection Guideline: for Collectors and Creditors*[3]
- Debts will only be collected by, or sold to, another party that has in place the same consumer protections as outlined above.

Note: where a customer is experiencing financial hardship, and the LMI provider is a member of the Insurance Council of Australia, Parts 10 (financial hardship) and 11 (complaints) of the General Insurance Code of Practice apply.

[2] https://asic.gov.au/regulatory-resources/find-a-document/regulatory-guides/rg-165-licensing-internal-and-external-dispute-resolution/
[3] https://asic.gov.au/regulatory-resources/find-a-document/regulatory-guides/rg-96-debt-collection-guideline-for-collectors-and-creditors/