Lenders Mortgage Insurance

Housing Loans Insurance Corporation (HLIC) was established by the Australian Government in 1965 to provide Lenders' Mortgage Insurance (LMI). It was introduced as a way to help more Australian people purchase their own home by using a smaller deposit. In 1997 GE purchased HLIC from the Australian Government and began GE Mortgage Insurance Co in Australia which in turn is now Genworth Financial.

LMI is a policy between a credit provider and a mortgage insurer. Therefore <u>it cannot be transferred by a borrower</u>. A borrower is not entitled to see the policy document as they are not the insured party. LMI providers will not discuss policy issues with borrowers directly as they protect their client's right of commercial confidentiality.

LMI protects a credit provider from financial loss in the event that a borrower defaults on their residential property loan repayments. The credit provider is the customer of the LMI policy issuer, not the borrower who pays the premium.

Australia today has two main mortgage insurers that dominate the Lenders' Mortgage Insurance (LMI) market. Most credit providers work with one of these on an exclusive basis or work with both insurers or have their own insurer.

Genworth Financial: According to their website Genworth Financial Inc. operates in over 25 countries, has 15 million customers and in Australia deals with close to 200 lenders. Genworth has insured over $300 Billion worth of residential mortgages in Australia and insures approximately 3,000 residential mortgages every week.

QBE LMI / PMI: According to their website the QBE Group is a top 25 company in the global insurance market and has insured loans in Australia, New Zealand as well as throughout Asia. QBE LMI was previously known as PMI which was part of an American owned mortgage insurer.

Smaller LMI providers include some that are owned by the credit providers they insure. CBA, Westpac, St. George, ING Bank and ANZ all have their own LMI product.

As captive insurers, the banks provide lenders mortgage insurance coverage only to their own loan portfolio. They in turn benefit from an independent review of its risk acceptance process and have access to a risk transfer mechanism to effectively manage their own housing loan risk profiles. As they have conservative underwriting profiles, the result is low claim levels. This allows them to retain profits which would otherwise flow to an external LMI provider.

The protection price (Policy premium) may be called a LMI Premium, Risk Fee, Loan Extension Fee (LEF), Low Deposit Premium (LDP), Equalisation fee or Reduced Equity Fee (REF).

Risks that are assessed before a policy is offered include:

1. The risk of insuring the credit provider in respect of the loan
2. The risk of default by the borrower on the loan (if insured by the Insurer)
3. The risk of the security property not covering all the "loss" incurred.

If the security property is required to be sold as a result of borrower default, the funds received from the sale may not cover the full balance outstanding on the loan. When this happens, the credit provider is entitled to make an insurance claim, subject to the terms and conditions of the LMI Master Policy.

The claim to the LMI provider is for an amount outstanding, (including loss of principal, unpaid interest, plus all reasonable recovery costs such as legal fees, marketing costs, repairs, maintenance, and outstanding rates). **The borrower remains liable to the credit provider for any amounts owing under the contract to them even if the mortgage insurer has paid that amount to the credit provider.**

A person who wishes to borrow more than 80% (full doc) and 60% (low doc) of the value of their residential property is normally required to pay for a LMI policy as a condition of loan approval. The loan to value ratio may decrease depending on the type and location of the residential property being offered as security.

The residential property offered as security and the specific loan are both subject to an established criterion set by the LMI provider who decides which property is acceptable and which loans will be approved or will be refused.

The criteria for approval and the policy price (premium) differ from lender to lender and LMI provider. The premium is increased as the loan to property value increases and the loan amount increases in dollar volume.

The "once-off" premium is usually passed on to the borrower as a cost of providing the loan and may or may not be capitalised onto the loan amount. The premium is due and payable at funding of the loan. GST is applied and State Government stamp duty is paid by the borrower on top of the premium.

Capitalisation of the premium is often favoured as the borrower does not have to pay the premium amount upfront, rather it is built into the repayment amount and spread over the term of the loan. Capitalisation does result in the borrower paying a higher price for LMI due to the effect of compounding interest on the LMI premium + stamp duty amount. Most low deposit borrowers do not have the savings or equity to pay the large LMI premium upfront.

Loans less than $300,000 have a cheaper LMI premium than loans between $300,000 and $500,000 which have a cheaper LMI premium than loans greater than $500,000. For example a person borrowing 95% loan amount of;

- $300,001 from CBA (Genworth) would need to pay $8,326 however they could reduce their loan amount by just $1 and reduce the LMI premium by $1,919 to $6,407 immediately.
- $500,001 from ING (Genworth) would need to pay $19.966 however they could reduce their loan amount by just $1 and reduce the LMI premium by $4,969 to $14,997 immediately.

The LMI policy is for the term of the loan. This means that if the borrower refinances their loan with the same credit provider and changes the original term (say 30 years) of the loan to a new 30 year term a full LMI premium will be applied as it is deemed to be a new insurance proposal. Most will deduct the first premium paid from the new premium to be applied however this only applies when the refinanced loan is taken out with the same credit provider.

ANZ, CBA, NAB and Westpac clients are **not entitled to refund** of premium if the insured loan is paid out in full in the first two years.

Depending on arrangements between QBE LMI and individual credit providers, a partial refund may be payable if all loans secured by the Insured Mortgage are repaid in full and the Insured Mortgage is discharged within 12 months of payment of the Premium in respect of the initial loan advance and QBE LMI is advised by the credit provider within 30 days of discharge. It is the responsibility of the credit provider to advise QBE LMI of the discharge of an Insured Mortgage and initiate any request for a refund. QBE LMI will then confirm any refund payable. Borrowers are advised to direct any premium refund enquiries to their credit provider.

Genworth Financial may have a separate arrangement with a credit provider for a reduced premium rate in lieu of taking premium refunds, if not they may refund 40% of the premium in the first 12 months or 20% up to 24 months if the insured mortgage loan is paid out in full and the credit provider requests a refund within 3 months. Borrowers are advised to direct any premium refund enquiries to their credit provider.

4 case studies for purchase in Victoria with a 95% lend using ANZ as a credit provider.

Money needed to purchase First Home Buyer		Money comes from where?	
Purchase Price	**$ 320,000.00**	94% Loan	$ 300,000.00
Government Fees	$ 13,380.00	LMI capitalised on loan max 97%	$ 6,611.00
Conveyance /establish say	$ 1,500.00	**Total loan**	**$ 306,611.00**
Lenders Mortgage Insurance ANZ	$ 6,611.00	**Savings needed**	**$ 28,000.00**
Total money needed	**$ 341,491.00**	FHOG	$ 7,000.00
		Total money available	**$ 341,611.00**
		Total money needed	**$ 341,491.00**
From $28,000- in savings equity in property at settlement = $13,389-		***Surplus***	**$ 120.00**

Money needed to purchase First Home Buyer		Money comes from where?	
Purchase price	$ 320,000.00	95% Loan	$ 304,000.00
Government Fees	$ 13,380.00	LMI capitalised on loan max 97%	$ 6,400.00
Conveyance /establish say	$ 1,500.00	**Total loan**	**$ 310,400.00**
Lenders Mortgage Insurance ANZ	$ 9,695.00	**Savings needed**	**$ 28,000.00**
Total money needed	**$ 344,575.00**	FHOG	$ 7,000.00
		Total money available	**$ 345,400.00**
		Total money needed	**$ 344,575.00**
From $28,000- in savings equity in property at settlement = $9,600-		***Surplus***	**$ 825.00**

Money needed to purchase Established Home		Money comes from where?	
Total Purchase Price	**$ 530,000.00**	95% Loan	$ 503,500.00
Government Fees	$ 25,222.00	LMI capitalised on loan max 97%	$ 14,100.00
Conveyance /establish say	$ 1,500.00	**Total loan**	**$ 517,600.00**
Lenders Mortgage Insurance ANZ	$ 21,744.00	**Savings needed**	**$ 61,000.00**
Total money needed	**$ 578,466.00**	**Total money available**	**$ 578,600.00**
		Total money needed	**$ 578,466.00**
From $61,000- in savings equity in property at settlement = $12,400-		***Surplus***	**$ 134.00**

Money needed to purchase Established Home			Money comes from where?		
Purchase Price	$	530,000.00	94.34% Loan	$	500,000.00
Government Fees	$	25,222.00	LMI capitalised on loan max 97%	$	14,100.00
Conveyance /establish say	$	1,500.00	**Total loan**	$	**514,100.00**
Lenders Mortgage Insurance ANZ	$	15,945.00	**Savings needed**	$	**59,000.00**
Total money needed	$	572,667.00	**Total money available**	$	**573,100.00**
			Total money needed	$	**572,667.00**
From $59,000- in savings equity in property at settlement = $15,900-			***Surplus***	$	**433.00**

Recommendations

1. **A review of lenders mortgage insurance refund arrangements and premium price as being a fair and honest in consideration of the claim history and low default rate and associated loss in Australia. Why are there loan amount brackets? Why is the premium based on a percentage of the loan amount rather than from the cost of a policy as directly related to the likelihood and cost of a claim? As the property value increases over time why is the premium based on the term of the loan which is usually 30 years?**
2. **Request information about premium price to determine if it is a fair reflection of the expenses and costs associated with running the insurer's business, what their margin is to produce a profit for the benefit of their shareholders at the expense of borrowers.**
3. **Technically the more efficient an insurance company is the cheaper their policies will be in a competitive market. A policy can also be cheap when the insurance company knows it is unlikely to pay a claim or the payout is minimal. Lenders mortgage insurance premiums with the very prudent lending practices and low default rates we have in Australia would suggest that borrowers are paying too much due to the lack of competition between players. Questions need to be asked to see if this is cartel behaviour. Are the major banks a group of companies who are supposed to be competing against each other but instead are they acting together to limit the supply and control the prices of their products.**
4. **An investigation to determine if credit providers who self insure LMI are using third line forcing as a borrower can not obtain a low deposit loan without it and you can not purchase the insurance from another provider. Three parties are involved the credit provider, the borrower and the credit provider's own LMI company. Does this have the affect of lowering competition?**
5. **Consider re-establishing a government owned Lenders Mortgage Insurance Company.**