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19 February 2018

Mr Simon Daley
Solicitor Assisting the Royal Commission
Australian Government Solicitor

By email: FSRCSolicitor@royalcommission.gov.au

Dear Sir

RE: Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

Thank you for your letter dated 11 January 2018 inviting early written submissions to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (**the Commission**). We welcome the opportunity to provide a submission.

We understand that you have invited submissions from financial services providers across a number of industry sectors. Genworth Financial Mortgage Insurance Pty Limited is authorised by the Australian Prudential Regulation Authority (**APRA**) as a general insurer and we note from the hearing of the Commission on 12 February 2018 that you have also written to a number of, if not all, other authorised general insurers.

Genworth Financial Mortgage Insurance Pty Limited has a subsidiary which is also authorised as a run off general insurer, Genworth Financial Mortgage Indemnity Limited. The parent company of both of these entities is Genworth Mortgage Insurance Australia Limited, which is listed on the ASX.¹ In this letter we use the name **Genworth** to refer to the Australian group of companies and, in particular, these 3 group entities, each of which is regulated by APRA.

1. The nature of our business

As noted above, we understand you have written to a number of general insurers authorised by APRA. We thought it might assist to explain at the outset the nature of Genworth's business, including why it is different to almost all other general insurers in Australia.

¹ The majority shareholder of Genworth Mortgage Insurance Australia Limited is Genworth Financial Inc., a company listed on the New York Stock Exchange, with subsidiaries operating in key financial centres such as the US and Canada.

a) **Genworth provides insurance to lenders, not to consumers**

Genworth offers Lenders Mortgage Insurance (**LMI**). This is insurance provided *to lenders* (i.e. banks and other non-bank lenders), to insure them against the risk that their customers (the consumers) default on their home loans secured by a mortgage.² The diagrams below demonstrate the nature of the relationships.

Fig 1: relationship between Genworth and lenders



Fig 2: relationship between lenders and their customers



So, to the extent that the Royal Commission is looking to enquire into the way in which general insurance products (e.g. home insurance, car insurance, funeral insurance etc.) are sold to consumers, or how insurers deal with insurance claims by consumers on policies held by them, that is not a feature of Genworth's business or product offering. Genworth's only interaction with the lender's customer is in the context of enforcing a mortgage in respect of which the lender has made a claim on the LMI policy. We discuss this in section (d) below.

b) **Genworth is authorised as a mono-line insurer**

Under Genworth's authorisation from APRA as an insurer, Genworth is *only authorised to offer LMI*. In other words, it is not authorised to offer a range of insurance products to the Australian market.

c) **LMI as a risk management tool for lenders**

² Genworth also provides reinsurance to other insurance providers.

LMI helps lenders manage the risk associated with residential mortgage lending. As an insurance policy issued for the benefit of the lender, a LMI policy protects the lender against the risk of loss on default by the customer. LMI is typically taken out by a lender to cover 100% of the risk of loss on high loan to value ratio (LVR) loans – that is, generally loans where the borrower's deposit is less than 20% of the value of the property being purchased. Even though the number of actual customer defaults may be relatively low, Genworth is on risk for 100% of the loss. Our LMI policies therefore assist lenders to manage the risk of significant losses, including from catastrophic events or scenarios.

Note that Genworth does not provide LMI to lenders for commercial lending activity. For example, Genworth does not insure small business loans or agriculture/farm financings. Its business is limited solely to insuring lenders in respect of residential mortgages.

d) LMI supports competition in financial sector

Genworth supports over 100 lenders across Australia, facilitating competition in the market for home lending, including through the support provided to smaller and regional based lenders. The role of LMI in this market segment is one of a number of matters which has been considered by the Productivity Commission, which released its draft report in January 2018 entitled *Competition in the Australian Financial System*.

e) Limited situations where we do engage with the consumer (home owner)

There is one activity which Genworth undertakes which does see it interact directly with consumers. That is where the consumer (home owner) defaults on its home loan and the lender makes a claim on its LMI policy with Genworth. In that situation, if Genworth accepts the claim on the LMI policy, Genworth takes an assignment of the mortgage from the lender. This usually occurs following a sale of the secured property by the lender as mortgagee in possession. The balance of the mortgage assigned to Genworth is usually only for the "shortfall" amount (if any) after applying proceeds from the sale of the secured property. Following assignment of the mortgage to Genworth, Genworth may take action to recover the shortfall amount from the borrower.

To put this in context, lenders insured by Genworth's LMI policies made claims in respect of around 7,340 mortgages which were underwritten between 2008 and 2018. In approximately 1,760 cases did Genworth recover a shortfall from the homeowner/consumer.

Genworth holds an Australian credit licence (No. 393269) which authorises it to take an assignment of a mortgage following a claim on an LMI policy and to take action to recover the shortfall amount.

2. Specific responses to questions on which submissions were invited

2.1 Question 1 – misconduct

Genworth maintains high standards of conduct and governance. We treat our compliance obligations as an insurer and credit licensee seriously and we have what we consider to be a sound compliance record. Genworth has not been subject to any enforcement action by either APRA or ASIC in respect of its activities between 1 January 2008 and now (the **Relevant Period**).

There is one matter which arose in the Relevant Period, to which we draw the Royal Commission's attention. The Credit and Investments Ombudsman (CIO) is currently making enquiries in relation to complaints which it received from 2 borrowers, where Genworth inadvertently disclosed their personal information to a third party debt collector. This occurred in circumstances where we should not have disclosed the information, because the relevant borrower had already discharged their obligations under their mortgage. We have identified 3 other instances where this occurred. In other words, personal information in relation to a total of 5 borrowers was disclosed. We have taken steps to address this and ensure this does not occur in the future. We are continuing to engage with the CIO in response to their questions to us. As far as we are aware, no borrower has suffered loss or harm as a result.

2.2 Question 2 – conduct/practice/behaviour/activity which falls below community standards and expectations

As discussed above, Genworth's customer base comprises bank and non-banks which offer home loans. We liaise with them regularly to understand their expectations. However, as we do not offer insurance to the consumer public, there is a question as to what the community at large may expect of Genworth in terms of standards. In the context of our business, we anticipate that the broader community may expect the following:

- a) The community may expect that the level of Genworth's insurance premiums charged to the lenders would be based on sound and prudent risk and underwriting principles having regard to the prudential standards to which it is subject. This expectation could arise given that the cost is ordinarily passed on to the borrower at the outset of the loan.
- b) The community may expect that Genworth would act responsibly and fairly in any action it may take to recover a shortfall owing on a mortgage, following a claim by the lender on the LMI policy and assignment of the mortgage to Genworth.

We have not identified any conduct, practice, behaviour or business activity which we consider falls short of these expectations.

In relation to expectation (a) concerning premium levels, Genworth considers that the insurance premiums it charges to its customers (the lenders) are based on sound and prudent risk and underwriting principles. Pricing decisions involve a consideration of a range of factors including the policy terms, financial and economic risk parameters, actuarial considerations, APRA's prudential capital

requirements and other regulatory requirements, as well as a need to generate an acceptable commercial return having regard to anticipated expenses and losses. Genworth reviews its insurance premiums regularly having regard to these factors.

In relation to expectation (b) concerning the recovery of a shortfall amount following a claim on the LMI policy and assignment of the mortgage to Genworth, we consider our approach is consistently responsible and fair and also consistent with our obligations as the holder of an Australian credit licence and the standards and expectations of a holder of such a licence.

From time to time Genworth receives complaints from consumers. The majority of the complaints arise from a lack of understanding of the LMI product by the borrower. We describe the nature of those complaints below to provide context:

- (a) Borrowers sometimes think that the LMI product provides some form of insurance to them and contact us to claim on "their insurance". We explain to the borrower that the LMI policy insures the lender, not the borrower. Around 30% of our complaints are of this nature.
- (b) Some complaints relate to the way in which *the lender* (i.e. not Genworth) has enforced their rights under the mortgage (for example, that they have not achieved a sale price in line with the consumer's expectations, or that the sale process did not meet their expectations), or the time elapsed between the sale process and Genworth's recovery activity. Around 40% of our complaints are of this nature.
- (c) Some complaints relate to the borrower's name being entered (appropriately by Genworth) as a default on their credit history file, which may have led to them being declined credit by another lender at a later time. Around 30% of our complaints are of this nature.

Importantly, in relation to the complaints of the kind described in (a) and (b) above, these commonly arise because of a lack of understanding by the borrower of the way in which the lender's LMI policy works. We have been active and vocal proponents of measures by which lenders may provide greater transparency to their customers. For example, we have supported the development of an "LMI fact sheet" which lenders would give to their customers to explain the role that LMI plays in the home loan process (and this would of itself help reduce the complaints in these two categories). We are pleased that this was taken up in the Khoury Report³, which recommended that the Code of Banking Practice should require the LMI fact sheet be given to all consumers. We also understand this recommendation is to be adopted by the Australian Bankers Association. In

³ Phil Khoury, *Independent Review of the Code of Banking Practice* (31 January 2017), Recommendation 68: <http://cobpreview.crkhoury.com.au/wp-content/uploads/sites/2/2017/02/Report-of-the-Independent-Review-of-the-Code-of-Banking-Practice-2017.pdf>. We note that the Insurance Council has made available on its website a factsheet on LMI. This is also available on the ASIC website and was provided to the Australian Bankers' Association for use by its members.

addition, we have published on the Genworth website a simple guide on LMI, which helps explain to consumers the role LMI plays.⁴

We are also conscious that the home lending market is a dynamic market, and our LMI product will inevitably evolve to meet market requirements and expectations. Recently, in January 2018, the Productivity Commission issued its draft report entitled *Competition in the Australian Financial System* in which it made a number of recommendations to improve competition in the home lending market segment. The draft report includes recommendations relating to LMI, with a particular focus on providing for lenders to offer borrowers a refund of a portion of the cost of LMI in circumstances where the borrower refinances.⁵ Genworth is an active contributor to policy development and welcomes opportunities to support competition in the home lending segment of the market.

2.3 **Question 3 – attribution to relevant factors**

Given our responses to Question 1 and 2, we make no submission in response to Question 3.

2.4 **Question 4 – RSE licensees**

Genworth is not an RSE licensee and has no relevant connection with any RSE. Accordingly, we make no submission in response to Question 4.

3. **Concluding comments**

Genworth is grateful for the opportunity to make early submissions to the Commission. We are committed to the highest standards of conduct and endorse the broader goals of the Commission – to ensure the continued robustness of Australia's financial system within strong regulatory and supervisory frameworks.

Yours sincerely



Georgette Nicholas
CEO and Managing Director
Genworth Mortgage Insurance Australia Limited

⁴ See <https://www.genworth.com.au/pdf/facts-about-lmi-falmi0416-v4-0.pdf>

⁵ Productivity Commission Draft Report entitled *Competition in the Australian Financial System*; in particular, chapter 8.