

Mr David Murray AO
Chair
Australian Financial System Inquiry
Via email: fsi@fsi.gov.au

Dear Mr Murray AO

The Australian Retail Credit Association (ARCA) welcomes this opportunity to provide a submission to the Australian Financial System Inquiry.

ARCA's submission outlines the importance of a well-functioning credit reporting system to the overall efficiency and effectiveness of the consumer credit system – itself a vital component of the overall financial system in Australia.

For any additional information, or to discuss this submission further, please contact Matt Gijselman, ARCA Head of Government, Regulatory & Industry Affairs on 02 9236 2426 or email mgijselman@arca.asn.au.

Thank you for the opportunity to provide this submission, and I wish the FSI Panel all the best in your deliberations.

Yours sincerely



DAMIAN PAULL
Chief Executive Officer

3 April 2014

Australian Retail Credit Association submission to the Australian Financial System Inquiry

April 2014

Introduction

The Australian Retail Credit Association (ARCA) is the peak industry body dealing with credit reporting and representing all major credit providers and major consumer credit reporting bodies in Australia.

Our Members are:

- American Express,
- Australia and New Zealand Banking Group Limited (ANZ),
- Bank of Queensland,
- Bendigo & Adelaide Bank,
- Capital Finance,
- Citibank,
- Commonwealth Bank,
- Customer Owned Banking Association (COBA),
- Dun and Bradstreet,
- Experian,
- GE Capital,
- HSBC,
- ING Direct,
- Macquarie Leasing,
- ME Bank,
- National Australia Bank,
- Suncorp,
- Toyota Finance Australia,
- Veda Group, and
- Westpac Group.

Since 2006, ARCA and our Members have advocated for reforms to credit reporting in Australia. The commencement of these reforms on 12 March 2014 has signalled the beginning of a system of comprehensive credit reporting in Australia.

The Australian Financial System Inquiry (FSI) provides an opportunity to consider and review the role of credit reporting within Australia's financial system, and, in doing so, to continue to strengthen our credit reporting system.

1: Credit reporting is a vital economic activity

1. The FSI's second term of reference includes a review of, and potentially opportunity to refresh, the philosophy, principles and objectives underpinning the development of a well-functioning financial system.
2. This aspect of the FSI requires a determination of what constitutes a well-functioning financial system and, particularly, what components are required from a competition, regulation and consumer protection perspective to create such a system.
3. ARCA's view is that a properly regulated comprehensive credit reporting system is an essential component of a well-functioning financial system.
4. Retail credit forms a significant part of the Australian economy. As at 31 January 2014, the total retail credit in Australia was worth approximately A\$1.48 trillion¹. Credit reporting has a significant impact on retail credit.
5. That is, the presence of a properly-regulated comprehensive credit reporting system results in:
 - Financial risk in retail credit being identified accurately and early;
 - Improved economic performance of retail credit lenders as credit is repaid, and an overall drop in debt collection or write offs;
 - Barriers to financial exclusion being eroded, with minority demographic sectors, who may have once been excluded from credit, being included;
 - Consumer benefit through the avoidance of over indebtedness; and
 - A boost to productivity and stimulation of the economy.
6. The recent reforms to Australia's system of credit reporting and the introduction of comprehensive credit reporting highlight the importance of credit reporting as an economic activity. In initial consideration of these reforms and their impact on retail credit, ACIL Tasman research conducted in 2004 estimated the economic value to Australia of introducing comprehensive reporting to be A\$5.3 billion over 10 years.²
7. The commencement of the reforms mean Australia's credit reporting system is now in line with the vast majority of Organisation for Economic Co-operation and Development (OECD) countries who have introduced comprehensive credit reporting – including Canada, Germany, Hong Kong, Japan, New Zealand, Singapore, the United Kingdom and the United States.

¹ Reserve Bank of Australia, Statistical Table D2 Lending and Credit Aggregates, 31 January 2014

² ACIL Tasman, 2004 "Dealing with Debt Default"

8. The reforms came about as a result of a number of recommendations made by the Australian Law Reform Commission (ALRC) in its 2008 examination of privacy in Australia – Report 108, *"For your information: Australian privacy law and practice"*. This report was the result of an inquiry commissioned by the former Commonwealth Attorney General, the Hon Phillip Ruddock MP, in 2006.
9. In considering the adoption of comprehensive credit reporting in Australia, the ALRC highlighted that such a reform would benefit Australia's economy, as follows:

"The ALRC recognises that, according to widely accepted economic theory, making more information available to credit providers will tend to increase efficiency in the market for credit. It also will assist in making credit more available to those able to repay and reduce rates of default (or both). There was no significant disagreement among stakeholders that more comprehensive credit reporting has the potential to improve risk assessment by credit providers, even among those who expressed concerns about how this improved risk assessment would be used in the credit market."³
10. There is a clear link between credit reporting and responsible lending. This was acknowledged by the ALRC in Report 108, which recommended that "repayment performance history only should be permitted to be contained in credit reporting information if the Australian Government is satisfied that there is an adequate framework imposing responsible lending obligations in Commonwealth, state and territory legislation"⁴. As a result, the amendments to the *Privacy Act 1988* were only implemented following the enactment of the *National Consumer Credit Protection Act 2009*, and legislated responsible lending obligations.
11. Despite the recognition of this link, the regulation of responsible lending is quite separate from credit reporting regulation. Whereas responsible lending regulation is undertaken by the national credit regulator – the Australian Securities and Investments Commission – regulation of credit reporting is currently undertaken by the national privacy regulator, the Office of the Australian Information Commissioner. We believe that credit reporting is as much an economic issue as a privacy issue, as recognised by the ALRC in their Report 108, and hence further development of the regulatory frameworks to recognise this may be required.
12. The ALRC's views on the benefits of comprehensive credit reporting are reflected internationally in reports which have considered, more broadly, the role that credit reporting plays in the economy. Each of these reports have emphasised that credit reporting, when properly developed and regulated, is essential for economic stability and growth.
13. In September 2011, the World Bank together with the Bank of International Settlements (BIS) published the "General Principles of Credit Reporting" which was the product of its Credit Reporting Standards

³ ALRC Report 108, "For your information: Australian Privacy law and practice", paragraph 55.143

⁴ ALRC Report 108, "For your information: Australian Privacy law and practice", paragraph 55.177

Setting Task Force. In undertaking this work, the World Bank and BIS highlighted the importance of credit reporting, as follows:

“Well functioning financial markets contribute to sustainable growth and economic development, because they typically provide an efficient mechanism for evaluating risk and return to investment, and then managing and allocating risk. Financial infrastructure (FI) is a core part of all financial systems. The quality of financial infrastructure determines the efficiency of intermediation, the ability of lenders to evaluate risk and of consumers to obtain credit, insurance and other financial products at competitive terms. **Credit reporting is a vital part of a country’s financial infrastructure and is an activity of public interest.**”⁵
(Emphasis added)

14. In the United States, researchers at the Political & Economic Research Council (PERC) have published a number of reports which analyse and identify the connection between credit reporting and its impact more broadly on an economy.
15. In their March 2009 report “New to Credit from Alternative Data”, PERC identified that generally credit reporting can be used as a tool to increase credit access and stimulate growth⁶.
16. PERC developed this reasoning in its April 2010 report “Financial Inclusion through Credit Reporting”. In this report, PERC argued that the use of credit reporting means that lending is expanded, both in who is eligible for credit and who will repay that credit. There were three macro impacts that thereafter resulted from credit reporting:
 - (a) Economic growth and stability;
 - (b) Price of credit (lower average interest rates); and
 - (c) Income distribution⁷.
17. In considering these macro impacts, PERC’s ultimate proposition is that collectively this is indicative of the key role played by credit reporting, as follows:

“Credit information sharing systems are key elements of modern financial sectors infrastructure. As with other kinds of infrastructure, its scope determines in large measure the extent to which different social segments in an economy can participate within the financial system.”⁸
18. It should be noted that, beyond the scope of the US market, the critical role of credit reporting is founded in fundamental economic theory.
19. The seminal paper in this area is a 1970 publication by Nobel Prize winner and economist, George Akerlof, “The Market for “Lemons”: Quality

⁵ World Bank, “General Principles for Credit Reporting”, September 2011, page 1

⁶ Michael Turner, Patrick Walker & Katrina Dusek, “New to Credit from Alternative Data”, PERC, March 2009

⁷ Michael Turner, Robin Varghese & Patrick Walker, “Financial Inclusion Through Credit Reporting”, PERC, April 2010

⁸ *Ibid*, page 7

Uncertainty and the Market Mechanism”⁹. Akerlof examined the economic impact of ‘asymmetric information’, that is, when either party to a transaction has insufficient information to be able to make an informed decision to enter into the transaction. This is also described as ‘adverse selection’.

20. Akerlof surmised that the effect of adverse selection is a source of market failure, so any market with adverse selection does not operate efficiently. Inefficient markets have social consequences, for example if you buy a car that is a lemon you become less trustworthy of the dealer. You can take the dealer to a court or tribunal to get recompense, but you then incur an expense in resolving the dispute. This expense would not have been incurred if the original decision to purchase had not been made. Analogously, creditors that lend on poor information may have to incur additional costs in enforcing their security interests. This places additional costs on the purchase and creates inefficiency in the market, which can be reduced if correct decisions are made by parties involved at the outset.
21. Recent research about the impact of financial exclusion indicates that these inefficiencies theorised by Akerlof are present in the Australian context. In turn therefore, credit reporting can be viewed as a vital economic activity which can be used to tackle the issue of financial exclusion.
22. This research, an ongoing study commissioned by the National Australia Bank, has demonstrated that in 2012, 17.7% of the adult population (or 3,123,519 people) in Australia were fully excluded or severely excluded from financial services. Financial exclusion is defined as existing where:

“... [i]ndividuals lack access to appropriate and affordable financial services and products – the key services and products are a transaction account, general insurance and a moderate amount of credit”¹⁰.

In this study, access to a moderate amount of credit, being just a credit card, was used as tool to measure access to credit.

Table 1: extent of financial exclusion in Australia 2007 - 2012¹¹

Degree of Exclusion	2007	2008	2009	2010	2011	2012
Included	45.7%	46.6%	44.6%	43.4%	40.8%	39.7
Marginally excluded	38.4%	38.7%	40.0%	41.0%	42.0%	42.6
Severely excluded	14.5%	13.8%	14.6%	14.8%	16.1%	16.6
Fully excluded	1.5%	0.9%	0.7%	0.8%	1.1%	1.1

⁹ *The Quarterly Journal of Economics*, Volume 84, Issue 3 (Aug 1970), 488 - 500

¹⁰ Connolly C, “Measuring Financial Exclusion in Australia”, Centre for Social Impact (CSI) – University of New South Wales, 2013, for NAB, page 6

¹¹ *Ibid.*, page 12.

23. Financial exclusion has both an economic and social impact, as explained by the study:

“Credit is a major financial tool to enable access to goods or services that are beyond the monthly budget such as vehicles and furniture. It can also play a significant role in smoothing consumption and protecting against income shocks and financial stress. Individuals unable to access credit from mainstream financial institutions are often forced to use the informal financial sector or fringe market, such as payday lenders.¹²”

24. Financial exclusion is also discriminatory, in that it tends to predominantly impact young people aged 18 to 24, students not in employment, people born in non-English speaking countries, and people earning between \$20,000 and \$25,000. Particularly in respect to young people who face financial exclusion, this study noted that the “lack of access to mainstream products makes this group vulnerable to predatory lending products and to the loss of uninsured assets.¹³”

Recommended approach

25. ARCA’s recommends that the FSI, in its review and consideration of what underpins the development of a well-functioning financial system, highlight and acknowledge the role of credit reporting.

2: Trans-Tasman sharing of credit reporting data should be enabled

26. The FSI’s fourth term of reference is the recommendation of policy options that *inter alia* promote competition and a stable financial system that contributes to Australia’s productivity growth and meets the needs of users with appropriate financial products and services.
27. ARCA considers that in order to achieve this goal, the sharing of credit reporting information between Australia and New Zealand should be enabled.
28. At present, Australia is New Zealand’s largest trading partner, occupying 21% of their total export trade. Australia is also New Zealand’s second largest source of imports at 15.3% of all their imports¹⁴.
29. In the context of the exchange of consumer credit data between Australia and New Zealand, there is a significant flow of people between Australia and New Zealand. At 30 June 2013, an estimated 640 770 New Zealand citizens were present in Australia¹⁵.

¹² *Ibid*, page 9

¹³ *Ibid*, page 7

¹⁴ <https://www.dfat.gov.au/geo/fs/nz.pdf>

¹⁵ Fact Sheet 17 – New Zealanders in Australia (produced by the National Communications Branch, Department of Immigration and Border Protection, Canberra, last reviewed December 2013)

30. In its December 2012 report, the Productivity Commission highlighted the problems that New Zealanders face when residing in Australia. New Zealanders can come to Australia without a visa application process, but are not automatically eligible to claim Australian citizenship in that they face the same restrictions as other immigrants. This results in a “large, unskilled workforce with heavily restricted rights, and which costs the federal and state governments very little”¹⁶.
31. As noted in the Explanatory Memorandum to the Privacy Amendment (Enhancing Privacy Protection) Act 2012, there are significant restrictions on the transference of credit reporting data beyond Australia:
- “The credit reporting system is restricted to information about consumer credit in Australia and access to the credit reporting system is only available to credit providers in Australia. The credit reporting system will not contain foreign credit information or information from foreign credit providers (even if they have provided credit to an individual who is in Australia), nor will information from the credit reporting system be available to foreign credit reporting bodies or foreign credit providers.”¹⁷
32. These restrictions mean that, for a New Zealand citizen residing in Australia, there is no way for that citizen to allow an Australian credit provider to search for their New Zealand credit report and corresponding credit history. Many Australian banks have a presence in New Zealand, however, the restrictions on exchange of data apply even in this instance.
33. The expansion of credit reporting information to allow for trans-Tasman data flow is strongly supported by industry. In the Senate Legal and Constitutional Affairs Legislation Committee Inquiry into the *Privacy Amendment (Enhancing Privacy Protection) Bill 2012*, Mr Steve Brown, Director, Consumer Risk Solutions at Dun and Bradstreet, stated:
- “We believe that it is desirable to allow credit providers on both sides of the Tasman the opportunity to receive credit files where a migrant from either country applies for credit. This would effectively fast-track their ability to establish lines of credit in their new home.”¹⁸
34. Further, we note the views expressed by the then government in the Explanatory Memorandum to the Privacy Amendment (Enhancing Privacy Protection) Bill 2012.
- “Consideration will be given to the sharing of credit reporting information with New Zealand, which has a very similar credit reporting system and close economic ties with Australia. When this occurs, it will be necessary to develop specific legislative provisions to amend the credit reporting system set out in Part

¹⁶ Robert Burton-Bradley, “New Zealanders, Australia’s ‘Underclass’”, New Matilda, 14 March 2013

¹⁷ Privacy Amendment (Enhancing Privacy Protection) Bill 2012, Explanatory Memorandum, Page 92

¹⁸ Official Committee Hansard, Senate, Legal and Constitutional Affairs Legislation Committee, Privacy Amendment (Enhancing Privacy Protection) Bill 2012, Friday 10 August 2012, Page 22

IIIA to establish the arrangements by which credit reporting information will be shared with New Zealand.”¹⁹

35. Such an approach to data flow is not without precedent: cross-border data flows presently exist in Europe²⁰.

Figure 1: Formal cross-border data exchange agreements in Europe²¹



36. Given the proposed data flow is between two countries only, ARCA considers that such restrictive legislation in Australia and New Zealand should not hinder these data flows. This is particularly so given the economic benefits that will be derived from enabling this exchange of information. With such a large number of New Zealanders potentially participating in the Australian credit market, enabling the collection of

¹⁹ Privacy Amendment (Enhancing Privacy Protection) Bill 2012, Explanatory Memorandum, Page 92

²⁰ See: Report of the Expert Group on Credit Histories, DG Internal Market & Services, May 2009

²¹ Marc Rothmund and Maria Gerhardt “The European Credit Information Landscape: An Analysis of a survey of credit bureaus”, Discussion Paper, European Credit Research Institute, 2011

their New Zealand credit histories would increase this rate of participation and the efficiency of the consumer credit market.

Recommended approach

37. ARCA recommends that trans-Tasman sharing of credit reporting data be enabled to facilitate better access to credit in both markets for migrants.

3: Repayment history information should be available to non-ASIC licenced credit providers

38. The FSI's second term of reference includes a consideration of the principles underpinning the development of a well-functioning financial system, including the need to balance competition, innovation, efficiency, stability and consumer protection, and also the effectiveness and need for financial regulation. The FSI's fourth term of reference relates to recommending policy options which promote a competitive and stable financial system that contributes to Australia's productivity growth, and meets the needs of users with appropriate financial products and services.
39. ARCA's further submissions focus on how the existing credit reporting system ought to be further developed. These further developments will enhance the efficiency of Australia's financial system, and as a result, boost Australia's productivity. It is ARCA's view that these developments will increase competition within the retail credit sector while maintaining a high standard of consumer protection.
40. The first development to the credit reporting system is the ability for Repayment History Information (RHI) to be accessed and contributed by non-ASIC licenced credit providers, predominantly telecommunications and utilities providers.
41. As highlighted under submission 1 above, financial exclusion in Australia has been identified as a significant problem. ARCA believes that broadening the categories of credit providers who can access and contribute RHI will be one means of tackling the problem of financial exclusion.
42. For most Australians, their first experience of consumer credit is frequently through a telecommunications (mobile, landline, internet) or utilities (electricity, gas, water) account.
43. Allowing their repayment behaviour for these products and or services to be contributed to the credit reporting system would go some way towards allowing those individuals to showcase their repayment behaviour to credit providers and gain access to responsible credit.
44. For those Australians who are presently excluded from mainstream credit because they do not have a 'credit history', allowing access to their currently unreported consumer credit accounts may be able to provide information about their credit worthiness to other credit providers.

45. The telecommunications industry has previously acknowledged its support for this expansion of comprehensive credit reporting. During the hearings of the Senate Legal and Constitutional Affairs Legislation Committee inquiry into the then *Privacy Amendment (Enhancing Privacy Protection) Bill 2012*, Mr John Stanton, Chief Executive Officer of Communications Alliance stated the following:

“With regard to the fifth dataset, concerning repayment history information, we are proposing that telecommunications providers have the ability to opt into that regime without being licensed. This way they would be able to provide a lead indicator to other financial service providers and it would also give the telcos a better understanding of a customer’s capacity to pay before finalising the sale of products and services to them. We recommend Australia follows the New Zealand approach to repayment history information.”²²

46. This recommendation was also supported by industry, with Steve Brown, Director, Consumer Risk Solutions, at Dun and Bradstreet, stating the following during the Senate inquiry hearing:

“We believe that credit providers other than those covered by the NCCP legislation should have the ability to contribute and receive comprehensive credit-reporting information. The overwhelming evidence from data studies around the globe demonstrates that, where telecommunications and utility payment information is available to lenders, it improves the ability of minority groups and the credit-underserved to get access to mainstream credit. This occurs by allowing individuals who may not yet have a financial service account to demonstrate creditworthiness through the conduct of their monthly account payments. This track record, once established, may be sufficient to give a bank confidence to provide a loan that would otherwise not be available, forcing many individuals to turn to more exploitative credit providers.”²³

47. These views were also reflected in ARCA’S submission to the Senate inquiry. In this submission, ARCA noted that more information makes it easier to understand an individual’s credit commitments and enhances responsible lending outcomes. ARCA further submitted that evidence from other markets is that more informed credit decisions have driven positive economic activity²⁴.
48. This submission remains consistent with ARCA’s views, research and experience. In particular, ARCA relies on extensive research undertaken by the Political & Economic Research Council (PERC), of the American, Australian and New Zealand markets. PERC’s research is also supported by the work undertaken by the World Bank and BIS through the Credit Reporting Standards Setting Task Force. The findings of this task force are that effective participation in the credit reporting system can drive benefits for consumers and withholding data from the system could

²² Official Committee Hansard, Senate, Legal and Constitutional Affairs Legislation Committee, Privacy Amendment (Enhancing Privacy Protection) Bill 2012, Friday 10 August 2012, page 16

²³ *Ibid*, page 22

²⁴ ARCA, Submission on the Privacy Amendment (Enhancing Privacy Protection) Bill 2012, July 2012

potentially lead to organisations not subject to reciprocity arrangements to contribute incomplete and inaccurate information²⁵.

49. In general terms, PERC's research has demonstrated that full-file comprehensive credit reporting increases lending to the private sector more than other reporting regimes, and is better for loan performance. This is because the use of more information tackles one of the key problems inherent in lending: imprecise knowledge of a borrower's likelihood of repaying. In turn, there can be greater lending because of the lower rates of delinquency and default²⁶.
50. In fact, PERC have emphasised the utility of so-called non-financial information (credit reporting information contributed by non-ASIC licensed credit providers, in the Australian context) for improving financial inclusion, as follows:

"Expansion of the scope of credit information sharing to non-financial payment obligation histories has been shown to be perhaps the most effective avenue to financial inclusion in terms of access to short and long term credit"²⁷.

51. PERC's views are based on simulations conducted involving utility and telecommunications repayment data. Their findings consistently showed that more information in the system results in better credit decisions, as follows:

"The results of these simulations consistently indicate a sizable reduction in the ability of lending systems to identify the good risks from bad risks with shifts from a comprehensive full-file data to negatively only or segmented data. Barron and Staten, using US data, compared the findings of a simulated negative-only reporting system with a full-file, comprehensive system and found that for a three percent default target of three percent, a negative-only reporting system accepts 39.8% of the applicant pool, whereas a full-file system would accept 74.8% of the pool."²⁸

52. Importantly, PERC has also considered whether the inclusion of those consumers traditionally excluded from credit has resulted in greater rates of default amongst these consumers – presumably on the basis that the reason for their exclusion was that they ought never have been provided credit in any case. PERC has found that the use of new data does not lead to above average levels of over-extension in the new-to-credit population. Instead, PERC found that inclusion of alternative data is most likely to help minority and low income consumers obtain access to affordable mainstream credit²⁹.

²⁵ World Bank, "General Principles for Credit Reporting", September 2011

²⁶ Michael Turner, Robin Varghese & Patrick Walker, "Financial Inclusion Through Credit Reporting", PERC, April 2010

²⁷ *Ibid*, page 10

²⁸ *Ibid*, page 10

²⁹ Michael Turner, Patrick Walker & Katrina Dusek, "New to Credit from Alternative Data", PERC, March 2009

53. PERC found no evidence that those new to credit who gain access to credit because of alternative data would experience increased financial difficulty over time. In this regard, PERC have stated:

“... [w]e find no evidence that gaining access to mainstream credit via alternative data on average harms consumers. On the contrary, the access itself combined with score changes over time suggest that, on average, consumers benefit.”³⁰

54. In this regard, PERC’s research has highlighted how financial exclusion is more prevalent in certain minority groups including young adults with no credit history, immigrants with little credit history, the elderly, divorcees or widows, ethnic minorities, and low income earners. PERC has noted that these consumers all tend to pay utility and telecommunications bills but where this repayment information is not included in the credit reporting system, the only information that is reported about these products would be if a default event occurred. “Given insufficient data, the default assumption of lenders is that no [repayment information] equals high risk. Such applicants are almost always rejected.”³¹
55. PERC’s research also demonstrates that the benefit for these types of accounts (utility and telecommunication data) is that customers are more likely to pay when they know their credit file is impacted by their financial habits. A PERC study demonstrates that 50% of consumers are “much more likely” or “somewhat more likely” to prioritise payment of utility or telecommunication bills if they knew the information was to be reported to credit reporting bodies³².
56. In 2012, PERC collaborated with Dun & Bradstreet to consider the impact of more comprehensive reporting in Australia and New Zealand³³. The research looked at what percentage of applicants would be considered risky borrowers when utilising positive information compared to the traditional ‘negative’ credit reporting system. The data used is from Australian credit providers (and a telecommunication company) utilising data from 2008 and 2009 across a sample size of 1.8 million Australians.
57. The results of this study suggest an increase of credit acceptance by 20%, against a target default rate of 3%, where telecommunications account data was reported.
58. The report also found that the Australian market performed in much the same way as the United States market, in terms of the impact of non-financial data on the credit system. However, given the more recent introduction of repayment history information into the Australian market, it was considered that the introduction of telecommunications account

³⁰ *Ibid*, page 19

³¹ Michael Turner, Patrick Walker & Katrina Dusek, “New to Credit from Alternative Data”, PERC, March 2009, page 6

³² Michael Turner, Patrick Walker & Katrina Dusek, “New to Credit from Alternative Data”, PERC, March 2009

³³ Michael Turner, Patrick Walker, Sukanya Chaudhuri, Joseph Duncan, Robin Varghese, “Credit Impacts of More Comprehensive Credit Reporting in Australia and New Zealand”, PERC, 2012

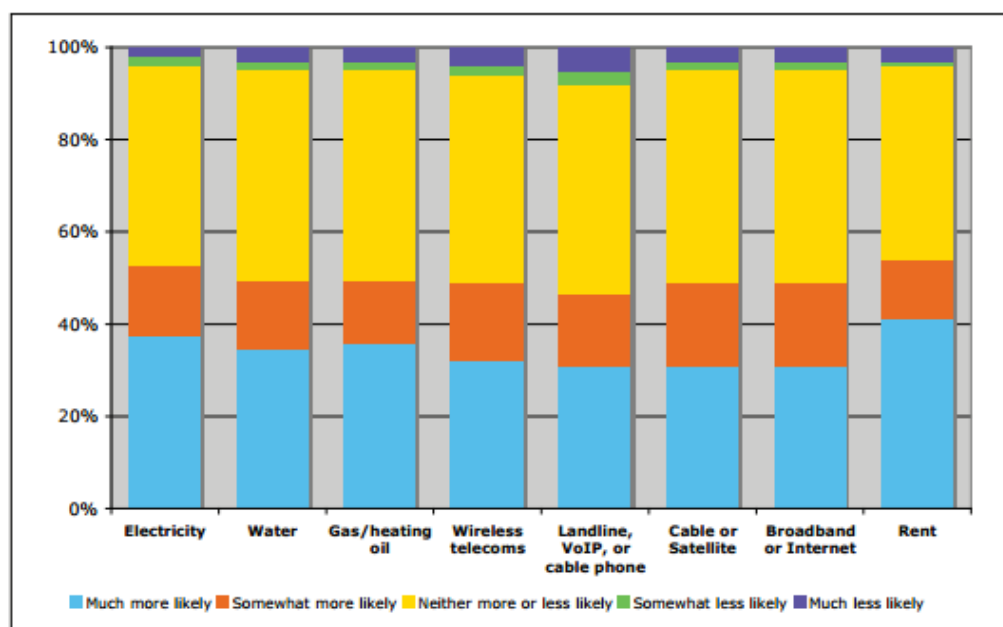
repayment history would likely have an even greater impact on credit decisions than it would in the United States³⁴.

59. PERC concluded that there was a very strong case for introducing telecommunications account repayment data into the credit reporting system:

*"... [b]eyond the increase in model performance and the increase in acceptance among records scoreable with and without the telecommunications data, a good number of consumers would be able to begin building the fair file credit record as telecommunications data is reported. This will become more and more important as Australia shifts to more comprehensive reporting. Since having no information on file is viewed much less favourably in a more comprehensive credit sharing environment than in a negative only environment, in which a lack of information can be viewed as a lack of derogatory information. So the reporting of non-financial account data (such as from telecommunication and utility accounts) will become ever more important in Australia and New Zealand."*³⁵

60. PERC identified that the benefits flowing from the expansion of comprehensive credit reporting apply to both credit providers and consumers. For those non-financial credit providers, there is an increased prioritisation of payment obligations when payment behaviour is reported. For customers, on-time payments are rewarded and identified, as opposed to only default events being identified³⁶.

Figure 2: Repayment likelihood if reporting repayment history³⁷



³⁴ *Ibid*, page 20

³⁵ *Ibid*

³⁶ *Ibid*, page 15

³⁷ *Ibid*, page 47

61. In the United States, PERC has conducted two further studies of non-financial companies to ascertain the impact reporting repayment information had on these organisations. The analysis identified that in the case of the first company, NICOR Gas, the following could be observed after they began reporting account repayment information:
- A 20% decrease in net bad debt over 3 years;
 - A decrease in late payments and increase in timely payments, with few customer disputes; and
 - Minimal implementation costs and increased efficiency in daily operations³⁸.
62. The second company, DTE Energy, similarly experienced an improvement in outstanding accounts. However, DTE Energy also recorded a significant increase in new accounts, particularly those for customers with no prior credit history – with this increase attributed to the move to comprehensive credit reporting³⁹.
63. In light of this extensive research, it is clear that the introduction of comprehensive credit reporting in Australia to encompass non-ASIC licensed credit providers will have economic and consumer benefits.
64. Furthermore, the expansion of comprehensive credit reporting will bring Australia's credit reporting system in line with those countries that utilise repayment history information in credit reports. In particular, the following countries enable exchange of data by utilities and telecommunications companies:
- New Zealand, pursuant to rule 11(3)(c) of the *Credit Reporting Privacy Code 2004*.
 - United States, pursuant to section 604 of the *Fair Credit Reporting Act 1970*.
 - United Kingdom, pursuant to the *Consumer Credit Act 1974* and the *Data Protection Act 1988*.
 - Canada, pursuant to the *Personal Information Protection and Electronic Documents Act 2001*.
 - Japan, pursuant to the *Law Concerning Regulation for Loan Business 1983* and the *Instalment Sales Act 1980*.

Recommended approach

65. ARCA recommends that the role played by the reporting of repayment history within the credit reporting system should be recognised as an effective means of addressing financial exclusion, and further that reporting such information is expanded to allow non-financial credit providers to access and disclose payment history information.

³⁸ *Ibid*, page 33

³⁹ *Ibid*, page 36

4: Government debts should be included in the credit reporting system

66. ARCA believes that government debts should be included in the credit reporting system.
67. The issue is that the non-reporting of government debts provides skewed information about an individual's creditworthiness. Credit providers are reliant on the individual to self-disclose this debt. Where that does not occur, this hampers the ability of a credit provider to accurately gauge the risk associated with the advance of credit. This is particularly so given that government debts are often paid in priority and can often be deducted directly from wages, before they are transmitted to an individual.
68. For government agencies, the non-reporting of debts may mean that these debts become a lesser priority – as it may be perceived that there is no impact on a credit file or credit score, creating fewer consequences for non-payment.
69. This issue was raised in a recent *Australian Financial Review* article entitled "ATO wants to name debtors". In this article, the following growth in tax debt is identified:

"Tax debt jumped 6.5 per cent from \$16.6 billion in 2011-2012 to \$17.7 billion in 2012-13. The growth in debt has in part been because total tax collected has also been rising. The taxman collected \$311.7 billion in net tax in 2012-13, an increase of 3.6 per cent on 2011-12.⁴⁰"

70. The Australian Taxation Office has made recent statements about the use of credit reporting to tackle these tax debts. Mr Geoff Leeper, Second Commissioner for the Australian Taxation Office, when discussing the general trend to increase in collectable debt and how to tackle it, commented as follows:

"One of the things we think might be at play here is that, because the fact of a debt to the tax office cannot be disclosed to the markets because of the secrecy provisions, there are no credit reference consequences from being in debt to the tax office. You certainly would get failure to lodge or general interest charge consequences, but being in debt to us does not affect your credit rating. This is a matter for government to consider at some point. The only way around it that we can think of is to propose that the Commonwealth as an entity have the ability to advise a credit market, 'Geoff owes \$41,000', without disclosing the nature of that debt.

...

It is all covered by the secrecy provisions, so unless we can construct some other way of advising the credit markets – but, of course, all you are doing then is trying to elbow your way to the front of the queue, and the small business person is still trying to pay the bank, the material supplier and things. So it is not a simple issue. We did notice that collectable debt went up as a consequence of the global financial crisis, and certainly the Small Business Association – correctly, in my view – praised the tax office for taking a more accommodating stance on debt during that particular event. We are not collectively out of the woods yet, but you would expect that at some point on-time payment and on-time debt performance

⁴⁰ Australian Financial Review, "ATO wants to name debtors", 13 March 2014, p17

should now be improving. It is a combination of factors. But we do think one of the main things is that a debt to the tax office, whilst it sits on the books, does not actually have credit reference implications. That is a policy matter for governments to consider.⁴¹

Recommended approach

71. ARCA submits that the credit reporting system should be expanded to include government debts. The ATO has raised the prospect of the use of credit reporting as a debt collection tool – but moreover, industry needs it because:
- Undisclosed tax and child support debts can significantly impact on a consumer's ability to pay a loan.
 - Unless an individual self-discloses the debt, or provides account statements for the account from which the debt repayments are being deducted – it is quite possible the debt could not be detected when undertaking a credit assessment.

5: Utilisation data should be included in the credit reporting system

72. As ARCA has noted on our consumer education website, www.creditsmart.org.au, more information in the credit reporting system can lead to better lending decisions by credit providers. In addition to the data sets outlined above (related to government debt and repayment history information from non-ASIC licenced credit providers), there is other data held by credit providers that would illustrate debt management.
73. Primarily, this data, known as credit utilisation, relates to how frequently a credit product is being accessed, and the balance of the credit account as reported to a credit reporting body. In their 2007 report to Congress, the US Federal Reserve had this to say regarding the utilisation of account balance in the credit reporting system:

"When evaluating credit history, creditors also consider the type and amount of debt an individual has and the proportion of available credit in use (credit utilization). For revolving accounts, credit utilization is measured as the outstanding balance divided by the credit limit, which is the maximum amount the individual is authorized to borrow on the account. For mortgage and instalment accounts, credit utilization is generally measured as the unpaid proportion of the original loan amount. High rates of credit utilization may reflect a financial setback, such as a loss of income or an inability to manage debt, and thus are generally viewed as an additional risk in credit evaluations."⁴²

⁴¹ Standing Committee on Tax and Revenue, Australian Taxation Office annual report 2012-2013 – statements by Mr Geoff Leeper, Second Commissioner, People Systems and Services Group, Australian Taxation Office. 28 February 2014, pages 7 & 8 of 14

⁴² Board of Governors of the Federal Reserve System "Report to Congress on credit scoring and its effects on the availability and affordability of credit" (Report, Federal Reserve System, 2007) Page 25.

74. Giving access to an account balance gives lenders more information to assess the risk of a prospective loan. While repayment history information allows a lender to assess a potential borrower's reliability in meeting obligations, credit utilisation represents a borrower's ability to manage debt. Access to this information could be a useful component that enables better compliance with responsible lending requirements. This was expressed by MasterCard in its submission to ALRC Report 108 where it stated:

"Without allowing current balance information to be stored on an individual's credit report, lenders do not have a source to confirm whether the statement is an accurate reflection of the borrower's true position."⁴³

75. National Australia Bank's submission on the topic was:

"...the balance of credit account and/or associated limit utilisation would provide for an even more informed lending decision to ensure borrowers are not placed in situations where they cannot meet their obligations. This should be considered as a future enhancement."⁴⁴

76. Credit scores are calculated differently depending on the scoring system used, however both major credit scoring models in the USA (FICO and VantageScore) place great importance on credit utilisation data to generate a credit score. Under the FICO credit scoring system 30% of a potential borrower's credit score is based on credit utilisation data.⁴⁵ Under the VantageSecure scoring system the potential borrower's credit utilisation data is responsible for 23% of the generated credit score.⁴⁶
77. Australian lenders are unable to access this information in credit reports under the new legislative framework. However, with credit utilisation data having such a substantial impact on credit scores in other jurisdictions, ARCA believes that over time, such information should be introduced to the credit reporting system.

Recommended approach

78. ARCA recommends that utilisation data, particularly the current balance of each credit account, should be considered by the FSI as a key factor necessary to expand and develop Australia's credit reporting system.

⁴³ MasterCard Worldwide, *Submission PR 425*, 7 December 2007

⁴⁴ National Australia Bank, *Submission PR 408*, 7 December 2007

⁴⁵ Sandra Block, *Here's how you can shape your credit score*, (29 January 2008) USA Today
<http://usatoday30.usatoday.com/money/perfi/columnist/block/2008-01-28-credit-score_N.htm>

⁴⁶ LaToya Irby, *Understanding Credit Utilization*,
<<http://credit.about.com/od/creditreportscoring/a/creditutilization.htm>>