# Competition in the Australian Financial System

Productivity Commission Consultation

25th September 2017

## Background

Since 1967 we have been Australia's leading provider of consumer credit reporting information, starting as the Credit Reference Association of Australia and then over subsequent decades as Data Advantage, Baycorp Advantage, Veda Advantage, Veda and since March 2017, Equifax.

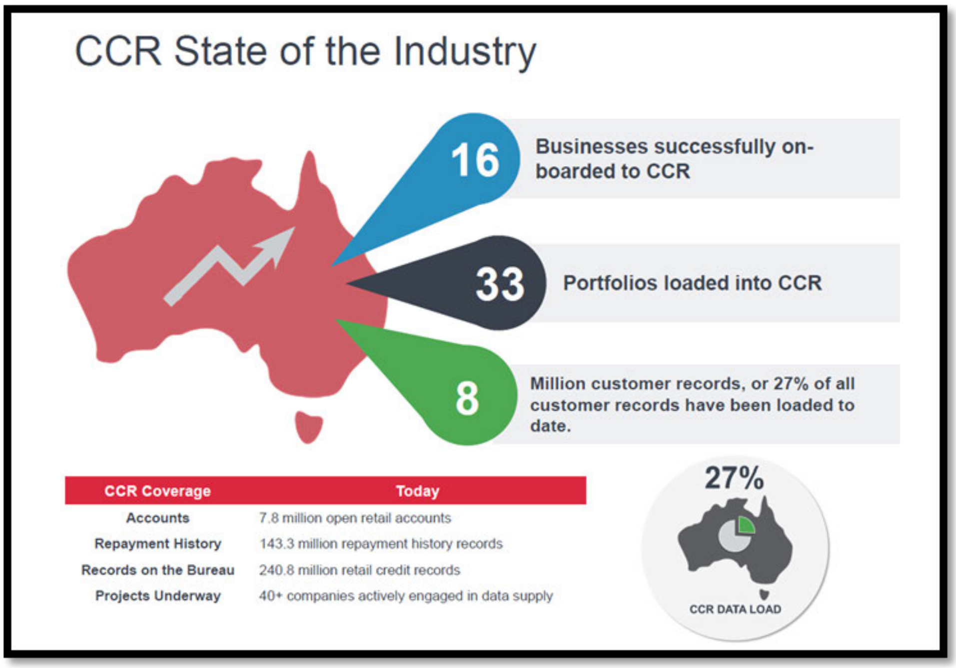
Our on-line solutions assist Australian businesses to meet their risk, fraud and identity challenges, embracing automated technologies that help simplify regulatory compliance for more than 6,500 customers, including the emerging digital currency and fintech sectors.

## Financial competitiveness - credit worthiness

Accurate assessment of credit worthiness is a particular challenge for new and smaller credit providers. The Global Financial Crisis concentrated the number of Australian credit providers, a trend now being challenged by the emergence of not just new lenders, but new lending platforms (peer-to-peer lending). As evidenced in the Productivity Commission's Data Inquiry, this sector remains vocal in their demand that large established lenders start supplying comprehensive credit reporting (CCR) information to credit reporting bodies. That inquiry's recommendation on CCR was embraced by the Government's in its 9 May Budget speech and in this submission we have an update on progress with supply of CCR, the obstacles impeding contribution and the encouraging data emerging from New Zealand.

### Supply of CCR

*Banks have project plans and resources committed– but 40% by end 2017 deadline looms*




More than 40 Australian lenders are working on programs to load CCR data, a cross section of credit providers ranging from the Big 4 to motor vehicle financiers and new lending platforms. However, every one of these CCR projects, regardless of how well resourced, is taking longer than expected, indicative of the scale of change CCR reform requires of lenders in order to supply and consume the data. Contribution of comprehensive credit reporting information in Australia has also been hampered by legislative complexity and at times conflicting regulator demands.

**Obstacles to supply**

*One issue, three regulators, multiple requirements*

The Productivity Commission has previously been advised about problems associated with repayment history information, hardship and varied contracts. These are still only partially resolved; a scheduled review of the Credit Reporting code now underway has included in its issues paper questions relating to contract variations:

> *"The literature indicates that there is concern around the definition of RHI in circumstances where terms of repayment of credit by a borrower, different from the original terms of credit, have been agreed between the CP and the borrower, for instance, where the borrower is experiencing financial hardship."*

We note there is an indefinite timeframe for the Credit Reporting Code review and the Issues Paper itself states "*please keep in mind that the important issue of financial hardship and the use of hardship flags is beyond the scope of this Review*"

In contrast to the Office of the Australian Information Commissioner (OAIC) framework, credit providers face a very different approach from the prudential regulator, APRA, whose regulatory guideline 223 – Residential Mortgage Lending requires that:

> "*hardship or collections decisions and activities that include some form of ongoing concession beyond that normally available (non-commercial terms) are required to be reported as 'restructured items*"[1]

Similarly, conduct regulator ASIC considers hardship to be a threshold issue when considering a loan for credit[2]:

> RG 209.3 A credit contract or consumer lease will be, and must be assessed as, unsuitable where, at the time of the assessment, it is likely that:
>
> (a) the contract does not meet the consumer's requirements and objectives;
>
> (b) the consumer will be unable to meet their payment obligations, either at all or only with substantial hardship; or
>
> (c) other circumstances prescribed in the regulations apply to the contract.

Not only does one issue have three differing demands from regulators, but just in credit reporting lenders and credit reporting bodies have a 400 page legislative framework

[1] Clause 97 http://apra.gov.au/adi/PrudentialFramework/Documents/Final%20draft%20APG%20223%20-%20Marked%20Up.pdf

[2] Regulatory guide 209 Credit licensing: Responsible lending conduct

including Part IIIA of the Privacy Act; associated regulations; the Explanatory Memorandum; second reading speech and finally the Credit Reporting Code.

New Zealand – with the same lenders – provides a stark contrast to Australia.

**New Zealand consumers benefiting from comprehensive credit reporting**

> "*Compared with the one price fits all practice that was common in consumer lending in earlier decades, risk based pricing lowers the cost of credit for the majority of borrowers but also expands credit availability to higher risk borrowers and leads to a broader array of loan products available to all income groups*"
>
> *Center for Capital Markets Competitiveness report on Risk Based pricing in consumer lending*[3]

New Zealand has embraced comprehensive credit reporting with gusto. Supply – including by the telco and utility sector - is now over 51 per cent and plans for contribution by NZ's remaining significant lenders are well advanced, meaning that figure is expected to jump to **close to 90 per cent in early 2018**. The swift transition reflects, in part, the concise and clear requirements of that jurisdiction's 60 page credit reporting code.

On both sides of the Tasman, the move from negative to positive credit reporting, as practiced by most all OECD economies, recognizes fundamental truths about the benefits better information in lending provides:

*Comprehensive credit reporting enables more people to access mainstream, better priced credit.* Repayment history information show how a person is managing financial commitments today and not be assessed solely on adverse information up to five years old. Financial stress – typically when a person loses their job or has a relationship breakdown can result in failure to pay bills and the listing of a default on their credit file. Under negative reporting, this black mark, up to five years old, may be the only information available on their credit report.

*Comprehensive credit reporting enables lenders to better comply with responsible lending obligations.* Australia and New Zealand have formal responsible lending obligations. Under both Codes, lenders must both inquire and verify information put to them and be satisfied that making repayments will not cause substantial hardship. Repayment history enables better identification of those who are truly overexposed or exhibiting credit stress and should not be taking on further credit obligations.

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[3] 2014 http://www.centerforcapitalmarkets.com/wp-content/uploads/2013/08/CCMC_RiskBasedPricing_FINAL_to_post_10_24_2014.pdf?x48633

*Better and more accurate data enables innovation and new competitors* As Australia is witnessing now, the emergence of new lending platforms, the commitment to open banking data and the exploration of alternate credit risk models underscores the premise that better data fosters greater innovation on the part of lenders, regardless of scale, ultimately leading to lending products more tailored to the needs of a consumer.

For many years, better priced credit was offered as "executive packages" based on the salary of an applicant. The emergence of risk based pricing models allow many more mainstream borrowers to access cheaper credit and enables those locked out to have an avenue back into mainstream credit, using their good payment history to further improve their risk profile and in turn gain access to better pricing.

Evidence backing these assertions is now emerging in New Zealand.

- Regarding the *overall result*, Equifax worked with one lender analysing credit card and personal loans applicants, first assessing the portfolios against only the negative information held and then re assessed with the additional positive information. This analysis demonstrates the swap-set effect, where a group of "good credit risk" people will now be shown to be poorer credit risk than previously thought, and therefore more likely to be declined credit, versus another group, previously declined credit, but who when assessed with additional information are now rated as capable of managing additional credit.
  - The result showed a net lift in approvals possible for additional credit.
  - Expressed as the dollar-value of applications, the net swap set would be a positive $50 million lift in successful applications - net $22 million for personal loans and $27 million for credit cards.
  - Expressed as the benefit to the community, the swap set shows an opportunity to lend responsibly to an additional 15,000 people whose good repayment track record demonstrates their credit rehabilitation.

- As to *who is benefiting*, research shows comprehensive credit reporting is benefiting financially marginalised communities in New Zealand.
  - In December 2016 Equifax analysed credit inquiries from people in postcodes regarded as being disadvantaged (New Zealand Index of Deprivation). The application of CCR data resulted in a **net six per cent lift** in people assessed as having a good credit score and therefore more likely to access mainstream, better priced credit.