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Making credit reporting 'fair'

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If you've ever defaulted on a loan, failed to pay a bill, been chased by debt collectors or been bankrupted, you can expect it to affect your credit rating.

Most or all of the details will be on files held by consumer credit rating/reporting agencies such as Baycorp Advantage or Dun & Bradstreet. But if you're a good risk, regularly apply for credit and make timely payments, little or none of that may appear on your files – mostly because of the Privacy Act.

Is that fair? Dun & Bradstreet (D&B) doesn't think so.

It's concerned our credit reporting system focuses on negative events such as defaults and bankruptcies while ignoring positive events. It notes New Zealand is one of only three developed countries with a negative reporting system. The other two are Australia and France.

It wants the system changed to incorporate elements of both, what it calls a "fair positive" system.

According to the paper, *Shifting to a fair positive system,* published on D&B's website, this would entail recording not just defaults, unsuccessful credit applications, judgments, dishonoured cheques and bankruptcies, but also the number of current credits held, the type of credit accounts being operated and their credit limits, the age of the account and the name of the credit provider.

Earlier this month, D&B sponsored a US advocate on the subject, Michael Turner, president of the Information Policy Institute in New York, on an Australasian speaking tour.

Credit rating frustration

He believes that not only is our credit reporting system unfair, it is also economically inefficient by forcing people to seek higher interest rate credit. It actually leads to more, rather than fewer, loan delinquencies and defaults, he claims. In other words, it's exacerbating the very problem it's supposed to alleviate.

"Thousands of people are potentially denied access to the New Zealand dream of home ownership, while many others are provided access to credit they can't afford because of the country's restricted consumer credit reporting system," says a statement jointly issued by Turner and D&B NZ chief executive Christine Christian.

Turner claims moving to a fair positive credit reporting system would mean better access to credit for under-served groups such as women, small businesses and young people with good payment histories. The overall result, he claims, would be "macro-economic benefits such as lower risk within the financial sector and a contribution to the national economy worth $5.3 billion over the next decade."

D&B and Turner acknowledge not everyone is as convinced as they are, so they want the respective arguments tested by a parliamentary inquiry.

Turner outlined his arguments in a 2003 submission to Congress.

"The national credit reporting system's mission is critical to the efficient functioning of the American economy. It should be classified with other vital infrastructure industries, such as the public switched telephone network and the national power grid. Like these vital industries, consumers frequently take the benefits for granted.

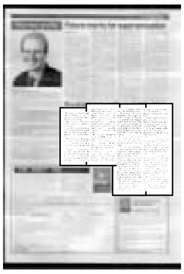
"They expect their calls to connect every time, and their appliances to always turn on, and, when they qualify, to receive credit instantly."

Among those not convinced is Wellington finance consultant Alastair Gustafson. Until early last year, a significant part of his work had been doing battle with credit reporting agencies to rehabilitate clients' ratings after they had been denied credit.

Having seen the system in action from close-up, he's sceptical about how some agencies work. But that said, while he thinks some of the players could improve their game, he's not convinced the system needs a fundamental overhaul.

First of all, he says the system is designed to protect lenders, particularly when they lend 80% to 90% or more of the value or price of a major asset.

In the past, the local bank manager knew his or her customers and their situations well enough to decide whether to advance them a loan. But now, customers shop around, they are more mobile and they change jobs more often. Consequently, lenders need to use central bureaux to establish people's reliability as borrowers, he says.



"The days of the bank manager scanning the *Mercantile Gazette* on a weekly or fortnightly basis are long gone," he says.

While he says the credit reporting system isn't perfect, it still works.

"Lenders have become aware of how flawed the system is and they've turned away good business when they needn't have," he says.

Their attitude is "better safe than sorry." If they relax their lending criteria, they will inevitably make more loans that go sour.

"Foreclosures catch up with you about two years later," he says. Increased foreclosures can put the lenders' own credit ratings at risk, cause their insurance premiums to rise, and make it harder for them to obtain funding at competitive rates.

David Tripe, director of Massey University's Centre for Banking Studies, can see Turner's point but he's not convinced the system needs an overhaul. He notes one result of changing to a positive credit reporting system is "it would be much easier to offer unsolicited credit."

While this would be good for the likes of D&B, as it would mean more business for them, he's not so sure anyone else would appreciate it. He also challenges Turner's assertion that lenders would be more willing to advance loans.

"There's an argument that it might make lenders more cautious," he says. Also, neither a positive nor a negative reporting system is much use with first-time borrowers. In both cases, they would have no file.

"There are probably some advantages in having a positive system," he says. But he isn't convinced a wholesale change is needed. He thinks much of the criticism of negative reporting could be a result of how the system is applied, rather than its nature. In particular, he says, many defaults may simply be disputes.

Consumers' Institute chief executive David Russell is more forthright. "Bollocks" is his printable response to Turner and D&B.

"Parliamentary investigations or law changes should not be made for the commercial advantage of any one organisation. What the advocates of positive reporting want is access to marketing databases. It provides a commercial database that can be worked to induce people to borrow more money," he says.

While he accepts some people may feel their credit rating is wrong, Russell points out the Privacy Act entitles them to ask rating agencies for a copy and to correct any errors.

William Cairns, co-principal of financier General Finance and mortgage lender Cairns Lockie, says the real problem is too much automatically ends up on people's credit records when it's immaterial but no one is prepared to exercise their judgment.

"People load a lot of defaults and judgments onto them, whereas in Australia they don't. I'd like people to put only serious stuff on them," Cairns says.

"At the end of the day, lenders are mostly interested in non-payments to financial institutions and utilities."

While one or two inconsequential or minor non-payments may not affect a rating, three or four can. The reality is, your record also has non-payment of library fines, parking tickets and the like; it can affect your ability to get a mortgage from a mainstream institution.

The Independent put the privacy concerns to Turner. His says while it's an issue, it's not as significant as often thought.

While he accepts positive credit reporting could lead to unsolicited marketing approaches, he says people are now more tolerant of junk mail and email spam.

The real concern is telemarketing, and this can be addressed by setting up a national "Do Not Call" register. In the US, Congress passed a law setting up a federal register within a day, he says.

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