CONSUMERS FEDERATION OF AUSTRALIA

Full-file[1] Credit Reporting –
Is it really the answer to credit overcommitment?

A significant part of the finance and credit reporting industries are currently lobbying hard for legal change that would allow the reporting of (and access to) more personal information to credit reporting agencies[2]. The additional information lenders want would relate to details about the consumer's other financial commitments, although some of this information can be reported under the current system.[3]

The industry argument goes that Australia is currently limited in the information that lenders can access about individuals – that our current system allows only "negative" information such as credit defaults and they want to be able to include "positive" information. In fact, the use of the terms "positive" and "negative" are somewhat misleading, as the additional information (such as a list of all outstanding credit) could be positive or negative for the individual consumer.

The arguments put by some industry players may initially appear to present a win-win for all –

> 'Let lenders have information about all a consumer's other credit commitments (and payment history perhaps) and they can better identify consumers who may be financially overcommitted. Lenders can therefore lend more responsibly – less loss for industry and less consumer suffering', they say.

Why Does Industry Want Full-File Credit Reporting?

To Reduce Defaults?

In fact, full-file credit reporting is likely to increase the numbers of consumer credit defaults rather than decrease them.

Industry is pushing the "reduce defaults" argument hard. However, while this is possible in theory and is being used as the "selling point", it is likely that this won't be one of the outcomes of full-file reporting.

Barron and Staten (2000) used the US comprehensive reporting system to draw conclusions about possible advantages for Australia of moving to an open-file system.

[1] Also called "positive" or "comprehensive" credit reporting. The term "positive credit reporting" is misleading, as additional information (such as outstanding credit) could be positive or negative information depending on the individual's situation.
[2] Current information allowed includes identifying details such as name and address, credit applications, credit defaults, current credit providers and bankruptcy.
[3] The current law allows any lender to record that they are a current credit provider, however this is rarely, if ever, reported.

Barren and Staten use different scenarios to model what they view as positive outcomes of more comprehensive credit reporting – either a higher approval rate (ie, greater availability of credit) for a target default rate or a lower default rate for a target approval rate. Note that this is an "either/or proposition", they don't claim that we can have both outcomes. They comment "Note that the results reported in Tables 3 and 4 suggest non-trivial changes in either the likelihood a loan is repaid (and thus, the cost of a loan) or the availability of credit…" In other words, if lenders have better risk assessment tools, they can choose whether they want a lower default rate or whether they want to lend more (retaining their current default rate). If they choose the latter the number of defaults would increase (i.e. the current default rate could remain the same, but because there is an increase in lending, the actual numbers of consumers in default would increase).

Although industry is emphasising the outcome of reduced defaults[4] (or pretending that both outcomes could be achieved at once), the research currently being used by industry itself makes it clear that the most likely outcome is more lending, rather than reduced defaults.

Barron and Staten found that based on their own research and the experience in the United States, the benefits of a more comprehensive credit reporting system included "Dramatic penetration of lending into lower socio-economic groups, making a variety of consumer loans available across the income spectrum" and a "Reduction in loan losses that would have accompanied such market penetration in the past."[5] So, while there may be an impact on defaults, this is in an environment where lending is dramatically increased.

They also say "over two million credit reports are sold by the three major national credit bureaus every day. Ready access to such personal credit data which can be used to evaluate creditworthiness has fuelled the explosion in consumer credit products since the mid-1970s." (p. 8)

The Federal Trade Commission agrees: "[t]he development of a national consumer reporting system, with its sophisticated risk models and automated underwriting, has contributed greatly to making credit more widely, inexpensively, and rapidly available."[6]

There are steps that lenders could take now to address some causes of overcommitment without changes to the credit reporting system. For example, in some cases the lender makes no enquiries about the consumer's income or other financial commitments (for example when offering pre-approved credit limit increases on credit cards[7]), and some

[4] For example, heading of Mastercard press release (April 2004) Call for Changed Credit Reporting System to Help Alleviate Spiralling Debt Issues

[5] Prof. John Barron. Prof. Michael Staten. "The Value of Comprehensive Credit Reports: Lessons from the US Experience" p 28.

6 Prepared Statement of the Federal Trade Commission on the Fair Credit Reporting Act, before the Senate Committee on Banking, Housing and Urban Affairs, July 10, 2003.

[7] Except in the ACT where this is required by law.

lenders (particularly some of those who take security over a home) are, or should be, aware that the borrower does not have the ability to pay.

Increasing Provision of Credit

There is broad concern in Australia about the current level of consumer debt, and the lending practices of some lenders.[8] So, do we really need increased lending, particularly to lower socio-economic groups? Industry might like us to believe that the consumer who now borrows from a payday lender could get a personal loan from the bank. However, it's more likely that these consumers will be targeted with less suitable products such as store credit and credit cards, which often trap individuals in a cycle of debt rather than improving their financial choices. We question in this time of record levels of consumer debt whether this could occur without detriment to consumers.

Other outcomes

According to a report of a presentation by Michael Staten[9], other outcomes of full-file credit reporting could include:

- Low risk borrowers may get better rates (because price matches risk)
- With certain restrictions, target marketing would be possible
- In the USA, full file reporting drives the decision with collections (e.g., soft or aggressive collection styles)
- Lenders can target customers from full file reporting
- Full-file credit reporting makes it possible to have instant credit availability

Whether Australia would see all these outcomes depends on when a credit provider was entitled to access a credit report. Broad access would enable this information to be used for targeted marketing by a range of credit providers, clearly not something consumer advocates would want to see in Australia[10]. Access by current credit providers would allow target marketing my current credit providers, and the information could be used to inform the type of debt collection strategy used. While it is important to examine how this might impact on debt collection practices, it would also enable debt collectors to ascertain the likelihood of a defaulting debtor from obtaining credit elsewhere to pay out the debt[11], thereby encouraging overcommitted consumers to borrow further. An

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[8] For example, Ian McFarlane, Governor, Reserve Bank said in November 2004 "There is a risk, however, that in attempting to resist the slowing in credit demand, financial intermediaries may be tempted to further lower lending standards, and that would carry with it serious medium-term risks. When I said earlier that lenders may be tempted to further lower lending standards, the use of the word further was deliberate. "

[9] Michael E Staten of Georgetown University, USA during a workshop on positive credit reporting conducted by the Australian Financial Conference in October 2002 , quoted in Credit Line Financial Counselling Services – Sharkwatch Magazine. Vol 3, No 4. 200. p. 14

[10] As far as we know, industry is not arguing to have such broad access.

[11] The problem of debt collectors pressuring consumers to borrow funds (usually at high interest) from another credit provider to pay out a debt has been raised by consumer advocates in the past, for example "Selling their Customers Out" 2002, Consumer Credit Legal Service

increase in instant credit availability is also another outcome that may simply increase irresponsible lending and impulse borrowing.

Problems with Credit Legislation

Consumer advocates have, for some years, seen the impact of irresponsible lending practices of a range of types of lenders. Irresponsible lending does not necessarily have a negative impact on the lender (for example lending secured by first mortgage, even when borrower can clearly not repay from income). In other cases, losses suffered by lenders are covered by very high interest rates, and/or a high level of lending.[12]

Our credit legislation desperately needs updating[13] to, among other things, establish an obligation upon lenders to act fairly (in relation to lending practices and use of the credit reporting system), and effective ways for these to be enforced. Dr Elizabeth Lanyon[14] points out that while other financial services providers are required by financial services reform legislation to act "honestly, efficiently and fairly", and to be able to continuously substantiate their conduct, such an obligation is much more difficult for regulators to enforce against a credit provider[15]. Accordingly, some of the worst practices in relation to consumer financial products occur within the credit industry.

Lanyon suggests that credit reforms could be expanded to include compliance standards which could be proactively vetted by the regulator, which could include, for example, maintenance of accuracy in credit reporting. A positive obligation to take into account consumer capacity to pay would also improve conduct.

Given the lack of any effective mechanism to force lenders to act responsibly in relation to lending practices, or credit reporting, considerable changes are required to credit legislation before we should consider giving lenders the ability to offer more credit to consumers and report more information to credit reporting agencies.

Problems with the current credit reporting regime.

Current credit reporting legislation is complex for industry and consumers, and could be improved. However, a range of consumer advocates' concerns about the current system are related to current regulation and complaints handling. These concerns include:

- Lack of accessible, fair and effective dispute resolution;

[12] It is important that we don't assume that no financial loss for the lender is the same as no hardship for the consumer. Consumer advisors see some consumers who are often "bailed out" by relatives, or who suffer considerable hardship to maintain debt payments.
[13] See "Changing direction? A perspective on Australian consumer credit regulation", Dr. Elizabeth Lanyon, 2004.
[14] ibid
[15] "The term "honestly, efficiently and fairly does not appear to have been defined, other than in general terms, although it has been used on some occasions, when coupled with another offence provision, to revoke a FSR licence.

- Lack of response by Baycorp[16] and by the Federal Privacy Commissioner when complaints are raised by consumer advocates in relation to possible systemic issues[17];
- Lack of transparency of Baycorp or the Federal Privacy Commissioner in relation to policies relating to credit reporting procedures[18];
- Complaints confusion, where it is unclear who has responsibility to resolve complaints. Unless the matter is resolved by Baycorp, Baycorp refers consumers to the Federal Privacy Commissioner (as required by the Act), but the Federal Privacy Commissioner refers to the credit provider;
- Length of time taken for Federal Privacy Commissioner to resolve complaints;
- Many credit providers who use the system[19] do not do so responsibly, and there is little incentive for them to do so[20] (While Baycorp removed over 65,000 defaults listed by the One-Tel Trustee after the Federal Privacy Commissioner found inaccuracies, we believe that many other systemic problems are not identified or remedied);
- Defaults listed for small amounts (for example $50 or less);
- Some defaults are listed many years (even 6 or more) after the default occurs.

Despite the fact that consumer concerns about inaccuracies and complaints handling have been voiced for some time, we are not aware of any industry members pushing for improvements in the current system.

[16] Baycorp is one of two consumer credit reporting agencies. Consumer advocates have had little experience with Dun and Bradstreet, possibly due to its more recent entry into the consumer credit reporting market.
[17] For example, in comparison with information exchange around systemic issues with regulators such as ASIC, and with some industries including banking and insurance.
[18] While many Advices are published by the Federal Privacy Commissioner, consumer advocates find it very difficult to clarify any issues that aren't the subject of published advices.
[19] The Federal Privacy Commissioner increased access to the system to utilities and any other provider who allowed at least 7 days to pay.
[20] For example, regardless of the time taken by a consumer to lodge a complaint, even if the default is eventually removed it is extremely rare for any financial compensation to be paid to the consumer.

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FULL FILE CREDIT REPORTING – KEY ISSUES

We are prepared to discuss these issues, but not to be a part of a dishonest industry marketing campaign.

Some industry players are lying. They are misleading the public about the likely outcomes of full-file credit reporting. The current emphasis on "reducing defaults", or "alleviating the debt spiral" and misusing research is unhelpful.

We accept that an increase in the availability of personal, financial information could be used to improve the accuracy of risk assessment.

However, we don't accept that the outcomes would be a good thing for consumers.

Full-file credit reporting is likely to lead to an increase in consumer lending (particularly to lower income consumers).

There is broad concern in Australia about the current level of consumer debt, and the lending practices of some lenders. We don't need increased consumer lending in Australia. The issue of an increase in consumer debt levels must be part of the full-file debate.

Credit legislation must provide practical remedies for irresponsible lending.

Current credit legislation is inadequate to protect consumers from unfair and irresponsible lending practices (compared, for example, with obligations of other financial service providers under financial services regulation). It would be particularly damaging to consumers to introduce changes that would see an increase in the level of consumer debt without introducing credit reforms that would give consumers and regulators practical tools to deal adequately with irresponsible, or predatory, lending practices.

***Current regulation of the reporting system is a disgrace*.**

Current legislation relating to credit reporting is complex, and raises some problems for consumers as well as industry. However, there are a range of problems with the current system, as outlined above, that have little to do with inadequate legislation. It is a priority for consumers that Government, the current regulator and finance and credit reporting industries act to address these problems that have gone on too long. The more information industry can collect, the more chance of inaccuracies.

It would be foolish to consider allowing the finance sector to access more of our personal financial information until the it, the credit reporting agencies and the regulator, can show they are serious about addressing the current problems with the credit reporting system.