



19 April 2018

Senate Standing Committees on Economics

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Dear Chair

**RE: National Consumer Credit Protection Amendment (Mandatory Comprehensive Credit Reporting) Bill 2018**

PERC is pleased to provide a submission to the inquiry into the proposed National Consumer Credit Protection Amendment (Mandatory Comprehensive Credit Reporting) Bill 2018. Our submission comprises the executive summary provided below and a full-detailed report into the legislation and Australia's credit information system more broadly.

PERC is the only non-profit public policy research and development organization exclusively dedicated to the relationship between financial inclusion through access to, and the use of, information and information solutions. PERC have undertaken projects in more than 25 countries on 6 continents and have been retained as consultants to the US Department of Treasury, the US Department of Housing and Urban Development, The World Bank, The International Finance Corporation (IFC), the Inter-American Development Bank (IDB), and the Organization for Economic Cooperation and Development (OECD). PERC serve as "Sherpa" to the APEC



Business Advisory Council (ABAC) on all matters relating to credit information sharing. PERC CEO and founder Dr Turner was appointed and served on the inaugural Data Privacy and Integrity Advisory Committee of the US Department of Homeland Security (DHS), and has testified before Congress and in federal courts on numerous occasions.

### **Executive summary**

Credit information systems (CIS) are a critical component of any nation's financial infrastructure. So important is the role of credit information in the efficient and effective operation of credit markets that it has gained considerable attention over the last decade from organisations such as the World Bank, Bank for International Settlements (BIS) and the Asia Pacific Economic Cooperation forum (APEC). In the case of APEC the implementation of a best practice CIS is regarded as such a high priority that in 2015 the member economies – including Australia - endorsed the Cebu Action Plan, which cites the World Bank's General Principles for Credit

Reporting to guide legal and regulatory frameworks for the development of best practice credit information systems across the region.

The reason for this focus is apparent when one considers the benefits of an optimally designed and regulated CIS. Improved access to credit, particularly for the under-served, lower costs for both consumers and lenders, and lower default rates have all been proven to be the outcome of a CIS system designed to promote competition among lenders, particularly in markets where monopolies or oligopolies exist.



Yet despite being a signatory to the Cebu Action Plan Australia lags most of the developed world and much of the developing world in establishing a best practice CIS. Accordingly, Australia's credit reporting system has failed to deliver the same economic benefits as experienced in other jurisdictions. The result is slower economic growth, higher interest rates and less access to credit. The impact of the latter point should not be underestimated. An estimated 1.86 million adult Australians are trapped in fringe lending markets paying exorbitant rates of interest on often poorly regulated credit products for no other reason than Australia's credit reporting system fails to take account of their positive risk profile.

It should also be noted that the sub-optimal design of Australia's credit reporting system imposes excessive costs on the millions of small businesses that are unincorporated and rely upon consumer credit to fund their operations. These businesses are often denied access to basic banking services and pay punishing rates of interest for credit products that are unsuited to their needs all because Australia's credit reporting system fails to adequately report on their true risk profile.

The Australian Government has recognised that something must be done. Following the failure of earlier reforms to bring Australia's CIS into the 21<sup>st</sup> century, the Government has announced its intention to introduce Mandatory Credit Reporting compelling Australia's major lenders to share credit information with credit bureaux in the hope that this will create a more vibrant credit reporting market and expose Australia's banking oligopoly to true competition. Unfortunately, the proposed legislation, as currently designed, is unlikely to achieve these objectives. Furthermore, it is highly likely that the unintended consequence will be to hand the

four major lenders even greater power over Australia's credit information system resulting in less competition and worse outcomes for consumers.

This need not be the case. Instead of a headlong rush to introduce these latest reforms after decades of relative inaction - often with the encouragement of vested interests - the Government should seize this opportunity to fundamentally rethink the structure and operation of Australia's credit reporting market. Using the 2015 APEC agreement as a guideline, the Government could create a CIS that exposes the banking oligopoly to real competition with significant benefits to consumers, small business and the Australian economy as a whole. It can't be overstated that the evidence from around the world clearly demonstrates that such a move would improve access to credit, lower default rates and boost economic growth.

Accordingly, this submission makes two core arguments:

1. That the Government should go beyond its current proposal and implement reforms consistent with the APEC Cebu Action Plan of 2015 that allow for credit bureaux to collect more comprehensive data (deeper and broader), compel credit providers of all shapes and sizes (bank and non-bank, large and small) to report that data, and expose Australia's credit market to high levels of competition.
2. That the legislation to introduce mandatory credit reporting should be amended to avoid a number of unintended consequences that are likely to reduce competition among lenders and further entrench Australia's existing banking oligopoly.

Such an approach would deliver an outcome consistent with the Government's stated intention of seeking to increase competition in Australia's banking sector

while delivering clear benefits to consumers, small business and the broader economy.

### **Key recommendations:**

#### **To Improve Australian Credit Reporting System & Increase Bank Competition--**

- **Mandate “deeper” credit reporting**—current law preserves a massive blind spot in the Australian credit reporting system. Namely, lenders are unable to see a person’s total level of indebtedness. This enables borrowers to over-extend

themselves and endlessly borrow from Peter to pay Paul. This is horrible for the entire lending system, and drives up the interest rates for everybody to pay for unnecessary bad debt. Mandating that lenders report account balances will fix this problem costlessly and instantly.

- **Permit “broader” credit reporting**—another historic blind spot in the Australian credit reporting system is non-financial payment data, also called alternative data. For many people—younger Australians with no prior credit experience, legal immigrants whose credit histories don’t travel with them, elderly Australians who are widowed or divorced---accessing affordable mainstream credit is impossible. This large population are trapped in the “Credit Catch 22” whereby in order to qualify for credit, you must already have it. One proven and effective means of helping this group build a credit history—or repair and rebuild one after life happens—is by having non-financial payment data reported. This could include regular monthly payments such as a wireless phone bill, payments for cable or satellite TV, broadband, gas, water, electric, and rent. New Zealand, the United Kingdom, the United States, China and many other countries permit

and encourage this type of reporting for exactly this reason. It is time for Australia do the same.

- Permit use of Predictive Data for Pre-qualifying Borrowers**—the single most effective manner in which credit report data can be used to galvanize competition among lenders in an oligopolistic market is by enabling them to use credit report data to market firm offers of credit to consumers. In countries where this is permitted, it has had three primary impacts: (1) greatly increased access to affordable credit for individuals and small businesses; (2) dramatic reductions in the cost of credit paid for lower risk borrowers; and, (3) immediate competitive impacts including new products, investments in innovation, and improved customer service. Given the current market structure for consumer and commercial lending in Australia, this tool will work wonders for borrowers including small business owners. Of course lenders will oppose it—and will likely cite privacy reasons (this is payment data, not privacy sensitive materials) to scare off politicians and regulators. Make no mistake, their opposition is purely from the fear of competition that will result should this measure be approved. If Australian lawmakers are serious about wanting a more competitive lending landscape, this is how to do it.

To Improve Australian Credit Reporting System & Protect Credit Bureaux Competition—

- Clarify that Mandate Is Permanent:** One interpretation of the exposure draft legislation is that once pre-November 2, 2017 contracts expire, large banks are free to discontinue reporting to one or all private credit bureaux. They are also permitted to report to a new entrant—including hypothetically a credit bureau

that is wholly owned by the big 4 lenders for their exclusive use only. By granting large lenders the right to pick and choose which, if any, credit bureau with which to share their data, they are granting large lenders massive leverage over credit bureau, including price-setting power. Contrary to the stated objective of the legislation, competition upstream and downstream will be greatly diminished should lawmakers fail to amend this provision. Lenders could elect to share with only one or two credit bureaux upstream, reducing competition greatly and enabling lenders to exercise undue influence over credit bureaux policies. Downstream, competition could be diminished if the depth of data were limited, if the uses for which credit bureaux data could be used were limited, or if access to a credit bureau's data were restricted in any manner. Given existing regulations, this is exactly the behavior to expect from the large lenders. Unless the rules binding lenders are changed, there is no reason to anticipate different outcomes.

- **Clarify that Mandate Applies to all Regulated Lenders**—excluding Tier 2 and Tier 3 lenders from the mandate opens the door to the Balkanization of the credit reporting market. Evidence from around the world, gathered over decades, shows that “segmented” credit reporting systems consistently underperform relative to comprehensive and full-file systems, in many cases dramatically so. Should the current draft legislation become law, all lenders other than the big 4 are free to determine whether or not they wish to report to a credit bureau, whether to report to more than one, and the duration of their reporting agreement. This certainly favors the incumbent credit bureau, which has had far more time to establish business relations with the full spectrum of lenders. While we recognize that reliably reporting customer payment data to all licensed credit bureaux could be a tall order for some small lenders in Australia, this is



certainly not the case for medium-sized lenders. Further, even the very small lenders will be able to report over time. The world is filled with examples of very small, cash-strapped micro-finance institutions consistently reporting payment

data to a credit bureau (see Bolivia, Brazil, China, India, Mexico, and the US for just some examples).

I would welcome the opportunity to speak with the Committee and answer any questions. While I'm located outside of Australia, I am able to accommodate a time that is convenient for the Committee. I can be contacted at [REDACTED] or you can initially contact PERC's Australian based Adjunct Fellow Mr. Damian Karmelich on [REDACTED]

Sincerely,

[REDACTED]

Michael A. Turner, Ph.D.

President & CEO