Submission to the Senate Economics Committee Inquiry into competition within the Australian banking sectors

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"…greater availability of credit data will tend to reduce information asymmetry between lenders and clients and reduce the information advantage of large banks over new entrants."

European Commission Directorate General for Competition
Report on the retail banking sector inquiry 31 January 2007

A foundation stone of the credit economy is credit reporting.

Credit reports give lenders the capacity to accurately assess and price the risk of lending and give consumers the ability to demonstrate their credit history.

Australia is one of only a handful of OECD countries restricting credit reports to negative information.

Essentially this limits credit reports to applications for credit (but not whether it was granted, or the type of credit) and defaults bankruptcy and court judgements over the past five years (seven for bankruptcies).

Credit reports in Australia are governed by specific legislation within Part IIIA of the Privacy Act. In 2008 the Australian Law Reform Commission recommended five additional data sets be permitted and draft legislation is about to be referred to the Senate Finance and Public Administration Committee.

The five additional datasets proposed are:

1. What type of credit was offered;
2. What the credit limit currently is;
3. When the account was opened;
4. When the account was closed;
5. Account payment history over the previous two years showing how often a person has been late making a minimum payment. Account payment history, a critical part of responsible lending, offers substantial insight into how well a person is managing their credit commitments.

Australia's current opaque credit reporting regime hinders competition in the finance sector.

Negative credit reporting gives established lenders a clear information advantage over new entrants when assessing lending risk. Their large existing customer base gives them broad insight into a consumer's ability to make repayments.

In contrast, a new lender, having to rely on the limited information available on credit reports, will have significantly less capacity to accurately differentiate high- and low-risk borrowers.

International research supports these conclusions.

In 2007 the Directorate-General for Competition in the European Commission examined in-depth competition issues in the banking sector and found that:

> *"...the extent of credit data market coverage is likely to influence the strength of competition in retail banking.*
>
> *Where the coverage of credit registers is low, large banks are more likely to have an advantage since their extensive client book will enable them to build more accurate risk models than smaller players and new entrants."*
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> *(European commission Directorate General for Competition Report on the retail banking sector inquiry[1])*

And more recently:

> *Creditors who are unable to access complete credit data could therefore price the credit product incorrectly by under- or overestimating a borrower's credit risk.*
>
> *(European Group on Credit Histories, 2009)*

Conversely, consumers are hindered from switching banks as their ability to access credit as a new-to-bank customer is significantly weaker under a negative reporting regime.

In 2008, Access Economics found in the Australian context that:

> *"The acceptance rate for new customers is often nearly half the rate for existing customers and around 50% of this difference can be attributed to the relative quality and quantity of information available."*
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> *(Access Economics[2])*

Positive reporting helps level the playing field, increasing competition as people find it easier to leave their existing bank and successfully apply for credit with a new lender.

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[1] European Commission Directorate General for Competition *"Report on the retail banking sector inquiry"* 31 January 2007

[2] Pg 3 *The benefits of broadening access to credit via comprehensive credit reporting."* Access Economics 2008

Similarly, banks will be more likely to compete for those potential new customers whose credit report shows them to be a good risk. Lower interest rates are likely to result as financial institutions compete to attract people who can demonstrate sound management of credit. The focus on income will broaden to include demonstrated ability to meet repayments.

Hong Kong moved to comprehensive reporting in June 2005 after a two year transition period. In its first review of the impacts, the Hong Kong Money Authority noted:

> *"A few major players said they were proactively offering lower interest rates products to selected credit card holders – presumably as a response to the challenge coming from non-bank players. New players continue to emerge and the consumer credit market has become more competitive."*
> *(Hong Kong Money Authority[3])*

In the Australian context, Access Economics[4] found that:

> *Positive credit reporting is one mechanism which provides a potentially efficient, equitable and low-cost means to facilitate competition across the retail banking sector....This would benefit consumers through:*
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> - *some reduction in the margins needed to cover lenders' costs;*
> - *helping the assessment of, especially, with low to middle income earners and customers without long credit histories such as younger people; and*
> - *allowing a wider range of lenders to operate in the market on more even terms.*
>
> *In addition, the introduction in January 2011 of responsible lending requirements, if unaccompanied by positive credit reporting, will further entrench the market advantage of the largest incumbent banks and will result in an increase in search costs and a decrease in approvals for smaller players trying to engage new customers.*

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[3] Pg 10 Hong Kong money Authority Quarterly Bulletin March 2006

[4] Access Economics Promoting competition through positive credit reporting, unpublished, in preparation for Senate Finance and Public Administration Committee hearings on credit reporting reforms

In conclusion the current laws on credit reporting inhibit equity and competition because:

- The limited information on credit files reduces the likelihood of banks lending to an unknown customer, making it harder for consumers to switch banks.

- Lenders entering a new market are disadvantaged in assessing risk – there is a very uneven information playing field.

- Borrowers cannot demonstrate their sound management of credit - people can be unfairly excluded from receiving credit or end up paying higher interest than they should.

- Competition to attract consumers with good credit profiles is disabled.

A move to positive reporting – as recommended by the ALRC and soon to be the subject of a separate Senate Committee inquiry – will help competition.