DUN & BRADSTREET SUBMISSION TO

SENATE ECONOMICS REFERENCE COMMITTEE
INQUIRY INTO POSSIBLE LINKS BETWEEN HOUSEHOLD DEBT, DEMAND FOR IMPORTED GOODS AND AUSTRALIA'S CURRENT ACCOUNT DEFICIT

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Executive Summary

Dun & Bradstreet (D&B) welcomes the opportunity to provide a submission to the Senate Economics Reference Committee Inquiry into possible links between household debt, demand for imported goods and Australia's current account deficit.

D&B is the world's leading provider of business-to-business credit, marketing and purchasing information, as well as receivables management services. In 2002, D&B opened a consumer credit bureau in Australia, introducing competition for the first time in this market. D&B is committed to providing Australia's most accurate and up-to-date consumer credit reporting solution. In addition, the company is committed to engaging decision-makers on the key issues underlying consumer credit reporting, including the criteria on which the industry makes credit available to consumers and the level of accountability in that system.

In this submission, D&B will respond to Terms of Reference (b), (g) and (j).

Broadly, D&B believes that the critical issue for examination is not household debt in itself but, rather, the affordability and sustainability of household debt. This reflects a view that not all debt is bad. Indeed, for most Australians, debt is critical to wealth creation.

The affordability and sustainability of consumer debt requires considered attention. Consumer debt has contributed significantly to economic growth over the last decade; however, a lack of affordability and / or sustainability could have a dire impact on the nation's ongoing economic strength.

This means the information on which lending decisions are based is critical. There is considerable evidence to suggest that Australia, which has a negative consumer credit reporting system, has higher rates of default than countries that have shifted to a positive consumer credit reporting system.

Accordingly, D&B believes that it is time for Australia to consider similar reforms. However D&B recognises there are many different views on this issue. Consequently, our recommendation is for a parliamentary inquiry into consumer credit reporting in Australia, rather than immediate legislative change.

Recommendation 1:

That a parliamentary inquiry be held into consumer credit reporting in Australia, with the following Terms of Reference:

- An analysis of the benefits and disadvantages arising from Australia's negative credit reporting system;
- An analysis of the benefits and disadvantages of international consumer credit reporting practices, with particular emphasis on the positive credit reporting systems used in the developed world (excluding Australia & New Zealand);
- A comparison of the two systems, with particular emphasis on:
  - lending rates;
  - default rates;
  - impact on economic growth;
  - impact on credit growth and type of credit growth;
  - errors in reporting;
- An examination of the legislative process required for the amendment of Australia's consumer credit reporting system – e.g., amendment to the Privacy Act;
- An examination of processes to remedy incorrect information contained within individual consumer credit reports;
- Should Australia amend its consumer credit reporting system?

Response to Inquiry's Terms of Reference

Terms of Reference (b) - the factors, including the lending policies of banks and other financial institutions, that contribute to household debt levels

There are a number of factors that determine household debt levels in Australia and internationally. Those factors include monetary and fiscal policy, wages and salary levels, consumer confidence, domestic consumption and import competitiveness, industry policy, credit marketing, cheap cost of asset-linked debt, and consumer literacy.

However, not all debt is bad. Debt is critical to home ownership and wealth creation. Unsustainable and unaffordable household debt should be the issue of concern.

The fact that non-housing linked debt is an increasing problem for Australia is demonstrated by the following figures:

- In December 2004, the total amount of personal credit, excluding housing finance, was $113.6 billion. That is a 12.7% increase over the last 12 months.
- In December 2004, the total amount owing on credit and charge cards was $30.21 billion. In December 1994, it was $5.62 billion.
- Of the $30.21 billion owing in December 2004, $20.22 billion is accruing interest.
- In December 2004, there were 11,598,000 credit and charge card accounts held in Australia. In December 1994, there were 6,599,000.
- In December 2004, the nation's total credit limit on credit and charge cards was $77.98 billion. In December 1994, it was $17.72 billion.

There are signs that this growth in non-housing debt is providing considerable problems for some Australians. A review of the 2003 / 2004 Annual Report of the Insolvency and Trustee Service Australia (ITSA) points to the increasing number of people acquiring access to credit cards they can not afford.

Non-business bankruptcies attributed by ITSA to 'excessive use of credit' account for 20% of all non-business bankruptcies. 'Excessive use of credit' was the only ITSA category that recorded an increase over the reportable 12 months. For bankruptcies within the age group of 25 to 44 years of age, 'excessive use of credit' is a strong second to unemployment for bankruptcies. For the age group of 55 and over, 'excessive use of credit' is the number one ranking reason for bankruptcy.

While these figures show only a 12 month trend, they point to the fact that a significant number of people experience financial hardship because of 'excessive use of credit'.

D&B believes that the capacity for lenders to make responsible lending decisions that are sustainable and affordable for both lenders and consumers is central to the debate about household debt. Australia's consumer credit reporting system is at the heart of this issue.

However, consumer credit reporting and the laws that govern it in Australia are poorly understood. Not only do consumers have little knowledge of what is included in an individual credit report and the purposes for which it can be used, but this lack of understanding generally extends to industry and consumer groups and to decisions-makers.

What is consumer credit reporting?

Lenders rely on two sources of information:

- Their own data, acquired through past experience with an applicant and on information provided on credit applications; and
- Data available through consumer credit bureaus.

Credit bureaus are central repositories of credit data used to generate credit reports.

Australia currently operates a 'negative' consumer credit reporting system. In the developed world, only New Zealand, Italy and France also continue to operate this type of system.

The type of consumer credit information that can be recorded and the purpose of its use are strictly regulated by the *Commonwealth Privacy Act 1988*.

A 'negative' consumer credit reporting system allows for credit bureaus to collect only the following information:

- Records of credit applications made by the applicant in the past 5 years;
- Records of some of the applicant's current loans accounts where the applicant has been in default over 60 days (it is worth noting that the credit provider can not list the account as overdue until it has sent the debtor a letter advising of the default);

- Where the account was listed as being over 60 days in default and that default was paid, the credit report will also list the date on which the default was paid (the default listing is not removed because the debtor has paid the outstanding amount);
- Court judgments;
- Dishonoured cheques where the amount was over $100 and the cheque was presented twice;
- 'Clearout Listings', also called serious credit infringements, whereby the credit provider has tried to locate the debtor unsuccessfully and reasonably believes that the debtor has decided not to pay the debt;
- Bankruptcy orders (including Part IX Debt Agreements).

Credit applications, overdue accounts (over 60 days) and court judgments are held on an individual's credit report for 5 years from the date of listing. Bankruptcies and serious credit infringements stay on the individual's credit report for 7 years from the date of listing.

The existing system does not allow for credit bureaus to record whether credit applications have been approved, and, if so, to what limit. Neither is there any information recorded on an individual's capacity to pay.

Why is there a link between household debt and consumer credit reporting?

D&B believes the critical issue about household debt is its sustainability and affordability. What is regarded as high rates of household debt need not be a concern on their own, particularly if they are linked to asset growth and are serviceable. It is also important to note that consumer credit growth has fuelled much of the nation's economic growth and is expected to continue to do so over coming years. Therefore, sustainable and affordable consumer credit is central to the nation's ongoing economic growth.

Critical to responsible, sustainable and affordable lending decisions is the quality of information available to lenders with which to make those decisions. Lending decisions can only be as good as the information on which they are based.

The current Australian system limits a lender's ability to determine a consumer's capacity to service debt. For example, a consumer who is struggling to make ends meet but is still managing to pay-off the minimum amount on existing loans can continue to increase his/her credit levels, because credit bureaus can only report on whether the consumer has defaulted on payments and not on the consumer's real capacity to meet further credit commitments.

In February 2005, a United Kingdom Treasury Select Committee inquiry into 'Credit card charges and marketing'[1] produced a report that looked at the issue of ongoing access to credit in circumstances where assessment was based on the lack of defaults and not on the ongoing capacity to pay.

The report noted that:

"Lenders may be unable to assess accurately a consumer's ability to take on additional debt. A consumer making the minimum repayment across a number of different credit cards may be struggling with debt but may be seen to have a good credit record."

The result of this type of behaviour is the ability for consumers to access new streams of credit to finance other credit repayments.

Additionally, the existing system does not allow consumers to demonstrate recent good payment history. This can mean that a minor default in the previous five years can prevent access to affordable and serviceable credit, even in altered circumstances. The following scenario is common and demonstrates this point.

Scenario: *A young person, age 16, has a mobile phone and forgets or is unable to pay his/her bill. It may be as little as $100 – a very common default amount for young people and mobile phones. At age 16, they think little of it because $100 seems a small amount and they have little or no understanding of how credit reporting systems work.*

At age 20, the same individual has entered the workforce, and, in contrast to when he/she was 16 years old, takes finances seriously. He/she has saved for a car but requires additional finance for the purchase. The application is rejected because the individual's credit report shows a previous payment default. The report makes no allowance for the fact the default was for only $100, that it occurred when the individual was only 16, or that the individual now has a good job and could easily service his/her desired level of finance.

Result: Resulting from this scenario is either no access to credit or access to credit from non-traditional lenders, often at exorbitant rates of interest and charges.

1 UK Treasury Select Committee - Credit card charges & marketing – February 2005

D&B therefore believes that core factors contributing to concern about household debt are:

- Growth in non-asset linked debt;
- Lack of quality information available to lenders on which to make responsible, sustainable and affordable lending decisions.

Terms of Reference (g) - whether there are other measures that might be taken in place of possible restrictions on lending practices which would be as effective

As outlined in our response to reference (b), D&B believes that the critical issue is not household debt in itself, but, rather, unsustainable and unaffordable household debt. This means that instead of focusing exclusively on lending practices, there must be a focus on the decision-making process that underpins a lender's capacity to make responsible, sustainable and affordable lending decisions. This approach requires a review of default rates.

D&B believes that reform of the consumer credit reporting system is required to improve lending practices.

D&B advocates minimal additions to the data that is allowable under the current consumer credit reporting system. Specifically, D&B recommends the addition of the following data:

- The name of each current credit provider;
- The type of each current credit account;
- The date on which each current credit account was opened; and
- The limit of each current credit account.

Amendment to the *Commonwealth Privacy Act 1988* is required to introduce these changes.

Some fear that this represents a shift to the USA-style 'full-file' positive consumer credit reporting system.

However, the additional data recommended by D&B does not provide the extensive information that is currently allowable in the United States. This reflects D&B's view that the American model has characteristics that are not palatable to Australians. Those characteristics relate primarily to the marketing of credit.

Appendix 1 provides a comparison between the extremes of the Australian and American systems and illustrates the proposed D&B model.

Evidence and argument that additional information results in lower delinquency rates

There are a number of international experiences that point to a link between the credit reporting system, sustainable credit growth and lower default rates.

In Hong Kong, reform of the credit reporting system has worked to stem the tide of personal bankruptcies, and in particular, credit card bankruptcies.

In the four years leading-up to 2002, Hong Kong experienced growth in personal bankruptcy of 1,900%. Around 12% of all personal bankruptcies were caused by credit card debt. Credit card write-offs stood at 13.6% by the end of 2002. This was significantly higher than comparable Asian nations, such as Singapore and Korea, which, at the time, had write-off rates of 5.5% and 6.1% respectively.

Defaulting customers in Hong Kong had acquired debts up to fifty-five times their monthly income in 2000 and forty-two times their monthly income in 2002.

One of the main reasons for Hong Kong's explosion in debt and defaults was a lack of positive consumer credit data for lenders to access and share. This was clearly the view of the Hong Kong Monetary Authority (HKMA), which, in 2001 and 2002, issued circulars arguing that the lack of credit data sharing was a clear reason for the growth in personal bankruptcy rates.[2]

Reform to consumer credit reporting was finally introduced in 2003[3]. It was a vital tactic in the campaign to stem the tide of personal bankruptcies. And, importantly, the HKMA spelled out that such a system could be and was introduced while maintaining strict rules on privacy.

The impact of this reform to consumer credit reporting in Hong Kong has been clear. HKMA figures show that, between December 2002 and December 2004:

- Credit card write-off ratios declined from 13.6% to 3.76%; and
- Credit card delinquency ratios declined from 1.25% to 0.44%.

2 HKMA, Circular on Bankruptcy & Consumer Credit Lending – Ref B9/32C & B9/69C

3 HKMA, Supervisory Policy Manual, "The Sharing and Use of Consumer Credit Data through a Credit Reference Agency" – Ref B9/32C & B1/21C

An American study by Professor Staten, Director of the *Credit Research Center at Georgetown University* in Washington DC, has also provided international data on the benefits arising from a credit reporting system that is more comprehensive than the existing Australian system.

Professor Staten conducted research into the effects of different credit reporting systems. The research was built around a credit-risk scoring model using the full range of information - both positive and negative - that is available in the USA. This was then compared to a negative model like the one used in Australia.

The research concluded that a positive reporting model resulted in significant benefits for borrowers and credit providers. It found that, assuming a credit provider aims to approve 60% of all credit applications, Australia's negative-only model produces a default rate that is almost 80% higher than if the full-file model were used.[4]

A McKinsey Quarterly Report examining the need for credit bureaus in Asia found that:

"Countries with bureaus that share both positive and negative data have lower write-off rates than might be expected given these countries' rates of credit card penetration."

"By sharing both positive and negative information, banks can make better lending decisions, use risk-based pricing methods more effectively, actively manage credit lines, collect debt more successfully, and reduce fraud."[5]

The previously-mentioned UK Treasury Select Committee inquiry into 'Credit card charges and marketing' found that:

" ... lenders need to share full information regarding credit card accounts and to assess ability to repay using full credit data and an examination of consumer's full credit commitments in relation to income."[6]

The Chairman of the Committee was reported as saying:

"Sharing more data will stop people being allowed too much credit and will prevent unmanageable levels of debt from building up."[7]

4 Prof. John Barron, Prof. Michael Staten, "The Value of Comprehensive Credit Reports: Lessons from the US Experience" – 2000

5 McKinsey Quarterly, 2003, Number 2, "Wanted: Asian Credit Bureaus"

6 UK Treasury Select Committee - Credit card charges & marketing – February 2005

7 Australian Financial Review – February 21, 2005

Clearly, the examples from the United States, the United Kingdom and Asia point to the benefits to sustainable and affordable credit growth that arise from a more comprehensive consumer credit reporting system.

D&B believes that reform in this area, through amendment to the *Privacy Act 1988*, would be a more effective measure to manage household debt than focusing on lending practices of banks and other credit providers.

Terms of Reference (j) - any related matters

As outlined, D&B believes that consumer credit reporting is a critical related matter. The critical role of credit reporting in the lending process is clearly demonstrated, and the ability of a reformed system to positively impact on manageable levels of household debt is proven internationally.

However, D&B recognises the many views on this matter and believes that there should be further examination. This leads to the sole recommendation of this submission.

Recommendation 1:

That a parliamentary inquiry be held into consumer credit reporting in Australia, with the following Terms of Reference:

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