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The Secretary
Senate Economics References Committee
Suite SG.64
Parliament House
Canberra ACT 2600

Email: economics.sen@aph.gov.au

Submission to Australian Senate Inquiry into possible links between household debt, demand for imported goods and Australia's current account deficit

To Whom it May Concern

Overview Of MasterCard

MasterCard International is a global, for profit payments company with one of the most recognized financial services brands in the world. MasterCard has approximately 25,000 affiliated financial institutions around the world. More than 1.1 billion MasterCard, Maestro and/or Cirrus brand cards are accepted at approximately 24 million locations including at more than 900,000 ATM locations worldwide. In order to ensure the proper functioning of its various payment products (*i.e.*, the interoperability of its products and services in the 210 countries and territories in which they are issued and/or accepted) and to safeguard the reliability of the transactions that flow through the network, MasterCard operates a global telecommunications network and global authorization and settlement systems, and establishes and enforces rules for participation in its network and systems. Since MasterCard guarantees the obligations of its member institutions to each other, it is also interested in and takes steps to ensure the fiscal soundness of its members.

MasterCard member financial institutions are the actual issuers of its cards ("Issuers") and/or the entities that arrange for merchants to accept its cards and that submit transactions initiated with its cards for settlement ("Acquirers"). MasterCard has a direct contractual relationship with each of its member institutions. In brief, MasterCard licenses its members to use its trademarks and service marks and, in return, its members agree to abide by MasterCard's rules[1] and to pay MasterCard certain fees and charges. MasterCard normally does not enjoy contractual privity with the ultimate users of MasterCard products and services, namely, the 24 million MasterCard and Maestro merchants or the 1.1 billion MasterCard, MasterCard Electronic, Maestro and Cirrus cardholders.

Bank Lending Practices

Improving the quality of credit in the Australian marketplace is one of the primary objectives of MasterCard International. As such MasterCard International is supportive of any government measures aimed at addressing this issue. However, if change is to occur it needs to happen in the full context of the broader issues of debt in Australian society and missed economic opportunities.

With this specific objective in mind this submission shall address only components (b), (h), (i) and (j) of the Terms of Reference of this Inquiry, and shall address them in general rather than addressing specific comments to each of the nominated sections.

In assessing whether and how much to lend a particular applicant for credit, a lender develops a risk profile of the applicant based any information it can gather about the applicant's situation. In general this includes information about other existing lines of credit, income, expenses, credit history, employment history and family situation. More often than not a lender relies on the applicant to provide the bulk of this information, and if an existing relationship exists with the applicant the lender will look at its own records as well. As a matter of course a lender will usually also check the credit bureau for any additional information, but with Australia's highly restrictive "negative" only credit reporting regime as enforced by the Commonwealth's Privacy Act.

In far too may cases, applicants are incorrectly granted credit due to the lack of substantive information being available about the applicant's true financial position.

MasterCard believes a robust financial services industry which serves the needs of its consumers requires three essential pillars:

1. A level playing field to promote competition;
2. Bankruptcy laws to deal with moral hazards; and
3. Access to positive credit information.

The Australian financial sector, more or less, provides the first two pillars, however an antiquated privacy regime has held back the provision of the third essential pillar. In this light the existing credit reporting model, regulated by the Commonwealth *Privacy Act 1988*, leads to unnecessarily high levels of risk in assessing finance applications and is clearly out of step with international best practice.

Incomplete Information

While the lender understands the financial products that they sell, they are fairly illiterate when it comes to understanding whom they sell to. A lender relies almost exclusively in some instances on a customer's declaration as to their current financial position. A lender in Australia is not afforded the

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[1] Among other things, MasterCard's rules include the so-called Honor All Cards and No Surcharge Rules. In addition, MasterCard's rules authorize its members in most countries to establish the interchange fees that apply to MasterCard, MasterCard Electronic and Maestro POS and ATM transactions. However, in some countries (e.g., the US, Australia, New Zealand, Canada, the UK), MasterCard POS interchange and ATM interbank fees are established by MasterCard management or the applicable MasterCard board of directors.

same tools of customer risk assessment that are available in almost every other country in the world, including countries such as the United States, United Kingdom, Canada, Hong Kong, and Singapore. The lack of comprehensive credit reporting in Australia means debt defaults are much higher than they should be[2], and according to a study commissioned by MasterCard, the Australian economy is forgoing up to $5.3 Billion[3] in GDP over the next ten years.

MasterCard, and other members of the credit provision industry, believe that the Government is better able to manage the fortunes of the economy by facilitating an improvement in the quality of consumer credit, while at the same time ensuring consumers are not entering into never-ending cycles of debt. Comprehensive credit reporting is an essential ingredient in the sustained achievement of these objectives.

Although MasterCard does not have a view on the long term prospects of the Australian economy, the existing issues with managing household debt will blow-out significantly when the inevitable economic downturn eventuates. Hong Kong unfortunately learnt this lesson too late, but it (together with other Asian economies), has hastily moved to implement a positive credit reporting system, coming in line with the other developed countries mentioned above. In our view it would be an extremely beneficial move for Australia to follow in step with this change, ensuring that it is better able to engineer a soft landing if such a downturn eventuates.

The Importance of Positive Credit Information

Credit markets are notoriously information inefficient with asymmetries existing across the spectrum of lenders and borrowers. This asymmetry prevents lenders from knowing enough about the borrowers, and from borrowers knowing enough about the lenders' willingness to lend. This common environment severely hampers the efficiency of the credit markets. The resulting inefficiencies impose high costs on both the financial industry and consumers in the form of lower returns for the former and higher costs in getting credit for the latter. This information asymmetry could be partially addressed when "negative" credit information is made available – information on delinquent behaviour which includes credit in arrears, court judgments on debts, personal bankruptcy and the like. This information asymmetry can be said to have been closed, however, only when "positive" information is also made available – information related to prospective borrowers' outstanding debt obligations, types of credit and their histories, even when the borrower has never defaulted or gone bankrupt.

In virtually all advanced economies such positive credit information is made available to close the information asymmetry through the establishment of a comprehensive positive credit information system, usually known as a positive credit bureau. The operations of the positive credit bureau are usually regulated to protect consumer privacy, as is demonstrated in the privacy sensitive United Kingdom.

The net effect of the availability of such positive credit information has been a lowering of the credit risk inherent in such markets. In a study[4] conducted on 43 countries, including most OECD countries, it was estimated that the sharing of positive credit information reduced credit risk by between one third and one half. It has been found that securitisation of mortgages, which depends on

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[2] *The Value of Comprehensive Credit Reports: Lessons from the US Experience'* by Prof. Barron (Purdue University Illinois) and Prof. Staten (Georgetown University, Washington D.C) November 2001, found that credit defaults could be reduced by up to 63% if comprehensive credit reporting was available in Australia.

[3] *Dealing with Debt Default - An Analysis of the Economic Benefits of Allowing Comprehensive Credit Reporting in Australia.* ACIL Tasman March 2004

[4] Japelli, Tullio and Pagano, Marco, 2000, "Information Sharing in Credit Markets: The European Experience", *CSEF Working Paper No. 35,* Centre for Studies in Economics and Finance, University of Salermo

positive credit information, had lowered mortgage rates by up to two percentage points in the US,[5] a very significant benefit to US consumers and the financial industry. The positive credit bureau thus allows credit provision to be more targeted and priced appropriately. Likewise, it has allowed borrowers to better signal their credit worthiness to the lending community.

Furthermore, discussions MasterCard has had with financial counselling organisations also reveal the social costs associated with debt defaults. A number of these groups support a move to positive credit reporting, as they see a direct correlation between the problems being experienced by consumers today, with the lack of credit information available to lenders at the application assessment stage. On the face of it, it is quite clear that the economic and social arguments point in favour of change.

Existing Credit Legislation

The Uniform Consumer Credit Code that operates in Australia to regulate lending practices is world class, and Code's Management Committee is continually looking at ways to keep the law up to date with developments in the industry and best practice disclosure processes as they emerge in other jurisdictions. In MasterCard's opinion there is no need to introduce further regulation of the credit provision industry. Notwithstanding the above, allowing for positive credit information to be shared amongst lenders will give the Credit Code greater empowerment, as lenders are better able to fulfil their legislative requirement of making reasonable enquiries of the applicants ability to service a loan.

Overall recommendation

Any government efforts aimed at understanding and changing consumer behaviours with respect to access and use of credit will be flawed unless they are accompanied by structural changes in the way in which we provide access to financial products. Eliminating the potential to enter into bad debt should work hand in hand with programs geared to deliver long term behavioural change.

MasterCard would be reticent to join efforts to effect this change unless this structural change occurs, we therefore call upon the Government to adhere to the Wallis Inquiry's recommendation and undertake a Parliamentary Inquiry into credit reporting at the earliest possible opportunity.

We would be delighted to discuss this matter with you in greater detail at a time convenient to you, or to respond to a government review of credit reporting in Australia.

Sincerely

Leigh Clapham
Senior Vice President &
General Manager – Australasia

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[5] Kitchenman, Walter, 1999, *US Credit Reporting : Perceived Benefits Outweigh Privacy Concerns*, Tower Group, Needham.