Review of Privacy: Credit Reporting Provisions

Issues Paper No. 32

Submission to the ALRC

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Introduction

ANZ welcomes the opportunity to provide comment to the Australian Law Reform Commission's inquiry into the effectiveness of the Credit Reporting Provisions of the Privacy Act 1988 (Cth) (Issues Paper 32).

'Comprehensive' or 'positive' credit information should enable lenders to make better credit decisions, but there is no consistent evidence that this occurs wherever such a system operates. Before ANZ is able to support the shift to a more comprehensive credit reporting model, a number of issues need to be considered as part of an examination of the costs and benefits of introducing a comprehensive credit reporting scheme in Australia. In particular, Federal Treasury should undertake an assessment of the social and economic impacts.

If the decision were made to move to a comprehensive credit reporting scheme, ANZ believes that the complexity and importance of this issue would require the appointment of an expert panel, including consumer representatives, to define the operational aspects of the model. Should this eventuate, ANZ would be pleased to participate in this process.

The Issues Paper poses a number of questions on which comment is invited. ANZ does not propose to respond to each question, rather this submission outlines some of the benefits and issues that ANZ believes need to be addressed.

Why move to comprehensive credit reporting?

The case for comprehensive or positive credit reporting generally relies on the argument that more information leads to closer pricing for risk, more competitive credit markets, increased availability of credit and better quality lending decisions.

Overseas experience suggests that positive credit reporting would lead to finer segmentation of customers and closer pricing for risk. As it currently stands, most credit card issuers offer a single interest rate per product, regardless of a customer's creditworthiness. Comprehensive credit bureau data in the United States was critical to the introduction of new competition and more efficient risk pricing.[1] Incumbent issuers lost low risk customers to new entrants offering lower rates. In response, incumbents such as American Express and Citibank began to offer tiered pricing, leading to an increase in competition and a decline in rates at each tier between 1990 and 1992. The proportion of customers facing more than 18 per cent fell from 70 per cent to 44 per cent during that time.[2]

Positive credit reporting will also create a choice for lenders about whether to lower their target default rate or whether to lend more while retaining their current rate. A model prepared by Barron and Staten shows that under a

[1] Barron, JM and Staton, M 2001, *The Value of Comprehensive Credit Reports: Lessons from the U.S. Experience*, p.11.
[2] Ibid. pp.10-11.

negative reporting system lenders targeting a 4 per cent default rate approved around 74 per cent of loan applications. However, under a positive credit reporting system lenders were able to broadly maintain their approval rate while at the same time decreasing their target default rate, alternatively lenders were able to maintain their target default rate at 4 per cent while increasing the number of applications approved to 84 per cent.[3] In other words, it appears that at a macro level, either credit could be expanded or default rates maintained, but not both.

The evidence about impact on defaults from countries where there is a positive credit reporting system is not consistent. In Hong Kong, for example, it has been reported that between 2003 and 2004 material defaults in credit accounts (excluding mortgages) fell by 38 per cent, while write offs fell by 64 per cent over the same time and this was largely attributed to the new positive credit reporting system.[4]

Experience in the United States suggests that the credit market would be expected to expand. Barron and Staten make the point that: "in the U.S. the combination of technological advances and flexible public policy toward data collection have fostered an explosion in consumer credit availability".[5]

Assuming the credit market were to expand, even with the percentage default rate remaining unchanged, Australia may experience an increase in the actual number of consumers that experience financial hardship. Assuming a default rate of 4 per cent, the potential increase in lending suggested by the Barron and Staten research could lead to the number of defaults per 100,000 loan applications increasing by 380, from 2948 to 3328.

Positive credit reporting may also lead to the increased availability of lending to previously excluded borrowers at higher interest rates than 'mainstream' borrowers, who may experience a higher default rate. The development and significant growth of the sub-prime mortgage market in the United States can be, in part, attributed to comprehensive credit reporting. While this has afforded access to home ownership to a greater number of people, it has also exposed these consumers to the declining housing market. While delinquencies have risen for all mortgage categories in the United States, the strongest growth has been in the sub-prime market.

ANZ believes that the Australian Government needs to take into consideration the current availability of credit in Australia, as well as the broader social and economic impact of an expanded credit market when determining the need for positive credit reporting.

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[3] Ibid. p.21, Table 3 "Effects on Credit Availability of Adopting a Negative-only Credit Scoring Model for Various Default Rates"

[4] Centre for International Economics and Edgar Dunn and Company, Options for Implementation of Comprehensive Credit Reporting in Australia [Prepared for MasterCard Worldwide] (2006), P 118

[5] Barron, JM and Staton, M 2001, *The Value of Comprehensive Credit Reports: Lessons from the U.S. Experience*, p.11.

Issues to be considered

If a move to positive credit reporting were to occur, the design of the system would have a bearing on outcomes, and so ANZ offers the comments below.

1. *Protection of Privacy & Controls over Data Access and Usage*

In ANZ's view, access to comprehensive credit information should occur only with the express consent of consumer applicants and be limited to credit providers assessing a credit application and credit reporting agencies. However, it is important to note that while a consumer may be able to refuse consent, a credit provider is unlikely to extend credit if it is unable to make an adequate risk assessment based on all the available information.

ANZ would not support unrestricted access for marketing purposes and considers that the information should be subject to adequate privacy protections when used for a lender's own customers with the customer's consent.

2. *Data Reciprocity*

In line with the current system, a comprehensive credit reporting system should be based on a principle of reciprocity. Only those credit providers who have submitted positive credit information should have access to the positive credit information held by the credit reporting agency. Credit providers who submit negative-only information (such as utility and telecommunication companies) should only have access to negative data.

The effectiveness of a comprehensive credit reporting system in Australia is likely to be dependent on the level participation of credit providers and the principle of reciprocity should provide a strong incentive for lenders to participate.

3. *Data Quality*

ANZ considers data quality an important aspect of any credit reporting system and supports the development of industry standards for data quality under a comprehensive credit reporting system. Under the current system, negative credit data is reported on an 'exception' basis. However, positive credit reporting would require a regular feed of 'current' data, which in itself may improve the quality and accuracy of the information held by credit reporting agencies.

4. *Complaints Handling & Dispute Resolution Standards*

ANZ considers that credit reporting should be supported by an accessible dispute resolution scheme, such as the Banking and Financial Services Ombudsman. This is necessary regardless of the type of credit reporting system. The Australian Retail Credit Association (ARCA) is working towards producing a Code of Conduct for participants in credit reporting, a key part of which is the establishment of a dispute resolution scheme which is likely to leverage off existing schemes.

5. Governance & Oversight Framework

ANZ considers the appropriate approach would be a self-regulatory model with adequate governance through an advisory body with representation from relevant stakeholder groups. The regulatory framework for a comprehensive credit reporting system need not be unnecessarily burdensome on credit providers but must also provide protection for consumers and their privacy. ANZ suggests further examination of overseas models, such as the United Kingdom, would be needed to determine which features would suit the Australian environment.

Conclusion

'Comprehensive' or 'positive' credit information should enable lenders to make better credit decisions, but there is no consistent evidence that this occurs wherever such a system operates. Before ANZ is able to support a shift to a more comprehensive credit reporting model, a number of issues, including those highlighted above, need to be considered as part of an examination of the costs and benefits of introducing a comprehensive credit reporting scheme in Australia.

If the decision were made to move to a comprehensive credit reporting scheme, ANZ would recommend the appointment of an expert panel, including consumer representatives, to define the operational aspects of the model. The design of the model would be important in ensuring consumers' privacy is protected.

ANZ would be pleased to provide any further information about this submission as required and can be contacted as follows:

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