1 April 2015

Dr Richard Chadwick
General Manager
Adjudication Branch
Australian Competition & Consumer Commission

By email: adjudication@accc.gov.au

Dear Dr Chadwick,

Australian Retail Credit Association Authorisation A91482 - Principles of Reciprocity & Data Exchange

The Consumer Action Law Centre (**Consumer Action**), Financial Rights Legal Centre (**Financial Rights**) and Financial Counselling Australia (**FCA**) welcome the opportunity to provide a submission on the likely public benefits and effect on competition of the Australian Retail Credit Association's (**ARCA**) proposed Principles of Reciprocity and Data Exchange (**PRDE**).

Overview

Our organisations have for many years expressed concerns about the impact of comprehensive credit reporting (**CCR**) on consumers. However, the legislature by enacting CCR has indicated that it considers such a regime beneficial despite these concerns. In our view, it seems that the CCR regime cannot be effective unless there is an element of reciprocity, as demonstrated by the lack of industry participation in CCR to date.

We acknowledge that there are some benefits of the PRDE. At the very least it is a positive step towards having a single source of free credit reports for consumers, and it is likely to improve consistency in data reporting and competition amongst credit reporting bodies (**CRBs**). However, we wish to provide some alternate views on a number of the other public benefits articulated in ARCA's application. In our view, CCR may be detrimental to consumers, particularly those who are financially excluded and marginalised, meaning transparency and enforceability of any reciprocity arrangement is imperative.

Our key concerns are that the PRDE does not resolve the critical problem of consistency in treatment of hardship variations on credit reports, and that the proposed PRDE may interfere with legitimate settlement negotiations that relate to the listing of credit defaults.

Briefly, this submission also argues that:

- the PRDE may result in increased lending, thereby increasing the overall number of consumers in default;
- while the PRDE is likely to reduce costs for some consumers, this will unlikely be the result for Australia's most vulnerable and marginalised consumers and may exacerbate financial exclusion;
- licensed credit providers (**CPs**) cannot rely on a comprehensive credit report to comply with their responsible lending obligations, nor can the financial regulator rely on a report to enforce these obligations;
- lower credit default rates are more a function of lender's risk appetite rather than a reflection on the quality of information provided to lenders;
- the PRDE will only be effective if the vast majority of CPs sign up to it;
- we are not convinced the monitoring, reporting and compliance process in the PRDE is sufficiently independent and transparent; and
- a comprehensive review process is needed to ensure that the PRDE is actually in the public interest.

1. About the contributors

Consumer Action is an independent, not-for profit consumer organisation based in Melbourne. We work to advance fairness in consumer markets, particularly for disadvantaged and vulnerable consumers, through financial counselling, legal advice and representation, and policy work and campaigns. Delivering assistance services to Victorian consumers, we have a national reach through our deep expertise in consumer law and policy and direct knowledge of the consumer experience of modern markets.

Financial Rights is a community legal centre specialising in financial services, particularly in the areas of consumer credit, banking, debt recovery and insurance. It fully integrates telephone assistance and financial counselling with legal advice and representation. Financial Rights also operates the Insurance Law Service, a national specialist consumer insurance advice service.

FCA's role is to support the financial counselling profession, providing a voice in national debates. FCA also advocates on behalf of the clients of financial counsellors for a fairer marketplace that will prevent financial problems in the first place.

2. Consumer benefits of comprehensive credit reporting

ARCA's application argues that one of the benefits of the PRDE is that 'lenders can... extend credit to more consumers without increasing default rates'.[1] Our organisations have for many years expressed concerns about the likelihood of CCR resulting in increased lending.[2] While increased overall lending might lead to greater community benefit in terms of consumers accessing goods and services, unless default rates are reduced, increased lending will necessarily mean that the overall number of people experiencing credit default will increase.

[1] Australian Retail Credit Association, 'Principles of Reciprocity and Data Exchange (PRDE) - Submission in support of Application for authorisation', 20 February 2015, section 5.2.
[2] Consumer Action Law Centre, 'Credit reporting and responsible lending', 2008, available at: http://consumeraction.org.au/wp-content/uploads/2012/11/Fact-Sheet-credit-reporting-and-responsible-lending-Dec-08.pdf.

By ARCA's own admission, a reduction in default rates is unlikely—ARCA talks of lenders being able to extend more credit 'without increasing default rates.'[3] It seems most likely that default rates will remain at a level acceptable to lenders, and there is little reason to suggest lenders' default risk appetite will change merely because of CCR. It therefore appears to us that with CCR, we will see more people fall into credit difficulties.

One of the leading industry reports on CCR found that based on their own research and the US experience, the benefits included 'dramatic penetration of lending into lower socio-economic groups, making a variety of consumer loans available across the income spectrum' and a 'reduction in loan losses that would have accompanied such market penetration in the past'.[4] What this means is that even if the PRDE has a positive impact on default rates in Australia (and we are not convinced that it will), this would be in an environment in which lending is dramatically increased, thereby increasing the overall number of consumers in default—and increasing debt stress substantially.

ARCA's application argues that the PRDE will create more effective competition amongst lenders, 'leading to potentially lower costs'.[5] While it we acknowledge that the PRDE is likely to reduce costs for some consumers, this will unlikely be the result for Australia's most vulnerable and marginalised consumers. Elsewhere in the application, ARCA acknowledges that the PRDE will lead to greater risk-based lending, which means for those deemed to be a higher credit risk will be charged higher interest rates or denied credit altogether.

In our view, at best, the overall the costs incurred by some consumers as a result of the PRDE may be lower but there will be many vulnerable consumers who will pay more for credit. This is particularly the case for products like credit cards, despite marginalised Australians already cross-subsidising wealthy card holders in the credit card market.

The application also states that one of the benefits of CCR is increased financial inclusion. Financial inclusion includes consideration of the fairness, appropriateness and affordability of the products. We do not believe the PRDE or the new CCR regime will necessarily increase these public benefits.

Instead we believe CCR will only increase risk-based pricing for consumers. Risk-based pricing already operates in Australia and it is expected to increase over time. This means consumers that live pay check to pay check and sometimes pay bills late will be charged higher interest rates, causing them to be more excluded from mainstream lending and other financial products. Higher interest rates are linked to increasing financial hardship as the cost of credit makes the debt more expensive to repay. In addition, any lowering of income will expose the borrower to financial hardship as s/he struggles to keep up with compounding interest costs. We remain concerned that CCR and this Code will lead to further "financial exclusion" or expensive rates of interest.

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[3] Submission in support of Application for authorisation, section 5.2.
[4] Professor John M. Barron & Professor Michael Staten, 'The Value of Comprehensive Credit Reports: Lessons from the US Experience', 2000, page 27, available at: http://www1.worldbank.org/finance/assets/images/value_of_comprehensive_credit_reports1.pdf.
[5] Submission in support of Application for authorisation, section 5.2.

3. Benefits for credit providers

ARCA's application argues that CCR will lead to “greater innovation in financial services".[6] ARCA has not articulated the kinds of innovation we can expect to see as a result of the PRDE. However, we warn that our experience with 'innovation' in credit has generally been creditor providers engaging in regulatory avoidance or extending risky products to those that can’t afford them (for example, in the payday lending industry).[7]

ARCA's application also states that CCR 'makes it possible to efficiently verify an individual's credit commitments and therefore assess credit applications'.[8] However, it is clear from ASIC Regulatory Guide 209 licensed CPs cannot rely on a comprehensive credit report to comply with their responsible lending obligations,[9] although such a report may assist them in verifying information gathered about a borrower.

CPs are required to assess a borrower's financial situation, needs and objectives. This involves obtaining information about the consumer’s actual income, expenses and other circumstances that are likely to affect their ability to meet the financial obligations of the proposed credit contract or consumer lease.[10] A credit report cannot set out a person's needs or objectives, nor can it provide information about a consumer's income, living expenses or likely future liabilities. However, it will enable lenders to 'more accurately price credit',[11] which as outlined above generally means more expensive credit for low income and marginalised consumers.

4. Benefits to regulators

ARCA's application argues that maximising the data available to CPs 'might assist [ASIC] when assessing compliance with responsible lending requirements' and that 'enforcement of responsible lending obligations could be simplified if there was ready access to comprehensive credit information by all CPs'.[12]

A comprehensive credit report has minimal bearing on whether a credit provider has met their responsible lending obligations. As set out above, CPs are required to assess borrowers' financial situation, needs and objectives. This involves obtaining information about the consumer’s actual income, expenses and other circumstances that are likely to affect their ability to make repayments. As ARCA states elsewhere in its application (especially where CRBs compete and hold different information), a credit report is unlikely to

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[6] Submission in support of Application for authorisation, section 5.3.
[7] For example, the Australian Securities and Investments Commission's (**ASIC**) recent report on payday lending identified 'problematic practices where payday lenders set the loan term on credit contracts 12 months or more in circumstances where the relevant file indicated that the consumer requested a shorter loan term of well under 12 months. This seems to be an attempt to ensure, even if the consumer pays out the loan earlier than the term, the lender still recovers12 months’ worth of monthly fees' - see ASIC Report 426: Payday lenders and the new small amount lending provisions, available at: http://download.asic.gov.au/media/3038267/rep-426-published-17-march-2015.pdf.
[8] Submission in support of Application for authorisation, section 5.3.
[9] Credit licensees' responsible lending obligations are set out in Chapter 3 of the *National Consumer Credit Protection Act 2009*.
[10] Australian Securities and Investments Commission, 'Regulatory Guide 209 - Credit licensing: Responsible lending conduct', November 2014, RG 209.30, available at: http://download.asic.gov.au/media/2243019/rg209-published-5-november-2014.pdf.
[11] Submission in support of Application for authorisation, section 5.3.
[12] Submission in support of Application for authorisation, section 5.4.

ever show a full picture of a consumer's financial situation or needs and objectives.[13] ASIC will not be able to substantiate a case of irresponsible lending based on a comprehensive credit report. The existence of a comprehensive credit report is unlikely to simplify enforcement, particularly given ASIC's significant evidentiary burdens.

5. Benefits to the economy at large

The application states that CCR can contribute to 'lower credit default rates'.[14] However, as noted above, in our view default rates are more a function of lender's risk appetite rather than a reflection on the quality of information provided to lenders.

6. Reciprocity obligations are needed to realise the benefits of comprehensive credit reporting

We believe the PRDE will only be effective if the vast majority of CPs sign up to it. We have been told informally on numerous occasions by senior people in the big banks that there is uncertainty about whether the bank will commit to the Code. ARCA has not provided evidence of its members' commitment to the Code.

7. Consistency obligations will prevent discrimination and facilitate competition

The PRDE does not resolve the critical problem of consistency in treatment of hardship variations on credit reports. This is a problem for CPs that will sign up under the comprehensive tier level of the PRDE to provide and receive Repayment History Information (**RHI**) about consumers. There is no clear resolution for how CPs are expected to record RHI when a consumer has entered into a repayment arrangement due to financial hardship. Without consistency on this one critical issue consumers are very concerned about the fairness, transparency and even workability of the PRDE as well as the entire credit reporting regime.

We believe it would be possible to deal with this issue in the PRDE, noting that it would only be valid to the extent that it does not conflict with any relevant legislation that may be introduced to deal with the issue. In the long run the issue of RHI and hardship will need to be resolved at the legislative or regulatory level. Until this issue is resolved somewhere, even temporarily, we do not believe it is possible for CPs to provide RHI consistently under the PRDE.

Consumer advocates have expressed our views on this issue repeatedly with ARCA and the OAIC. The following is a brief summary of our position:

- RHI must be reported in a way that accurately reflects the hardship variation entered. For example:
    - if a hardship arrangement allows a debtor a moratorium or variation on payments for a certain period, RHI should never suggest that there was an obligation to make payment existed and payment was missed. Under contract law, repayments can be varied by agreement for a range of reasons, including

[13] Submission in support of Application for authorisation, section 2.1.
[14] Submission in support of Application for authorisation, section 5.5.

hardship. If the contract is varied and the debtor meets the obligations under the varied contract, then there can be no missed payment; and
    - CPs should carefully explain (and confirm in writing) whether a variation will have any impact on a debtor's credit file.
- Additionally, the way RHI is reported should avoid operating in a way that discourages debtors from seeking a hardship variation.

We agree with ARCA that the current situation (where there is a lack of uniformity over how RHI will be reported) is unacceptable. We are keen to work with the industry to find a workable solution. However, we do not support ARCA's proposal to put a temporary hardship flag on credit reports in place of RHI as this would cause many debtors (we suspect the majority of debtors) to avoid asking for a hardship variation if they knew that other CPs will be informed about the hardship variation and may react by closing or restricting existing credit contracts. We also note that the Government (in developing the credit reporting laws) has repeatedly rejected industry calls for hardship flags.

We propose that future discussion on this topic needs to be informed by independent research on:

- what kinds of processes have been used in other jurisdictions, and how well they have worked; and
- consumer testing to gauge attitudes of consumers (particularly low income, disadvantaged and vulnerable consumers) against a variety of RHI reporting options.

In our view, it should be clear under Principle 1 that where a CP has chosen to contribute comprehensive information under the PRDE, the CP must not disclose a payment as overdue if the individual entered into a hardship arrangement. During the period of the hardship arrangement, RHI should be recorded as "Current up to and including the grace period", in accordance with clause 8.2(c)(i) of the *Credit Reporting Code 2014* (**the CR Code**). If CPs are offering genuine hardship arrangements, the debt is no longer 'overdue' for the hardship period meaning it should not be reported as such.

'Hardship arrangement' should also be defined in the definitions section of the PRDE. For example: 'Hardship arrangement' means a consumer has made a ‘hardship request’ as defined in section 1.2 of the CR Code and the consumer has formally agreed with a CP to a moratorium or variation on payments for a certain period of time due to financial hardship.

Detailed guidance then needs to be produced to explain when credit reporting information can be disclosed for the purposes of assisting a debtor to avoid defaulting under clause 16.2 of the CR Code. At present clause 16.2 to open to wide interpretation, which is concerning given the growing number of predatory business models purporting to assist consumers with debt problems.

8. Enforceability

One of the big issues for consumers in the credit reporting system is that data on their credit reports is not always correct. The new CCR regime increases the amount of data on consumer credit files, and accordingly increases the probability of incorrect information being recorded.

There are significant concerns over the accuracy of information contained in credit reports. In 2013, a survey conducted by the Office of the Australian Information Commissioner found that of those who had accessed their credit report, 30% found the information in the report to be incorrect. Only 57% were able to have the information corrected.[15] This raises significant potential for mismatching of individuals to debts owing.

Inaccuracies disadvantage consumers because they create the potential to be unfairly denied credit and pursued for debts that do not belong to them. It also disadvantages CPs because they are less able to rely on credit report information as an accurate gauge of a person's creditworthiness and leads to inefficiencies in the credit system.

We are not convinced the 'monitoring, reporting and compliance' process under Principle 5 of the PRDE is sufficiently independent and transparent to create any real public benefits. It is in the public interest to have effective mechanisms in place to review information on credit files and rigorous methods of ensuring data quality. We do not believe ARCA has demonstrated that the monitoring, reporting and compliance procedures under the PRDE will assist the public interest in identifying systemic problems with data quality in credit files (i.e. consumer advocates will still have to rely on individual clients recognising incorrect listings on their reports).

At the very least, monitoring and compliance functions should be independent from the industry, so as to facilitate consumer confidence. We recommend that any governance or decision-making bodies (such as the PRDE Administrator Entity, Independent Determination Group and/or the Eminent Person Panel) include representation from consumers, and be chaired by someone independent from the industry. Reporting must be public, and encourage transparency of all decision-making and/or sanctions.

Other options that could be considered to improve enforceability and transparency include:

- providing the PRDE Administrator with additional powers to undertake compliance audits of signatories;
- allowing the PRDE Administrator to initiate a report of non-compliance where the PRDE Administrator has concerns regarding data quality and accuracy;
- requiring the PRDE Administrator Entity to report systemic non-compliance to the Privacy Commissioner;
- providing a mechanism for consumers to make complaints to the PRDE Administrator about data quality and accuracy;
- establishing a Consumer Advisory Panel;
- enabling non-compliant CPs and CRBs to be expelled from the PRDE; and
- introducing an enhanced self-reporting regime, which could be similar to the 'significant breach reporting' regime for Australian Financial Services Licensees under the *Corporations Act 2001*.

[15] Office of the Australian Information Commissioner, 'Community Attitudes to Privacy survey', 2013, page 45, available at: http://www.oaic.gov.au/images/documents/privacy/privacy-resources/privacy-reports/2013-community-attitudes-to-privacy-survey-report.pdf.

9. Other considerations

Review of PRDE

CCR has only recently changed. To the best of our knowledge there are no licensed CPs using the five new data sets available under the new laws. We contend that Australia must be distinguished compared to countries such as the United States of America because Australia has strong responsible lending laws for credit. This means that the lender must obtain detailed information from each new client about their financial position. This information is (for the most part) more comprehensive than the information available on the borrower's credit report. The credit report complements this information by providing a history of defaults. It is also arguable that RHI may provide some information that may not be obtained through responsible lending. Although the credit report may provide further information it is not necessary for CPs to comply with responsible lending obligations in Australia. It is in this context that Australia needs to take great care not to simply "cookie-cut" solutions from other countries to try and fit our unique conditions.

We note that ARCA is seeking approval in a situation where no CPs are using the extra data sets. This is risky as it is seeking to predict what will happen when that is not known. We recommend that any approval needs to incorporate a comprehensive review process to ensure that the PRDE is actually in the public interest.

Ability to negotiate with creditors and the role of EDR

Representatives of consumers (which includes solicitors, financial counsellors and other caseworkers) regularly include the contents of credit reports in negotiated settlement outcomes. Settlements are reached following disputes about the debt claimed. The PRDE cannot and should not interfere with legitimate settlement negotiations. It is a matter between the parties to determine how a dispute is settled and the PRDE must specifically acknowledge the rights of both parties in this matter. Interference with settlement negotiations and the ability of the parties to comprehensively settle a dispute is contrary to the public interest.

The PRDE also must acknowledge the role of External Dispute Resolution schemes to make rules that delay or remove listings. An EDR scheme will be ineffective in resolving the entire dispute if credit report listings cannot be removed.

We suggest adding another exception to the requirement to contribute credit information under Principle 1, which would provide that a CP can delay, remove or choose not to list credit defaults about a consumer if:

- the CP has entered into a binding settlement with the consumer, or is in the process of legitimate settlement negotiations with the consumer in regards to the listing; and/or
- the CP is acting in accordance with a recommendation or determination of an EDR scheme in relation to a dispute with the consumer.

If you have in queries in relation to this submission, please contact Katherine Temple, Senior Policy Officer at Consumer Action Law Centre on (03) 9670 5088 or at katherine@consumeraction.org.au.

Your sincerely,

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