AUSTRALIAN
RETAIL
CREDIT
ASSOCIATION

26 October 2018

The Honourable
Commissioner
Royal Commission into Misconduct in the Banking,
Superannuation and Financial Services Industry

Dear Commissioner

Australian Retail Credit Association submission to the Interim Report

Thank you for the opportunity to make a submission on policy issues identified in the Interim Report.

Our submission focusses on the availability of data to assist credit providers to meet their responsible lending obligations under the *National Consumer Credit Protection Act* (NCCP Act).

In respect of the questions set out in Chapter 10, Section 8, our comments relate to:

- Consumers: How should the lender assess suitability?
- Are changes in law necessary: Should the financial services law be simplified?

We were motived to make this submission due to the following passage from the Interim Report (at page 269):

> *"Banks' dealings with customers seek to minimise risk to the bank. The bank fixes its risk appetite. It decides to whom it will lend and on what terms. It decides whether security should be provided and what form and value it should take. Hence, banks have only as much 'skin in the game' in their dealings with customers as the bank chooses. And there is always a striking asymmetry of power and information between bank and customer that favours the bank."*

With respect, we disagree with the key assertion in that passage that there is always an asymmetry of power and information that favours the bank. The question of whether the bank will lend to a person depends on the picture of their financial position that a prospective customer presents to the bank and whether the bank has accurate, complete and relevant information with which to verify that picture.

In respect of the verification process, a customer will invariably have more information regarding their own financial situation than the bank that is being asked to lend money. This information includes the facts of the customer's financial situation, such as income, expenses

and current liabilities; but also, more subjective matters, such as the customer's behaviours and attitudes to money and debt, and the customer's future life plans that may affect their financial position including decisions they may be contemplating around career, education or family.

Nearly every country with a developed financial system has addressed part of the information asymmetry that credit providers face through the creation of a credit reporting system which records an individual's previous history with credit and makes the record available to prospective lenders to help assess and verify new credit applications[1]. The credit report assists the lender to verify the facts of the customer's financial situation (as it relates to existing financial liabilities), but also gives insight into the customer's behaviours and attitudes to debt (through the customer's previous history with debt).

The ability of a bank to get accurate, complete and relevant data regarding a customer's financial situation in an efficient manner assists a credit provider to lend responsibly and ensure that credit is available to those who need it on fairer terms. In relation to credit reporting, regulatory policy has, until quite recently, restricted the development of the system so that it only held "negative" data e.g. defaults. The regulatory reform process that enabled more "comprehensive credit reporting" (CCR) from March 2014 still severely restricted the depth and breadth of data that may be reported in Australia compared to other markets such as the UK, Canada, and the US. While there are other methods for a bank to obtain data to undertake a verification process those methods lack the structure, standardisation and security of the credit reporting system.

ARCA considers that the credit reporting system, as established under *Part IIIA* of the *Privacy Act* (Part IIIA), should be further enhanced to permit the exchange of information regarding the actual balance of a customer's existing credit accounts, together with details of the actual payments required and made in respect of those accounts. In addition, the review currently being led by the Attorney-General's Department into whether consumers under financial hardship arrangements should be identifiable in the credit reporting system, should be completed as soon as possible (see xv in Appendix A).

We have set out detailed comments in Appendix A.

About ARCA

The Australian Retail Credit Association (ARCA) is the peak industry association for organisations involved in the consumer credit reporting system in Australia. Our objects include promoting, through education and advocacy, responsible credit assessment and credit management practices. Membership of ARCA is voluntary and includes the thirteen largest banks, and a broad range of fintechs, finance companies, credit union and mutual credit providers. The four national credit reporting bodies are ARCA Members. Our 42 Members account for well over 95% of all consumer lending in Australia.

Our role extends to a governance function in respect of the operation of the industry-developed framework for credit reporting that supports consistent and efficient credit reporting and data exchange. We created and administer the Principles of Reciprocity and Data Exchange and the Australian Credit Reporting Data Standard, which are key pieces of the framework.

[11] For further background on the basis information asymmetry that exists see International Finance Corporation (2012) "Credit Reporting Knowledge Guide", page 4. The IFC is part of the World Bank.

ARCA was also engaged by the Information Commissioner to act as the code developer under section 26P of the *Privacy Act* to develop the credit reporting code of conduct, which was then registered as the *Privacy (Credit Reporting) Code 2014* (the CR Code).

Again, we thank you for the opportunity to make this submission in respect of the policy issues raised in the Interim Report. We would welcome any opportunity to provide further comment on this issue.

If you have any questions about this submission, please feel free to contact me.

Yours sincerely,

Mike Laing
Executive Chairman

Appendix A – data availability to assist with responsible lending assessments

i. We note the following passage from the Interim Report (at page 269):

Banks' dealings with customers seek to minimise risk to the bank. The bank fixes its risk appetite. It decides to whom it will lend and on what terms. It decides whether security should be provided and what form and value it should take. Hence, banks have only as much 'skin in the game' in their dealings with customers as the bank chooses. And there is always a striking asymmetry of power and information between bank and customer that favours the bank.

ii. With respect, we disagree with the key assertions in that passage. While it is correct that a bank decides on the 'type' of person to whom it would *like* to lend (or, sometimes, the type of person to whom is *doesn't* want to lend), the question of whether the bank will lend to a person depends on the picture of their financial position that a prospective customer presents to the bank and whether the bank has accurate, complete and relevant information with which to verify that picture.

iii. In respect of the verification process, it is incorrect to say that the asymmetry of information between the bank and customer always favours the bank. A customer will invariably have more information regarding their own financial situation than the bank that is being asked to lend money. This information includes the facts of the customer's financial situation, such as income, expenses and current liabilities; but also, more subjective matters, such as the customer's behaviours and attitudes to money and debt, and the customer's future life plans, including decisions they may be contemplating around career, education or family.

iv. While a bank that already provides financial services to the customer, including savings or transactional accounts, will have access to that customer's financial records, even this may not provide a complete picture of the customer's financial position – if only because the customer may have undisclosed financial commitments with other lenders. This affects all types of lenders, but is a bigger problem for smaller, newer lenders who are less likely to hold an existing relationship with the customer (and are less likely to provide transactional accounts that can give an indication of that customer's income and expenditure).

v. Nearly every country with a developed financial system has addressed the challenge of verifying customers' existing financial liabilities with the development of a credit reporting system which records an individual's previous history with credit and makes the record available to prospective lenders to help assess and verify new credit applications. The credit report assists the lender to verify the facts of the customer's financial situation (as it relates to existing financial liabilities), but also gives insight into the customer's behaviours and attitudes to debt (through the customer's previous history with debt including repayment history).

vi. The benefits of the credit reporting system are not just limited to verifying the existence or value of existing financial liabilities. It also provides the bank the ability to predict the likelihood that a prospective borrower will default based on the customer's behaviours and attitude to credit (as indicated by their history with previous credit).

vii. As noted in the Interim Report (at page 24) this is a significant part of the bank's credit assessment process, but the bank's responsible lending obligations are *not* limited to this assessment. In that regard, the assessment of the customer's behaviours and attitude to previous credit is also relevant to the responsible lending assessment required by NCCP Act as it is a key indicator of whether *further inquiries and verification* are required of a customer.

viii. For instance, if two customers apply to a lender and the lender can see from their respective credit reports that, despite their apparent identical financial circumstances, one customer has regularly missed payments on their existing credit cards, this may be a trigger for the lender to take additional steps to understand and verify that customer's financial circumstances – whereas the other customer may be approved without referral as their credit history is consistent with what is expected based on the other information that the bank has collected and verified. That is, the credit reporting information is relevant to the question of scalability of what constitutes 'reasonable' inquiries and verification, such that the lender may be required to take further action if that information is not consistent with what the lender otherwise knows about the customer.

ix. Australia has historically had a very limited credit reporting system, which permitted the sharing of only so-called negative information between credit providers. That 'negative' information primarily related to payment default, adverse court judgement and bankruptcy of an individual.

x. Following a law reform process[2], the Privacy Act was amended in 2014 to permit additional – but still limited – forms of credit information to be shared through the system. This information included consumer credit liability information (CCLI), which includes information about individuals' current consumer credit arrangements such as the type of credit and credit limit, and reporting of repayment history information (RHI), being information about whether or not a customer has made their credit repayments on time.

xi. These additional forms of credit information are very valuable to lenders. Australia is still in its implementation phase – around 30% of open accounts are currently being reported with additional information – in around 12 months that will increase to around 80% of accounts.

xii. Nevertheless, the level of information available through the Australian credit reporting system is still very limited compared to most jurisdictions with similar financial systems, including the United States, Canada and the United Kingdom.[3] Despite the recognised benefits that come from lenders having access to accurate, complete and relevant data regarding a customer's existing credit arrangements, the previous law reform process baulked at giving lenders access to other beneficial information such as

[2] Being the passage of the Privacy Amendment (Enhancing Privacy Protection) Act 2012, following the Australian Law Reform Commission review, "For Your Information: Australian Privacy Law and Practice", May 2008.
[3] See Table 1, page 3, Annexure 1 to ARCA's submission to AGD Review of Hardship and Credit Reporting

the actual balance of the customer's credit account, or the actual repayments required and made under the credit contract.

xiii. Such information would be invaluable in undertaking the assessment described in paragraph vii, as the fact that a prospective borrower had maintained a high balance on a credit card held with another bank, while only paying minimum monthly payments would be a key indicator that the new bank needed to take additional inquiries and verification of the customer's circumstances.

xiv. The reticence to give lenders access to relevant data has been a persistent drag on the effectiveness of the credit reporting system in Australia since at least 1991 when Part IIIA of the Privacy Act came into effect to, inter alia, prevent the industry moving to a 'positive' system.[4] At the time it was recognised that Australia was enabling "the most restrictive credit reference laws in the Western world"[5]. The reticence continued through the 2007 law reform process that led to CCLI and RHI being added to credit reporting – but rejected balance and payment details - and continues today.

xv. ARCA has also been advocating for a change to the credit reporting system for over 10 years to allow lenders to record the fact that a customer has been given hardship assistance. This has been strongly opposed by some stakeholders, some of whom have further suggested that where a bank has temporarily agreed to withhold collections activity in respect of overdue payments (an 'indulgence') the bank must report those payments as being no longer overdue. That is, the credit report of a customer who is not capable of making their contractual payments, and is not in fact making their payments, should show other credit providers that the customer is up-to-date. This would significantly limit the ability of the credit reporting system to ensure that customers – who are in the midst of a financial crisis – don't exacerbate their problems by obtaining additional credit.

xvi. Industry has recently seen progress in respect of this issue as, following a review requested by Government, the Attorney-General's Department has proposed a framework that would allow for a hardship arrangement to be reflected on the consumer's credit report.

xvii. ARCA is hopeful that this issue will be resolved soon. However, it is important to note that the uncertainty regarding the treatment of hardship under the credit reporting system has resulted in a delayed adoption of the new credit reporting system by many lenders.

xviii. The Commission has previously highlighted the need to use actual data to verify information on a lending application.[6] The credit reporting system is a critical independent verification tool that supports better responsible lending. It is a tool that

[4] This is not to suggest that Part IIIA of the Privacy Act is unwarranted. It provides a clear, structured system for credit providers to access accurate, complete and relevant regarding a customer's credit history, while providing strict consumer protections which balance the credit industry's need for data and consumers' right to privacy. Our comment relates solely to the information that is permitted to be shared under the system.

[5] G Greenleaf, 'The Most Restrictive Credit Reference Laws in the Western World?' (1992) 66 Australian Law Journal 672, 672.

[6] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Hearing 23 March 2018; P 992-993) and (Hearing 19 March 2018; P 465-466).

allows a lender to have greater transparency over what credit cards, home loans, personal loans, and other types of credit a customer has, and more importantly, their track record for repayment. Nevertheless, the full potential of the credit reporting system to improve banks' responsible lending processes are not being realised due to a continued reluctance to provide lenders with access to relevant information regarding customers' existing credit arrangements.

xix. ARCA considers that the credit reporting system, as established under Part IIIA, should at least be updated to permit the exchange of information regarding the actual balance of a customer's existing credit accounts, together with details of the actual payments required and made in respect of those accounts. In addition, the work currently being done in respect of the introduction of a hardship flag should be completed as soon as possible.

xx. Other methods of verifying a customer's existing financial liabilities may be available, or will be available, to lenders. The Consumer Data Right - in particular the Open Banking regime - may provide lenders an additional source of valuable data to help verify existing liabilities. However, this regime is dependent on the customer giving consent to the lender to access their data for that purpose. It is likely that a customer, who is having financial trouble will not give such consent (or at least, may not disclose the existence of accounts that may be in arrears). This contrasts to the credit reporting system which establishes a framework to give a lender the right to report and access relevant information.

xxi. Importantly, the credit reporting system is subject to a very strict compliance regime that is tailored to the purpose for which the data is being exchanged. Amongst other things, this regime restricts the types of businesses that may access the data and the purposes for which it can be used and disclosed (e.g. the data cannot be used in any way for marketing purposes). Subject to the finalisation of the Open Banking Rules, that system is not tailored to the exchange of data for credit assessment and responsible lending purposes, and, given the regime is based on consent, does not have the inbuilt protections that apply to the credit reporting system.

xxii. There are also other, non-standardised, means of a lender obtaining data to verify a customer's existing financial liabilities, which are less efficient, robust or secure than the credit reporting system. For instance, a lender may ask for account statements for existing financial liabilities, however that process is neither efficient or robust (as there is the risk that such statement can be doctored). Likewise, screen scraping technology that requires a customer to hand over their internet banking credentials imposes additional security risks on the customer.

xxiii. Unlike the credit reporting system, the data obtained by each of these methods is not standardised, which imposes further inefficiencies and difficult in using that data. For example, the reference data that might identify the merchant on a customer's transactional statements is not standardised across banks. Statements produced by an individual bank for its customer contain reference data generated by the bank servicing the merchant, limiting the usefulness of this data for the consumer and their bank (and anyone who may subsequently seek to access and use this data through other channels). Expecting banks to utilise inefficient methods of verifying a customer's existing financial liabilities risks reducing the amount of credit made available to consumers

and, in particular, reduces the credit - or increases the costs of credit – available to consumers who are closer to the margin of affordability, such that they would require additional assessment and verification under the scalability model of responsible lending.