

**ARCA response to the
draft report on the
Review of Australia's Consumer
Policy Framework
undertaken by the
Productivity Commission (PC)**

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PART A – AUSTRALASIAN RETAIL CREDIT ASSOCIATION (ARCA) BACKGROUND

1 The ARCA was established in 2006 as an independent industry sponsored body focussed on retail credit issues.

2 The Charter of the ARCA is, “To lead the ongoing examination of retail credit practices and the development of improved policies for the betterment of the consumer credit industry”. Its primary objective is the continued improvement of responsible credit provision.

3 The ARCA has particularly focused on all matters related to the sharing and use of credit reporting information and has developed a (currently unauthorised) code of conduct to improve the associated policies and practices under the following governing principle:

“Credit reporting data is shared only for the prevention of over-commitment, bad debt, fraud and to support debt recovery and debtor tracing and other uses in accordance with the law, with the aim of promoting responsible credit provision.

Credit reporting data is not shared for direct marketing purposes”.

4 The ARCA consists of the most senior credit executives of financial institutions, telecommunication companies and credit bureaux.

5 The central advisory body of the ARCA consists of the following groups:

(a) Data Sharers and Users:

(i) Major Banks (ANZ, CBA, NAB, Westpac);

(ii) Other Australian Banks (St George, BOQ, BW);

(iii) Telecommunication Companies (TCNZ);

(iv) International Banks +/- Non-bank Lenders (Amex, Citigroup, GE, HSBC); and

(v) Building Society or Credit Union (Abacus).

(b) Credit Reference Agencies (D&B, Veda).

6 Since its formation, the ARCA has implemented a number of significant improvements to credit reporting, notably:-

(a) Developed an industry code of conduct, with principles and rules for credit reporting operations;

(b) Improved complaint handling with the establishment of single points of contact;

- (c) Established minimum default reporting standards;
 - (d) Collaborated with the BFSO, OPC and consumer advocates to improve and recommend new default reporting definition;
 - (e) Reviewed international practices and progressed data quality improvements with a work group established to produce a common industry data reporting standard;
 - (f) Developed 'scheme of arrangement' reporting standards;
 - (g) Improved the linkage of credit reporting to existing hardship policies;
 - (h) Established policies for 'ageing of default listings' notably for divested debt portfolios; and
 - (i) Established ongoing engagement with consumer and privacy advocates.
- 7 The ARCA submission to the ALRC Discussion Paper⁷² not only gained the unanimous support of all ARCA members thereby illustrating the consolidation of industry views on these matters. It is also worthy of note that the ARCA submission was also endorsed by the ABA (Australian Banker's Association) a further demonstration of industry's conformity.

The ARCA Submission on behalf of the credit reporting industry

- 8 This submission is made on behalf of the majority of all current ARCA members but it should be noted some members have to conclude their review. If there are significant changes these will be advised to the commission but it should be noted that all the Australian Major Banks have confirmed their support.
- 9 ARCA is writing to draw the Productivity Commission's attention to the close relationship between aspects of its terms of reference and recommendations concerning consumer credit, and the Australian Law Reform Commission's (**ALRC**) reference and recommendations regarding credit reporting.
- 10 The Productivity Commission has drawn attention to widespread concerns about inappropriate lending by some providers and over-borrowing by some consumers.
- ARCA's submissions to the ALRC have sought to address these concerns by promoting improvements that will enable more responsible lending by:
- (a) allowing lenders and borrowers to get access to the best up to date information when making a credit decision; and
 - (b) reforming consumer protection (particularly complaints handling, data quality, and a Code of Conduct binding on the industry).

- 11 In ARCA's view, better information for borrowers and lenders is an essential enabler of improvements in responsible lending and credit provision to the benefit of consumers and credit providers.
- 12 For individual borrowers, better information means fairer access to credit.
- (a) Under the current system, a borrower with a period of financial instability, for example following marriage break-up may suffer credit rationing, despite rapidly re-establishing a good payment history, because the current credit reporting system does not show that good payment history, but keeps defaults for up to five years.
- 13 For lenders, better information means:
- (a) Access to individual's credit performance information electronically via CRAs as currently banks and credit providers cannot see from the CRA information whether a new borrower is overcommitted (but not yet overcommitted) since the Privacy Act permits only collection of negative default data. Overcoming this lack of information is vital as;
- (b) 55% of bankrupts have no default on their credit file the last time they applied for credit before going bankrupt; and
- (c) over-committed consumers have an incentive to misrepresent their circumstances in applying for credit. In a recent galaxy survey (Sep 2007), 18% admitted to having misrepresented their financial circumstances when applying for credit.
- 14 Research undertaken by ARCA member - Veda Advantage [1] also shows that:
- (a) 1.9 million adult Australians claim to have been denied credit despite having a good payment history;
- (b) Young people (25-34 years old) are the most likely to be denied credit despite a good payment history; and
- (c) 80% of Australians believe that people who pay their debts on time should be entitled to borrow money at a lower rate. [2]
- 15 ARCA has also supported reforming consumer protection as part of efforts to promote responsible lending. We note that while some consumer protections can be built into privacy regulation, others should more appropriately be dealt with in consumer credit regulation or general consumer regulation.
- 16 ARCA is considering the point from consumer and privacy advocates that better information (positive data) is a necessary but not sufficient condition for responsible lending. In particular consumer advocates are asking for more specific obligations on responsible lending and marketing to accompany a move to better information

with positive reporting. ARCA is working on ways to incorporate sufficient consumer protections within its Code of Conduct.

PART B – SUBMISSION ON SPECIFIC ISSUES

- 17 The ARCA congratulates the Productivity Commission on the depth and completeness of the review of Australia’s Consumer Policy Framework as set out in its draft report. ARCA’s response to issues raised in the report needs to be read in the context described in the overview above and in the context of ARCA’s role.

Issue 1 – Responsible Credit Provision

- 18 The guiding principle of the ARCA response is the continued improvement of responsible credit provision.
- 19 ARCA highlights below 9 issues relevant to consumer credit raised in the draft report and its response to them in view of ARCA’s unique position in the industry.
- 20 ARCA supports responsible credit provision and notes that current regulation severely limits the ability to prevent excessive lending. To enable further improvements to responsible credit provision, ARCA supports a national approach to the regulation of credit products and advice and the regulation of financial brokers and non-bank lenders. A uniform system of regulation will clear anomalies between states and between credit providers who do not fall neatly into specific categories.
- 21 An ability to deal with complaints by increasing the limit for complaints handled by the Banking and Financial Services Ombudsman (BFSO) should be increased to \$500,000. Most members of ARCA that work with the BFSO ARCA support this submission but it should be noted some members need to finalise their internal policy decision on this matter.
- 22 ARCA has developed an unauthorised code of conduct that it seeks to progress to authorised status and be applied as the industry binding code of conduct. ARCA has also recognised that it is important for an independent policy and compliance committee to be established to support the overall governance and evolution of the code of conduct. This committee would have an equal balance of members from the community and industry with an independent chair. The committee are to be responsible for approving policy changes and managing compliance to the code with the ability to sanction both credit providers and CRAs should they not comply with code policies.

Issue 2 – Keeping pace with financial reform

- 23 As indicated in the draft report, some commentators suggest that credit regulation has not kept pace with other developments. For example, the non-implementation of the uniform Consumer Credit Code Recommendations referred to in chapter 4 of the report, indicates regulation does not keep pace. ARCA advocate a 3 tiered

approach to regulation with full details available in the ARCA submission in response to the ALRC's DP72.

Issue 3 – Inter Jurisdictional issues

24 It has been suggested by some stakeholders that the regulation of credit reporting is divided between regulators along subject matter lines. ARCA recommends that a single regulator is responsible for all matters related to credit reporting and that this should be the Privacy Commissioner (OPC). ARCA supports a single regulator to help ensure the consistency of policy decision making and reduced complexity, noting that the lending industry is already a highly regulated sector with compliance to multiple regulations requiring careful consideration to limit duplication and unnecessary complexity.

ARCA is, however, concerned that the regulation of credit under the auspices of the ASIC and regulated as part of the Corporations Act under the Financial Services provisions, would be an inappropriate forum. This is considered later but ARCA references earlier enquiries and earlier submissions where industry has clearly set out a case that this would be an inefficient and costly way to regulate consumer credit.

25 ARCA acknowledges that credit reporting is a specialised area and that the OPC will need to have the appropriate resource and skill base to fully support the changes resulting from implementation of the ALRC recommendations. ARCA, working closely with its industry base, suggests it may be able to provide access to highly skilled resources that could be seconded on a programmed basis to the OPC to support its resourcing requirements. Should such a recommendation be progressed these resources would operate on a 'Chinese wall' basis. We suggest these resources will be invaluable to support the initial review period of the regulation.

26 ARCA notes the Productivity Commission's consideration of the UCCC and consumer credit legislation. It also notes that a succession of government inquiries including the Wallis Inquiry on have recommended that credit be regulated at a national level, and that state jurisdiction is an anomaly. ARCA supports this view

27 The PC has proposed that credit regulation could be brought within commonwealth jurisdiction under ASIC, while retaining the UCCC:

- (a) ARCA notes widespread industry concerns that the FSR regime administered by ASIC is in urgent need of streamlining and reform;
- (b) Consequently, ARCA notes that industry would likely be concerned at the premature abolition of the UCCC and the absorption of credit into generic FSR regulation until it is reformed; and
- (c) ARCA believes that industry is likely to see merit in considering the midway course of retention of the UCCC with ASIC oversight and continued

Commonwealth State reform via the Ministerial Council on Consumer Affairs.

Issue 4 – Significant Innovations in Credit Contracts

- 28 ARCA recognises that there have been significant innovations in credit contracts and non-conforming loans. ARCA also notes that this is an increasingly complex market. ARCA agrees with the recommendations of the Productivity Commission to increase the use of Tribunals to allow for dealing with such complex arrangements.

Issue 5 – Proliferation of credit providers

- 29 The question of the proliferation of credit providers is best addressed by ADR and self regulation. ARCA agrees with the position set out by the Productivity Commission in its draft report.

Issue 6 – Current high debt levels unsustainable

- 30 ARCA notes the Productivity Commission has raised the issue that high levels of debt are regarded as unsustainable. Solutions for this include recommendations already raised by ARCA in relation to improving responsible credit provision. Other measures for improving responsible credit provision may include improvement of the UCCC, changing licensing regimes and closing some of the loopholes currently within the UCCC.

Issue 7 – No historical data set to predict response to downturn

ARCA supports the pre-screening of clients prior to direct marketing activity as an important technique to reduce the amount of inappropriate credit promotion, the following points describe how this is used to improve responsible credit provision

- 31 The term pre-screening has been defined in the proposed ARCA definitions to the ALRC to ensure that any such action undertaken in respect of a list of names will operate to reduce the list, giving a harm reduction outcome and enhancing the principle of responsible credit provision. ARCA is concerned that there is some confusion between the use of personal information for direct marketing and the use of credit reporting information in the process of pre-screening. ARCA's proposed definition is the process by which a credit reporting agency uses credit reporting information to identify individuals with poor credit worthiness and to exclude them from a list provided by a credit provider without disclosure of credit reporting information to the credit provider or another party. An illustration of the pre-screening process can be provided if this is helpful to clarification of the procedure.
- 32 This approach reduces the volume of direct marketing of credit offers to credit provider customers with poor credit history.

- 33 Note that the credit provider does not receive any information from the CRA unless the customer submits an application and provides consent for a credit check in relation to that application.

Issue 8 – Competition and the real cost of credit

ARCA advises that the sharing of credit data needs to be managed by a principle of reciprocity as described below, this is more complex issue than possibly realised by some stakeholders but is also a matter that ARCA recommends is determined and managed by industry.

- 34 ARCA supports the principle of reciprocity for the use of credit information available from CRA. It notes, however, that its practical implementation is likely to be more complex than suggested in the ALRC's DP72. To illustrate: as credit providers are from different industries, ARCA believes that a credit provider shares all available information from its particular industry e.g. a Telco should be able to access all credit reporting information from a different industry e.g. a bank. ARCA also acknowledges that although there may be limitless variations to the forms of reciprocity, it may for implementation purposes also need to keep the policy relatively simple.
- 35 As this is only of relevance to industry it is recommended that this is the responsibility of the industry COC to manage.

Issue 9 – Excessive fees and charges

- 36 ARCA notes comments from the commission and will support policies as far as they apply to responsible credit provision and involve as necessary the policy and compliance committee of the industry code of conduct to review matters of detail.

Submission Conclusion

- 37 In summary ARCA has the support of the substantial majority of Australia's credit providers, representing an estimated 90 percent of Australia's outstanding consumer credit balances.
- 38 ARCA is supportive that the current credit reporting regulatory regime should be significantly amended and ARCA has sought to develop the ALRC approach into the proposed three tier structure that facilitates:
- Parliamentary scrutiny of fundamental rights and obligations in Credit Reporting regulations;
 - An industry Code of Conduct that details rights and obligations, but also permits regulation to respond to changing consumer and market demand;
 - Continuous review of the detailed underlying policies and procedures in an authorised code of conduct.

- 39 Existing regulation has resulted in unnecessary complexity and an inability to advance Australia to more prudent, responsible and modern methods for the collection and use of credit reporting information, ARCA seeks to ensure any new regime avoids repeating this approach.
- 40 The standardisation and improvement of credit reporting procedures and a code of conduct that is obligatory to credit providers if they are to access CRA credit reporting information will deliver significant improvements to data quality, enhancing results for both industry and consumers.
- 41 Consumer protections and servicing standards will be improved with the establishment of new credit reporting commitments to consumers and complaint handling procedures.
- 42 This careful extension of allowable credit reporting information will improve the predictiveness of the information which will result in improved responsible credit provision standards. ARCA acknowledges there are community concerns about the amount of allowable information and continues to work with community stakeholders to resolve these concerns as much as is reasonably possible..
- 43 And finally ARCA is absolutely consistent in its view that credit reporting information must not be used or disclosed as a source for acquiring prospects for direct marketing purposes and that a serious breach of this obligation should not only result in a civil penalty but should also include suspension from the future use of credit reporting information.
- 44 In conclusion ARCA requests that the Productivity Commission in making recommendations about consumer credit:
- (a) note the close relationship between the ALRC reference and its own reference in relation to consumer credit;
 - (b) note the value to stakeholders of considering the relevant responsible credit provision recommendations together, not separately;
 - (c) note the strong (and uncontested) industry view that better information (positive data) is a necessary condition for more responsible credit provision; and
 - (d) note that ARCA is working with consumer and privacy advocates to identify the key issues in responsible credit provision and marketing that can be dealt with in its own Code, or under privacy regulations, or should better be dealt with in the consumer credit jurisdiction.

APPENDIX A – ARCA CREDIT REPORTING PRINCIPLES

- 45 ARCA has established the following Credit Reporting Principles and would recommend incorporating these in the Code of Conduct:-

- (a) *Responsible Credit Provision;*
- (b) *No marketing* usage of credit data with significant penalties for non compliance (with the exception of an agreed procedure to prevent or reduce offers of credit being sent to those that should not receive such offers);
- (c) *Consumer commitments* policies established;
- (d) Data Sharers to share and use credit bureau data on the *principle of reciprocity*;
- (e) The *consumer's credit standing* that can be used to gain best personal advantage is best achieved through the provision of complete and accurate information;
- (f) The Principles are governed by a *Code of Conduct* that is robust, transparent with all relevant controls and compliance policies and procedures;
- (g) *Consumer complaints and disputes* are well and fully managed;
- (h) Data definitions and standards to maintain and continually *improve data quality*;
- (i) *Security* of shared and used data;
- (j) *Independent oversight*;
- (k) An *implementation roadmap* developed that continuously improves credit reporting over the long term and to the fullest possible participation; and
- (l) *Access to data is electronic.*

APPENDIX B– ALLOWABLE CREDIT REPORTING INFORMATION

Overview

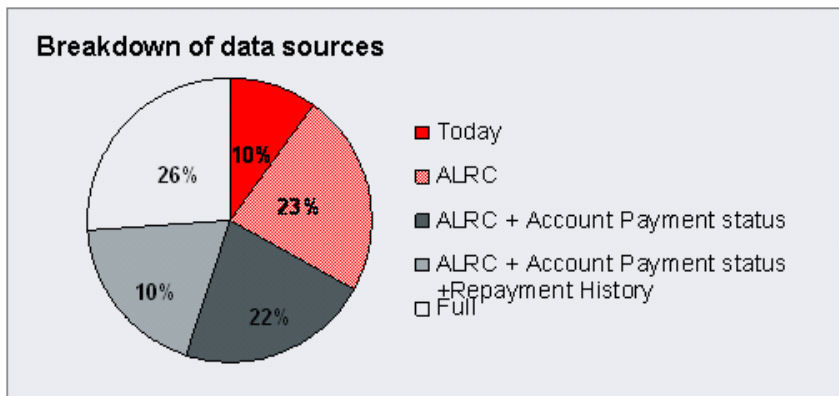
- 46 The following provides the rationale for the ARCA recommendation regarding the types of personal credit information that should be permitted under new regulation.
- 47 In overview the ARCA advises that the best process in terms of fully understanding a consumer's ability to repay a debt or potential debt is to have full disclosure of all the relevant credit information. To achieve this, ARCA believes that full comprehensive credit reporting would provide the optimum solution to the community at large. However, ARCA also acknowledges that there are concerns that need to be addressed and that a gradual process of implementation is likely to gain more support and enable us to measure our achievements and constantly review how this can be further enhanced.

Recommendation Rationale

48 The guiding principle and motivation for ARCA is to achieve improved standards of responsible credit provision. It is also important to note that ARCA is unequivocal in its intent to not allow the use of incremental credit reporting information for the use as a source of acquiring prospects for direct marketing and indeed fully supports that a serious breach (subject to appropriate governance procedures) of such a protocol should have as a remedy the removal from future use of credit information available from credit reference agencies.

49 The tables below outline the current and proposed levels of information available to credit providers for the purpose of making decisions on responsible lending. It is apparent that our current negative information environment does not provide sufficient information and as shown in point 50 the value of increased amounts of data are assessed.

Bureau Scenarios



Today	ALRC	ALRC + Account Payment Status	ALRC + Account Payment status + Repayment	Full
Current bureau information	'Today' information	'ALRC' information	'ALRC + Account Payment' status information	'ALRC + Account Payment status + Repayment' Information
Application Data	Information on all credit accounts	Delinquency history	Repayment history	Balance history
Internal data	Limits		Credit turnover	Transaction and purchase history
	Opened date			Debit turnover
	Active or inactive			Unsecured exposure
				Outstanding

50 ARCA members including the 4 Major Banks and a number of our international financial services groups have undertaken a detailed analysis of the predictive value

of different levels of credit information reporting. Five levels were assessed which shows that by increasing the allowable content to the level recommended, only a 23% improvement in value be attained as detailed below:-

Overall weighted contribution to customer behavioural scorecards		
Scenario	Percentage Contribution	Incremental Contribution
Today	10%	10%
ALRC	23%	33%
ALRC + Account Payment status	22%	55%
ALRC + Account Payment status + Repayment History	19%	74%
Full	26%	100%

- 51 The above chart clearly illustrates why credit providers are concerned by the limited predictive value of the recommendation and why it is important to have allowable data under constant review so that significant improvements to responsible lending can be achieved for the benefit of the community. ARCA can provide from its ALRC submission a more detailed presentation of the analysis undertaken by a number of ARCA members.
- 52 ARCA also notes the inaccuracy of application information used to assess a credit application. ARCA highlights to the ALRC that the incidence of application error is exceedingly common. This takes the form of both human error but more importantly fraudulent input, particularly in situations where the consumer is already vulnerable to debt stress, especially in light of the increasingly challenging credit and economic environments.
- 53 ARCA advised the ALRC that the current credit information available in Australia and also the reliance on application data (see separate analysis) does not adequately support the guiding principle of responsible lending most notably for borrowers that may already be in a state of financial stress.
- 54 ARCA notes the following research findings that have been provided by Veda from their survey of 11000 randomly selected households:-

- (a) Question, "Have you ever exaggerated your financial situation even if only a small amount to get credit?" Answer "Yes" from 18% which equates to 2.67M Australian individuals;
- (b) Question, "Have you ever been denied credit despite a good payment history?" Answer "Yes" from 13% which equates to 1.9M Australian individuals; and
- (c) Question, "Do you agree or disagree that someone who pays their debts on time should be entitled to a borrow money at a lower interest rate?" Answer, "agree or strongly agree" 80%.

- 55 ARCA acknowledges the concerns of other stakeholders, and recognises the need to compromise. For these reasons ARCA supports the ALRC's proposal with the addition of a 24 months account payment status but on the basis that the details of allowable content fall within the scope of the code of conduct so that it can be under continuous review to facilitate the optimum outcome for responsible credit provision. ARCA believes that a modest, single increase to the ALRC DP72 proposal without the implementation of full comprehensive reporting will gain widespread support, will significantly improve responsible lending and most importantly will be implemented by credit providers and credit reference agencies as the case for change will be considerably stronger with this increase in data
- 56 The additional information will enable credit providers to more effectively assess the financial situation of borrowers that may not yet have recorded a default (nearly 90% of the community) who may be starting to move into a situation of financial stress. The existing allowable data only provides protection for those that are already in a default situation (only about 10%).

ARCA Recommendation

The following describes the key points of the recommendation from the ARCA:-

- 57 It should be noted that a minimum payment for a line of credit product including credit cards is qualified as a contractual payment.
- 58 ARCA accepts that other full comprehensive credit reporting content data previously requested e.g. historical and current balance and delinquency repayment amount data has been removed. It is noted that this additional data will bring further responsible credit provision benefits but ARCA also notes the need for credit providers and credit reference agencies to demonstrate to individuals that they can deliver improvements from the foregoing recommendation and gain the confidence of all stakeholders including the improvements to data quality standards and consumer protections before further expansion of allowable content.
- 59 ARCA also assumes that to deliver improved data quality standards that credit providers will be obliged to provide monthly updates to individual files including exposure to credit line increases.

- 60 ARCA reconfirms that the regulation in regard to such matters as allowable personal information files should be detailed in the code of conduct so that it can be under regular review subject to appropriate governance to ensure the guiding principle is best supported.
- 61 ARCA reconfirms that access to personal credit information held at credit reference agencies is to be governed under a principle of reciprocity as detailed in our response to Issue 8.