



AUSTRALIAN
RETAIL
CREDIT
ASSOCIATION

Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

9 November 2018

Dear Sir/Madam,

Submission on Senate Economics Reference Committee Inquiry - Credit and financial services targeted at Australians at risk of financial hardship

Please find **attached** the Australian Retail Credit Association's (ARCA's) submission to the above inquiry.

If you have any questions or concerns regarding this submission, please direct these to ARCA's Legal & Regulatory Affairs Manager, Elsa Markula [REDACTED]

Yours sincerely,

Mike Laing
Executive Chair



ARCA Submission to the Senate Standing Committee on Economics

Credit and financial services targeted at Australians at risk of financial hardship

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.

ARCA works closely with its Members to identify issues impacting the credit industry, particularly where those issues affect credit decisions and management.

ARCA is uniquely placed to comment on the operation of the credit reporting system. ARCA played an important role in the establishment of the current system (through its role as the developer of the Privacy (Credit Reporting) Code, and the drafter of the Principles of Reciprocity and Data Exchange (PRDE), the data sharing rules authorised by the Australian Competition and Consumer Commission (ACCC) and used by industry for the exchange of comprehensive information). Through its information website CreditSmart (www.creditsmart.org.au), ARCA also provides resources for consumers navigating the credit reporting system.

ARCA's submission to the Senate Standing Committee is based on the following fundamental principles:

- A properly functioning credit reporting system supports consumers by providing an easily accessible, reliable source of objective information about that individual's creditworthiness. Where the credit reporting system can function in this manner, it will support better lending decisions to the benefit of consumers, and ultimately reduce the cost of lending (both by making the application process more efficient, and further by ensuring that fewer loans default).
- A credit report can provide vulnerable consumers (including those who have previously experienced financial hardship) a means to objectively demonstrate their own creditworthiness, and in doing so, aid in credit rehabilitation. Conversely, where an assessment is being made as to whether a new loan is not unsuitable for a consumer¹, a credit report can provide important information to any potential lender about the risks of lending to that consumer, and prompt the lender to make further enquiries into the suitability of a lending product to that individual.

¹ Such an assessment being required as part of the responsible lending obligations of the credit provider, see *National Credit Act* and ASIC's RG209: Credit Licensing, Responsible lending conduct.

- It is important that a credit report contains complete information about the full extent of a consumer's credit liabilities. It is equally important that information contained in a consumer's credit report is accurate and up-to-date. The more complete, accurate and up-to-date a credit report, the more reliable it is as a tool to verify a consumer's liabilities. Moreover, requirements that data is complete, accurate and up-to-date are critical obligations under the Privacy Act.

The credit reporting system is most effective and valuable for credit providers and consumers when all consumer loans are recorded in the system. Financial service providers and other lenders who operate outside the credit reporting system can undermine the effectiveness of the credit reporting system.

To date only "mainstream" lenders are sharing comprehensive credit reporting (CCR) data, and they are doing it under the ARCA developed rules (the PRDE). Payday lenders, and providers of 'buy now, pay later' products do not report accounts in the credit reporting system, which creates an absence of information about a consumer's utilisation of these products. This creates a lending dichotomy between 'mainstream' and 'alternative' lending sources. It can be difficult for both lenders and consumers to traverse these different lending sources as reliable information about the full extent of a consumer's liabilities may be difficult to obtain.

Providing further credit to customers without appreciating existing liabilities puts customers at risk of over-indebtedness and mainstream lenders are already seeing the flow on consequences. For example, anecdotally we are aware of customers utilising buy-now, pay-later products which require direct debit authority, and as a result of prioritised repayments on those products, consequently falling in to arrears on other mainstream credit products.

As ARCA's submission argues, it is important that, wherever possible, *all* relevant lending information is accessible to other lenders (and accessible in an objective, reliable format).

Impact of credit repair agencies

It is noted that the scope of the Terms of Reference for the Inquiry includes debt management firms, debt negotiators and personal budgeting services, as well as credit repair agencies. ARCA has focussed on credit repair agencies in its submission, given ARCA Members have the most experience dealing with these organisations. This is not to undermine or diminish the feedback of other stakeholders on the impact of the other debt management type organisations, and ARCA appreciates the insights offered by other stakeholders about the impact of these organisations, and the possible need for reform of the regulation of these organisations.

There is currently no uniform regulatory framework for credit repairers. Firms are not required to hold a credit licence or an Australian Financial Services license, although some of these firms also engage in regulated activities and will hold the required licenses for those activities.

Most are not subject to any specific regulation beyond the general consumer law, which includes prohibitions against misleading and deceptive conduct and unconscionable conduct.

The credit repair sector previously has been subject to a number of studies and inquiries, including:

- Energy & Water Ombudsman NSW, *Research survey report: Consumers' use and experience of 'credit repair' agents*, published in 2012²

² https://www.ewon.com.au/content/Document/EWON%20Credit%20Repair%20Report_2012.pdf

- In 2014, the Financial Ombudsman Service released a suite of documentation³ in relation to proposed changes to its terms of reference. Responding to “paid dispute agents” such as credit repair was a key focus of these changes.
- Ramsey et al, ‘A quick fix? Credit repair in Australia’, published in 2015 in the *Australian Business Law Review*⁴
- ASIC’s 2016 Report 465⁵ “*Paying to get out of debt or clear your record: the promise of debt management firms*”

In addition, in February 2016, 16 industry and community stakeholders issued a joint communique⁶ following a roundtable that examined options for regulating the credit repair sector. This joint communique called for regulation of this sector and the wider ‘debt management’ sector.

In the absence of regulation of the credit repair sector, there is no reliable information available which details the number of these agencies currently operating, the cost to consumers of using these agencies (compared to directly approaching credit providers or credit reporting bodies to dispute an entry), and the cost to industry of engaging with credit repair agents seeking removal of accurate information as opposed to dealing directly with the consumer. Even when it is possible to compile a list of credit repair organisations, credit repair organisations may play a ‘behind the scenes’ role (that is, providing the consumer the proforma material required to dispute their credit report, but without the credit repair agent being identified).

The promise of the credit repair sector is to help consumers with negative listings on their credit reports, often at significant upfront cost for the consumer. Anecdotal information provided by ARCA Members about the impact of credit repair demonstrates that credit repair operates in a manner designed to benefit the credit repair organisation above all else.

Credit repair customers are rarely referred to the free, alternative sources of help or advised they could resolve the problem themselves at no cost. A consumer can seek correction of inaccurate information on their credit report for free, and by contacting any credit provider or credit reporting body with whom they’ve previously dealt with. Where a correction request is made, a response to that request is required within 30 days. If information isn’t corrected, the credit provider or credit reporting body has to explain why this is the case, and how the consumer can complain to an external dispute resolution body⁷. All credit providers or credit reporting bodies are required to be members of EDR schemes⁸.

Credit repair agents will embed themselves in the corrections process by:

- Representing to consumers that they are entitled to have their credit report ‘fixed’, ‘cleaned’, ‘washed’ or ‘repaired’ simply because that consumer pays a fee to the credit

³ <https://www.fos.org.au/news/news/consultation-on-proposed-terms-of-reference-changes/>

⁴ <http://financialrights.org.au/wp-content/uploads/2015/06/Ally-O'Brien-Ramsay-Credit-repair-in-Australia.pdf>

⁵ <https://download.asic.gov.au/media/3515432/rep465-published-21-january-2016.pdf>

⁶ <https://www.arca.asn.au/docs/1262/joint-communique-on-regulatory-reform-of-debt-management-firms>

⁷ Privacy Act 1988, sections 20S to 20U, sections 21U to 21W; Privacy (Credit Reporting) Code 2014, paragraph 20

⁸ Privacy Act 1988, sections 20E and 21D

repair agent rather than explaining the salient facts: that the information can only be corrected if it is incorrect⁹.

- Failing to advise consumers that the same service is available for free, simply with the consumer engaging directly with the credit provider or credit reporting body, or EDR scheme.
- Seeking to place commercial pressure on credit providers or credit reporting bodies to remove correct information. This occurs by referring disputes to EDR, with the knowledge that the cost of the EDR dispute is required to be borne by the credit provider or credit reporting body (as a requirement of EDR membership).
- Prolonging EDR disputes (and therefore continuing to increase costs for the credit provider or credit reporting body) by raising issues with little supporting evidence (but which require further investigation). For instance, where disputes involve the entry of a default listing, a consumer may be encouraged to dispute the listing on the basis that they never received any default notices, or that they were experiencing financial hardship at the time the default was entered. Both the issues of default notices, and the failure to provide financial hardship assistance are issues which cannot be easily resolved without further investigation of credit provider records, and the consumers' supporting material. The need for further investigation then means the dispute has to progress to the next stage in the EDR process. A review of published Financial Ombudsman Service (FOS) determinations reveals that these two issues are the most common issues raised in default listing disputes which progress to determination level¹⁰, and are predominantly decided in favour of the credit provider – ultimately because of a lack of supporting information provided by the consumer.
- Related to the prolonging of EDR disputes, credit repair also encourages raising vexatious disputes, both with the credit provider or credit reporting body, as well as then lodging these vexatious disputes with EDR. An example of the approach from credit repairers is for them to lodge correction requests at a credit reporting body for the same person using multiple versions of their names in the hope that one of them would 'slip through' and whatever they are challenging would get removed. For others, they have also been known to repeatedly lodge a correction request for the same item even though it has been proven correct.
- Vexatious disputes are lodged in circumstances where the credit repair agent has no basis to believe the information is correct (and may have not even verified the reasons for the dispute with the consumer), and otherwise has no grounds to demonstrate the process of reporting the credit information is incorrect. Vexatious disputes may also raise niche interpretations of law, which are unlikely to succeed and make no difference to the actual dispute outcome for the consumer. However, for credit repair organisations the purpose of raising these types of disputes is to impress upon the consumer the knowledge of that credit repair organisation rather than deliver the consumer a meaningful outcome.

⁹ There is no general power in the Privacy Act to 'remove' information. Once disclosed, information will be retained in the credit reporting system for the defined period in sections 20W and 20X, following which it will be destroyed. The only exception to this is where the information is incorrect or no longer current and is updated.

¹⁰ Determination level is the final stage of the EDR process, and the most expensive. Case fees for FOS are between \$3,320 and \$9,490.

Credit repair and comprehensive credit reporting

To date, credit repair organisations have predominantly sought corrections of ‘negative’ datasets, being default listings, judgements or bankruptcy information or credit enquiries. Even in that context, the influence of credit repair is significant. One ARCA credit reporting body Member has advised that credit repair corrections request volumes (focussed on this negative data) have increased by 50% since June 2018 to around on average 40 a day.

With the recent widespread contribution of comprehensive credit information into the credit reporting system¹¹, ARCA’s concern is that credit repair will focus its efforts on comprehensive data.

Comprehensive credit information includes information about a consumer’s current accounts and their repayment behaviour. Unlike existing negative data sets, a single month’s comprehensive data (for instance, the inclusion of a telecommunications account in the consumer’s list of current accounts, or the record that payments on a consumer’s credit card account were up to date in April) will not significantly impact the assessment of an individual’s creditworthiness.

Comprehensive credit information represents a new type of information in the credit reporting system. Because consumers may not know much about this information, what it means or how it is used, there is a risk that credit repair will exploit this to their advantage. For example, the credit repair business model could evolve to offer consumers an opportunity to ‘clean’ their repayment history (a monthly dataset, entered over a maximum of 24 months). Conceivably, this could result in consumers paying even more money to credit repair – in the misguided belief that a single negative RHI entry is equivalent to default listing.

Where comprehensive credit information is utilised properly, it can empower consumers in their dealings with financial services companies: by providing a clear demonstration of their credit credentials. However, if consumers are misled about comprehensive credit information, this opportunity to empower consumers, particularly those vulnerable consumers, could be lost.

Industry has put considerable effort in to consumer education to support wider understanding of comprehensive credit reporting. We are aware that the credit repair industry promotes a self-serving message around credit reporting and we understand such messages can be confusing for customers. Whereas industry seeks to empower customers to understand and take charge of their own credit report, the credit repair industry benefits from confusion and ignorance of credit reporting and on that basis the credit repair industry seeks to over-complicate credit reporting in order to sell itself as a solution.

Impact of payday lenders

To date, payday lenders have not shown an interest in joining ARCA, or participating in the comprehensive credit reporting under the PRDE. This is partly because the business model used by payday lenders focuses on minimising any upfront lending costs incurred by the payday lender, to then maximise the profit derived from lending relatively small sums of money. Furthermore, payday lenders have specific legislative requirements to meet their responsible lending obligations which are different to “mainstream” lenders and require the payday lender to access information not able to be held by the credit reporting system¹².

¹¹ See: <https://www.afr.com/business/banking-and-finance/financial-services/banks-to-sign-landmark-datasharing-deal-20180911-h159au>

¹² See Regulatory Guidance 209.47 Inquiries and verifications that must be made for small amount credit contracts

This disconnect between the payday lending sector and the rest of the financial services industry does have a number of consequences, for both industry as well as consumers.

Very little objective information is available about an individual's use of payday loans. This can make it difficult for that consumer to then transition to mainstream lending as the absence of information may make it necessary for lenders to treat that individual as at greater risk of financial hardship.

Equally, where information about a consumer's use of payday loans is not readily available, there is a greater risk that this information is not disclosed to prospective lenders.

As the credit reporting system matures with the entry of comprehensive information, the barrier to payday lending participation, being the cost of access to data, is likely to diminish. This should provide an opportunity for a reassessment of the payday lending sector's participation in credit reporting.

Impact of 'buy now, pay later' providers and short-term credit providers

ARCA notes that the 'buy now, pay later' provider model is relatively new. ARCA welcomes the innovation these providers have brought to the delivery of financial services. These products have, within a very short period of time, become firmly embedded within the retail market. ARCA considers there may be advantages to these providers participating in the mainstream credit reporting system, as a 'buy now, pay later' product could provide a means for certain consumers, particularly young people, to build a credit history.

However, ARCA has the following concerns with the 'buy now, pay later' products:

- The 'buy now, pay later' products vary in design, and these variances may have significant implications for consumers and their credit reports. Some products are more aligned with revolving credit-type accounts¹³, whereas other products are designed so that each separate transaction establishes a new "account" for the consumer¹⁴. This product design, particularly the 'new transaction/new account' structure poses both operational challenges for industry, but also could lead to adverse consequences for consumers.

For instance, if this information were integrated into the credit reporting system in its current form, it could result in multiple account entries for a consumer and, if that consumer were to default on their payments, multiple default listings (provided each outstanding transaction amount is greater than \$150).

This has the potential to distort the information in the credit reporting system, and confuse consumers, who may not understand the consequences of their 'buy now, pay later' product's design.

- The design of these products creates regulatory arbitrage as these products are currently not subject to responsible lending obligations, compared to mainstream lenders who are, and whose competitive position may be undermined because of the higher regulatory standards they must comply with. In this regard, these products appear to operate in a substantially similar manner to a credit card (with an overall credit limit, albeit a 'shadow' limit, which can be re-utilised as you pay down your balance), yet because of their design currently avoid regulation. This means these products are not subject to responsible lending obligations, including the recent ASIC

¹³ For example, ZipMoney: <https://zipmoney.com.au/terms-and-conditions/>

¹⁴ For example, Afterpay: <https://www.afterpay.com/en-AU/terms-of-service>

instrument which now requires lenders to consider the ability of a consumer to repay the entire credit limit of a credit card within three years of the credit decision¹⁵.

- The marketing of some products as payment services rather than credit (within the meaning of the *National Consumer Credit Protection Act*). Consumers should be made aware and supported to understand when any product that will leave a footprint (by way of comprehensive credit reporting or mere enquiry) on their credit report.

Reform to current regulation

Credit repair organisations

ARCA's strong view is that there is an urgent need to reform regulation of credit repair organisations. In fact, there is a broad consensus between regulators, consumer advocates, and industry participants in the credit reporting system that reform is needed to the credit repair sector. While some have argued previously that a self-regulatory approach would be best for the credit repair sector to improve consumer outcomes, ARCA's view is that self-regulation would not work for a number of reasons including a lack of uniform corporate structure across the industry, a lack of unifying industry voice to assist with the develop of the self-regulatory approach and a weak culture of reporting and compliance.

Existing regulation is not sufficient to adequately respond to the impact that debt management firms have on the credit reporting industry, and vulnerable consumers. Rules (whether in the form of new legislation, or amendment to the existing legislation¹⁶) should be imposed on the operation of the credit repair organisations and, in addition, credit repair organisations should be licenced.

Recently, ASIC succeeded in taking credit repair agent Jordan Malouf, and his organisation, Malouf Group Enterprises Pty Ltd to the Federal Court and obtaining an award of \$1.7 million for misleading and unconscionable conduct for breaches of the Australian Consumer Law¹⁷. While this development is welcomed by ARCA, the prosecution of Malouf took a number of years to occur, and no doubt cost a considerable sum in legal fees. While the Malouf Group operated five different credit repair websites, when considered in the context of the industry as a whole, the Malouf Group and its activities represents a relatively small portion of that industry. Requiring ASIC to investigate the conduct of each credit repair organisation, and undertake prosecutions of the nature seen in the Malouf Group case would require considerable resources and would unlikely stop the emergence of new entities that operated in the same manner.

If the debt management industry were, however, both licensed and subject to tighter legal requirements through new rules, ASIC would be positioned to more easily monitor and police the activity of this industry.

A robust rules and licensing framework could ensure, among other requirements, that consumers are:

- Advised up-front of the cost of engaging credit repair and the availability of free services;
- Provided an assessment of their particular case in advance of proceeding with the credit repair services, and the consumer's prospects of success;
- Enabled to withdraw from the credit repair process at any stage.

¹⁵ ASIC Credit (Unsuitability – Credit Cards) Instrument 2018/753

¹⁶ Either amendment to the National Credit Code, or to the Australian Consumer Law

¹⁷ See: <https://asic.gov.au/about-asic/news-centre/key-matters/malouf-group/>

To achieve this, ARCA proposes a six-point plan that would impose conduct obligations on the credit repair sector to ensure they are meeting community expectations:

1. **Compulsory EDR membership** – we propose credit repairers are required to join the Australian Financial Complaints Authority (AFCA).
2. **Satisfy threshold requirements** – we propose a “fit and proper” persons obligation be applied to key individuals in a credit repair business, similar to those placed on a licensed credit business¹⁸.
3. **A requirement to act in a client’s best interests** – we propose a best interests’ duty be imposed, similar to the duty imposed through the Future of Financial Advice reforms on financial advisers. In addition to, consumers should be provided with an assessment of their particular case in advance of proceeding with the credit repair services, including information on the consumer’s prospects of success, and be advised they can withdraw from the credit repair process at any stage.
4. **Satisfy competence standards** – a minimum set of standards for those advising consumers should be imposed, similar to those applied to financial advisers and brokers.
5. **Provision of Key Fact Sheet (KFS) and written cost estimates** – the lack of effective communication to consumers is of major concern. Consumers should be provided with a written KFS that advises of the free corrections and complaints avenues open to consumers, AFCA membership details, and other information including a written cost estimate for the credit repair services.
6. **Prohibition on transfer of consumer business** – ARCA is concerned that some small amount credit providers are using credit repair to funnel consumers into high interest credit products. These referral arrangements should be banned.

Such a framework would have to clearly be structured to capture credit repair organisations, but to exclude financial counselling and advice services from its scope.

We propose that these obligations be delivered through a licensing regime administered by ASIC, and include an annual compliance certification process.

Payday lenders

ARCA considers that any reform of payday lenders should consider the sharing of data within the payday lending sector leading to the utilisation of the credit reporting system by this sector, and the benefits the integration of payday lending data could have both on payday lenders, but more importantly, the financial system as a whole and consumers.

‘Buy now, pay later’ providers and short-term credit providers

ARCA notes that ASIC has recently undertaken a review of ‘buy now, pay later’ providers, and short-term credit providers. Without the outcome of this review being published, ARCA does not consider that it is appropriate to provide any recommendations on the reform of these providers. We do believe that the regulatory environment should be competitively neutral, and in this respect this sector is taking advantage of a regulatory loophole. We also believe the

¹⁸ <https://asic.gov.au/regulatory-resources/find-a-document/regulatory-guides/rg-204-applying-for-and-varying-a-credit-licence/fit-and-proper-people/>

potential impact on the consumer's credit history because of the manner in which some products in this sector are designed needs also be considered in any reform.