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Roadmap to Reform

Lessons from around the world to guide consumer credit reporting reform in Australia

Executive Summary - October 2008

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Prepared for the **Asia Pacific Credit Coalition** and **Dun & Bradstreet Australia**

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RESULTS AND SOLUTIONS

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Acknowledgements

In preparing this report, we have drawn lessons from our experiences in researching and engaging bureaus worldwide, including bureaus in Oceania, North America, Latin America, Africa and Asia. We have also relied on the input and experiences of a number of people over the years. We would especially like to thank Christine Christian and Damian Karmelich of Dun & Bradstreet Australia, Tony Lythgoe of the International Finance Corporation, Tony Hadley of Experian, Robert Ryan of TransUnion, and Marlena Hurley of Centrale Rischi Finanziaria Data for their specific insights. Needless to say, all positions and opinions contained in this report reflect the views solely of the authors, and not the APCC, advisors, or interviewees.

Finally, we would like to thank the members of the Asia Pacific Credit Coalition (APCC)—Citibank, Dun & Bradstreet Australia, Equifax, Experian, GE Money, and TransUnion—for their grant for this research, as well as their feedback and insights. This project would not have been possible but for their support.

A note about language & terminology

In Australia 'comprehensive' reporting has come to be understood to mean including both 'negative' and 'positive' data (i.e. account existence and performance).

However in most other countries 'comprehensive' and 'positive' have different and distinct meanings.

'Positive' data means information on the timeliness of payments, including whether payment was on time or was moderately late. The payment information may contain the payment date relative to the due date. Positive information often includes data on account type, lender, date opened, inquiries, debt, and can also include credit utilization rates, credit limits and account balances. It stands in contrast to negative-only reporting.

'Comprehensive' reporting is a system in which payment and account information, whether full-file or negative-only, are not restricted by sector, that is, the system contains information from multiple sectors. Such a system is in contrast to segmented reporting, in which information in files is restricted to one sector such as banking or retail.

The language in this report is consistent with the global terminology reflecting the background and experience of the writers.

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Executive Summary

The issue of positive credit reporting has been one of some controversy in Australia over the last two decades. That controversy has been as strong within the lending community as it has without.

However, more recently a general consensus has emerged recognising the benefits that can derive from a credit reporting system that allows the collection of positive, in addition to negative, information from creditors.

That consensus is evident in the now broad based endorsement of positive reporting by Australia's leading credit providers including the nation's major banks, finance companies and credit bureaus[1].

Furthermore, the benefits of more data have now been recognised by the *Australian Law Reform Commission* (ALRC), which in its 2008 inquiry into the Privacy Act recommended a form of positive reporting be allowed[2].

The specific focus on credit reporting laws by this inquiry followed an intensive campaign by Dun & Bradstreet Australia for a government initiated inquiry. The recommendations of the ALRC highlight just how far the domestic debate has come. This is the first government inquiry of any kind to endorse the benefits of positive reporting.

Generally, the benefits of this reform are recognised to be:

- Lower rates of delinquency and defaults;
- Increased lending through reduced rationing, including to the small business sector; and,
- Reduced interest rates for low-risk borrowers[3].

At a macro-level these benefits translate to an improvement in economic growth and performance[4].

Additional evidence of the broad consensus recognising the potential benefits of positive reporting comes from long-term opponents of such a reform. Some of the more vocal opponents now recognise the potential for positive reporting to improve lending decisions, although it should be noted they do question whether all lenders would use such a system for this purpose[5].

[1]Submissions to ALRC inquiry into Privacy Act.
[2]ALRC, For Your Information: Australian Privacy Law and Practice, 2008.
[3]Turner et al.
[4]ACIL Tasman research commissioned for MasterCard International, 2004.
[5]C Bond, Should we have positive credit reporting?, ITSA Bankruptcy Congress, July 28, 2006.

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It is these concerns that led to this piece of research. While the potential benefits of reform have become broadly accepted there remains concern about how those benefits could be realised while ensuring high standards of consumer protection.

Roadmap to Reform reflects the changing nature of the domestic debate and presents legislators and industry professionals with an examination of, and response to, the challenges that arise from reform, including the unique challenges of the initial transition period.

Part of a global debate

While emerging in response to the domestic debate, **Roadmap to Reform** is also a reflection of a broader debate taking place within Australia's most important trading region – APEC. The issue of positive and comprehensive credit reporting is now being actively discussed and considered within a number of APEC countries, assisted in large part by the efforts of the *Asia Pacific Credit Coalition* (APCC).

The APCC is a coalition of major lenders and credit bureaus that have come together to engage APEC governments on the need for, and benefits of, reform. The establishment of the coalition reflects the broader reality that domestic financial systems are increasingly interdependent with those of other countries and ensuring their ongoing development is critical to the outlook for cross-border investment and trade. Dun & Bradstreet is a founding member of the APCC.

The APCC has played a critical role over recent months in elevating the priority of credit reporting reform throughout the APEC region and within the formal APEC structures. This has resulted in the APEC *Business Advisory Council* (ABAC) recommending common credit reporting standards throughout the region to the forthcoming APEC Finance Minister's meeting in November. The *Asian Bankers Association* has also issued a policy paper endorsing a regional standard for consumer credit reporting that includes positive and comprehensive reporting as the system's cornerstones. The issue will also be included in the ABAC annual report to the APEC Leaders Forum.

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Key findings

1. The 'Valley of Transition' – the revelation of over indebtedness

Many economies that have made the transition from negative to positive reporting have experienced a short-term credit contraction and an increase in defaults as economies and lenders come to terms with the real meaning of the newly available data. Often the new data reveals a clearer picture of over-extension in which the true number of consumers using credit to meet other credit commitments is exposed. This often results in a transitional reduction in lending because of uncertainty about borrower risk.

In time lending returns to normal levels and indeed increases. Importantly, this increase in lending is not accompanied by a similar rise in delinquencies. This increased lending, particularly to traditionally under-served sections of the community, improves the stability of the financial system because of the broader base across which risk is spread.

2. Small business is a key winner from positive reporting

Credit scoring, which is facilitated by positive data, improves access to credit for creditworthy small businesses. Scoring is the preferred decision-making tool by larger lenders for assessing small loan applications. Positive reporting provides those large lenders with access to information that enables scoring, making them more inclined and able to engage in small business lending. This attracts large lenders into the market that have not historically engaged in small business lending. This has a positive impact on the broader economy as small business is a key driver of economic growth.

3. Increased amounts of data assist in the fight against identity theft & fraud

More data provides a stronger base from which to detect identity theft and fraud. At the most basic level, the simple recording of accounts opened on a credit report allows the monitoring of whether any unusual credit behaviour is occurring. At the more sophisticated level, positive reporting is generally accompanied by increased levels of automation that improves identity verification and data quality and matching. Consumer monitoring of their own credit reports is an important element in the use of more data to fight identity theft and fraud.

4. Gradual versus rapid reform – community support a vital ingredient

Each country manages the transition from negative to positive credit reporting in its own way. The speed with which reform is implemented reflects a number of issues including technology, regulation, organisational culture and societal values. However, in countries where there is a poor understanding of credit reporting systems or a degree of hostility to the use of greater amounts of data, gradual reform can be a better way to enhance community understanding of, and support for, positive reporting. Community engagement in the credit reporting system is a core recommendation of this report.

5. Even limited additional information is of value

Full-file and cross-industry reporting produces the clearest benefits. However, adding even some limited additional information to credit reports can have very real benefits. The inclusion of the existence of credit accounts allows lenders to acquire a true understanding of existing commitments and can greatly assist with identity theft and fraud detection.

6. The number of data sharers is as important as the data they share

Participation of a large number of data sharers is critical to the overall performance of a positive credit reporting system. The number of data sharers has a significant impact on acceptance and default rates. A positive reporting system without widespread contributions from credit providers will not realise the full potential of expected benefits.

7. Cost or investment

Numerous studies have shown that credit providers who contribute data have realised the benefits accrued outweigh the costs of investing in information technology and other system changes.

Glossary of commonly used terms

Comprehensive reporting: A system in which payment and account information, whether full-file or negative-only, are not restricted by sector, that is, the system contains information from multiple sectors. Such a system is in contrast to segmented reporting, in which information in files is restricted to one sector such as banking or retail.

Data furnisher: The supplier of the data, most commonly the supplier of the service to whom a consumer has a payment obligation.

Data user: The end user of the data, usually but not necessarily a financial firm. In finance, the information is used either manually or in automated computer models to allocate and monitor loans. Other users include central banks, landlords, cell phone providers, and employers.

Full-file reporting: The reporting of both positive and negative data. On-time payments and late payments are reported. Delinquencies are reported at 30 days (sometimes 15 days) following the due date. Other positive information on an account, such as credit utilization, is also reported.

Negative data: Adverse payment data on a consumer. It consists of late payments (usually more than 60 days or more commonly 90 days past due), liens, collections and bankruptcies.

Negative-only reporting: The reporting of only negative data.

Positive data: Information on the timeliness of payments, including whether payment was on time or was moderately late. The payment information may contain the payment date relative to the due date. Positive information often includes data on account type, lender, date opened, inquiries, debt, and can also include credit utilization rates, credit limits and account balances. It stands in contrast to negative-only reporting.

Segmented reporting: A system of reporting information, whether full-file or negative only, in which only data from one sector or a limited number of sectors, e.g., retail or banking, are contained in reports.