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Data Availability and Use
Productivity Commission
GPO Box 1428
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Submission response to Productivity Commission Issues Paper on Data Availability and Use

FIMA welcomes the opportunity to contribute to the Productivity Commission inquiry into the *benefits and costs of options for increasing availability of and improving the use of public and private sector data by individuals and organisations.* Our submission is focussed solely on the area of consumer credit data with particular reference to Recommendation 20 of the Financial Services Inquiry and Item 2(d) of the Productivity Commission Terms of Reference.

We have focussed our submission on retail credit data where one of our principal advisors, Stephen Johnson, has considerable experience. Whilst working at NAB, Stephen was a founding member of the Australasian Retail Credit Association and was its inaugural chairperson in 2003. He has been actively involved in the retail credit industry as a consultant and advisor since 2005 following previous executive roles in credit across Australia, New Zealand, UK and USA.

Our research indicates that implementation of the two most significant legislative changes for consumer lending, National Consumer Credit Protection Act 2009 (“NCCP”) and Privacy Amendment (Enhancing Privacy Protection) Bill 2012 (“CCR”), have not achieved optimal outcomes for consumer credit in Australia. Furthermore, without changes to the way industry and consumers can deal with credit data, Australia is vulnerable to adverse outcomes if economic conditions were to worsen as well as unnecessarily inhibiting financial innovation and competition. Our submission provides insights and recommendations for improving retail credit outcomes for lenders, borrowers and the economy.

Mandate reporting of partial CCR

It is unacceptable that in the data-driven credit markets of 2016, lenders are still unable to accurately assess a borrower’s total lending commitments. All lenders maintain ledgers of customer lending accounts and the infrastructure required to share this type of information is available via the Credit Reporting Bodies. We accept there may be issues in sharing data such as repayment history information from a

definitional, competitive advantage and consumer protection perspective. However, there are limited impediments to lenders sharing four CCR data fields (known in the industry as “Partial CCR Data”): date opened, date closed, type of credit and credit amount.

We encourage the Productivity Commission to recommend that government mandate reporting of partial comprehensive credit reporting by all licenced credit providers by the end of 2017. This is a pragmatic recommendation, which is founded on the reluctance of key industry players to share their CCR information. The recommendation helps address a key gap in the data required to support the Responsible Lending Obligations (RG209) of NCCP by providing ready access to a borrower’s complete lending commitments. The information will help prevent consumer over-indebtedness and ensure lenders have data to support their responsible lending obligations. The data could be made available to government researchers, academics and other stakeholders to help inform and respond to the level of consumer indebtedness in Australia.

Mandate reporting of Consumer Credit Defaults

One of the less recognised adverse consequences of the changes to the Privacy Act implemented in March 2014 is the diminished number of defaults being reported by lenders to Credit Reporting Bodies. A study has recently been commissioned by FIMA to assess the potential impacts of diminished default reporting. Interim results of the study suggest that around 15,000 consumers per month may no longer be reported as having a credit default due to changes in the Privacy Act.

Reporting consumer credit defaults (known in the industry as “Default Listing”) is not a legislated requirements of lenders and relies on cooperation between lenders and Credit Reporting Bodies through a voluntary arrangement. To a large extent, reliance on Default Listing becomes redundant once CCR Repayment History Information (RHI) is reported by all lenders. Given the current delay and difficulties in getting RHI data shared between lenders, information from the Default Listing process becomes critical to ensuring prudent allocation of credit.

Interim results of the FIMA study show that there are now a considerable number of consumers who would not have previously obtained lending that are now getting access to credit. A large proportion of these consumers are now in financial difficulty and either in arrears or on a hardship plan with their lender.

We encourage the Productivity Commission to recommend that government mandate reporting of consumer credit defaults by all licenced credit providers by middle of 2017. As noted above, infrastructure required to share this type of information is available via the Credit Reporting Bodies. This recommendation is driven by a need to arrest the increasing number of consumers that are likely to face financial hardship due lack of movement by industry to share consumer credit defaults or repayment history information.

Establish an Office of Consumer Credit

Ideally, we would like to see substantial changes made to the Credit Reporting sections of the Privacy Act and to the Responsible Lending sections of NCCP. However, having experienced a gestation period of over ten years to get to the current sub-optimal position, we are not confident that necessary changes can be made within a reasonable timeframe.

We believe that mandating the reporting of partial comprehensive credit information and consumer credit defaults will reduce information imbalances between lenders and borrowers and facilitate competition between lenders. We believe this is a single but important step in dealing with the range of data-sharing

issues in the consumer lending market. Research has shown that addressing the information asymmetry between lenders and borrowers will have significant positive outcomes for the economy.

Consumer credit data is unique relative to other data as it defines consumer creditworthiness and therefore must consider consumer and privacy protection, financial system stability and economic growth. Consumer lending underpins the strength of the economy and is becoming more data driven each year. New entrants to this market are good for innovation but need to consider the privileged position of being able to use data to assess a consumer's creditworthiness – supervision and oversight of data usage from a credit perspective will be vital to ensuring consumers and lending markets are protected from adverse outcomes.

We believe the consumer credit sector should be supported by a government agency that incorporates the functions of prudential supervision, economic analysis, consumer and privacy protection, controlled innovation and competition so that optimal outcomes are achieved and adverse consequences are minimised. These functions are presently under the remit of multiple agencies such as APRA, ASIC, AOIC, ACCC and Treasury. We believe that an agency that can leverage good practices across these functions with a dedicated focus on consumer credit can ensure controlled growth and innovation across the sector while also ensuring protection of lenders and consumers in the digital age.

Conclusion

FIMA thanks the Productivity Commission for the opportunity to put forward our views about how some of the immediate data issues in the retail credit market can be addressed with pragmatic solution. We believe that sharing credit information will go a long way to preventing adverse economic and consumer outcomes while also encouraging controlled innovation in retail credit markets.

Yours Faithfully

Stephen Johnson
Principal Advisor

Information supporting FIMA submission to Productivity Commission Issues Paper on Data Availability and Use

1. Financial Services Inquiry

FSI recommendation 20 *supported industry efforts to expand credit data sharing under the new voluntary comprehensive credit reporting regime* adding that *if, over time, participation is inadequate, Government should consider legislating mandatory participation.*

The issue was passed to the Productivity Commission to address as part of its inquiry into the benefits and costs of options for increasing availability of and improving the use of public and private sector data by individuals and organisations in its Terms of Reference as follows:

2. Examine the benefits and costs of options for increasing availability of private sector data for other private sector firms, the public sector, the research sector, academics and the community. Where there are clear benefits, consider ways to increase and improve availability. The Commission should:
    d) provide an update on existing data sharing initiatives in Australia, including the uptake of the credit reporting framework. Consider recommendations for improving participation in such initiatives.

2. What is consumer credit data?

Credit data has a unique position in the spectrum of data. For centuries, lenders have grappled with issues associated with understanding the creditworthiness of a borrower. The advent of computing power and digitised data has shifted credit assessment from an art practised by experienced credit professionals to a science performed by data analysts trained in statistics. However, the fundamentals of considering the likelihood a borrower repaying a loan have not changed.

Credit data is typically used to address two questions:

- What is the willingness of the borrower to meet their loan obligations?
- What is the capacity of the borrower to meet their loan repayments?

Willingness deals with a borrower's propensity to comply with their contractual obligations and is typically assessed using predictive models that use historical information to predict future performance.

Capacity involves assessment of a borrower's financial positon to determine whether they have sufficient surplus income to meet their repayments.

In Australia, two significant legislative interventions (NCCP[1] and CCR[2]) attempted to introduce better use of credit data into the Australian financial services industry to address the issues of willingness and capacity. In both cases, the legislation did not solve the problems identified without unexpected consequences.

3. The Problem – information asymmetry

When lenders can't distinguish good borrowers from bad borrowers all borrowers are charged an average interest rate that reflects their pooled experience[3]. This type of cross-subsidisation means that borrowers with productive uses for loans are cross subsidising less qualified borrowers who are less likely to put their loans to productive purposes. The effects of information asymmetry in credit markets create inefficiencies in the economy through less than optimal allocation of capital and unproductive costs of risk analysis.

Prior to introduction of automated credit decisions and credit scoring, information asymmetry was addressed through manual processes including customer interviews and seeking evidence of a customer's financial situation through documents such as payslips, tax returns and bank statements. Emergence of digitised data, computing power and statistical techniques combined with competitive consumer lending markets and changing consumer behaviours led to introduction of statistically-based credit decisions. These provided lower cost, quicker and more consistent decisions which drove industry towards lower cost business models based on data. However, the available data did not completely address information asymmetry, particularly in Australia where lenders were blind to a consumer's full financial situation (capacity) and the reliability of them repaying a loan (willingness).

The issue of completeness of information was evident in the UK Housing Crisis in the early 1990's and was a catalyst for many UK banks joining the positive data sharing regime that emerged immediately after the crisis.

Importantly, access to data about consumers must be qualified when being used for credit purposes. The US Mortgage Crisis[4] in 2008 was largely founded on poor use of information culminating in an over-reliance on FICO credit scores to assess and approve credit decisions.

Consideration must also be given to the level of intrusion allowed into the lives of consumers; credit should not be constrained because an individual has legitimate concerns about the use of their data.

The challenge of information asymmetry was a catalyst to the formation of ARCA and evolution of Comprehensive Credit Reporting.

4. How did CCR evolve?

In 2003, after many years of informal discussions, credit reporting agency Dun & Bradstreet, convened a meeting of their major customers to discuss the industry's appetite to lobby for changing the Privacy Act to incorporate positive credit data. The Privacy Act of 1988 codified the sharing of data between organisations through third party intermediaries known then as credit reporting agencies. After a number of meetings between senior credit executives of large banks, lenders and telcos, the group agreed to form the Australasian Consumer Credit Council in 2004.

Many of the individuals that formed the Council had considerable experience in the UK consumer credit market and were able to convey the positive and negative aspects of the credit reporting environment in the UK. Their experience led to the Council adopting the UK Steering Committee On Reciprocity (SCOR)[5] as the founding principles for development of a positive credit reporting regime for Australia.

The Australasian Consumer Credit Council was later renamed as the Australian Retail Credit Association (ARCA) with the objectives described below:

Objectives

The Australasian Retail Credit Association is a forum of Australia and New Zealand's most senior credit executives to discuss, debate and provide input into the operations and policies of consumer credit reporting services. The council will take a direct leadership role in examining retail credit issues and developing and sponsoring policies for the betterment of the retail credit industry.

The Australasian Retail Credit Association will address:

1. *International 'good practices' for developing a legal framework for credit reporting;*
2. *The use of credit data to expand access to credit for marginal borrowers such as small business and low income consumers; and*
3. *Strategies for public education and outreach so that both borrowers and lenders are willing and active participants in the credit reporting system.*

The Australasian Retail Credit Association will guide the Governing Principles of Data Sharing in Australia and New Zealand. Data are shared only for the prevention of over-commitment, bad debt, fraud and to support debt recovery and debtor tracing, with the aim of promoting responsible lending.

Retail refers to a broad definition that includes consumers, households, self-employed people, small business enterprises and other non-corporate entities.

ARCA put forward recommendations for changes to the Privacy Act to include positive credit data. These were subsequently submitted to the Australia Law Reform Commission[6] as part of its review of Privacy Laws in Australia. By the time the ALRC had delivered its recommendations, the positive reporting proposal put forward by ARCA had been diluted to a point where the business case for sharing data was no longer commercially viability for most lenders.

In an article published in 2013[7], FIMA foreshadowed some difficulties and concerns that faced introduction of CCR which was due to come into effect from March 2014. FIMA suggested that because of these, CCR would not be implemented before the end of 2015. As at mid-2016, there are few signs that CCR data will be shared at all[8].

The article concluded that there is strong evidence that comprehensive credit reporting provides significant advantages over a negative-only credit reporting regime. However, the Australian transition from negative reporting to comprehensive reporting is largely an unprecedented and unique approach which will create challenges for government, regulators and the industry. Most studies into the implications of positive credit reporting have relied on translating overseas experience into an Australia environment. The timing and approach in Australia is different and therefore the impacts are largely untested.

In the lead up to CCR legislative implementation in March 2014, some organisations had developed the necessary CCR infrastructure primarily aimed towards "vaccinating" themselves from the potential consequences of adverse selection.

However, any chance of these organisations commencing to share data when it became permissible in March 2014 were dashed when a last minute change was mandated by the Attorney General as a result of a radio interview by commentator Alan Jones with David Grafton[9]. The change applied a "grace period" of 14 days for reporting first missed payment in repayment history information. The coding required for lenders to make this change was significant and caused delays of 6-12 months to "early mover" organisations which were ready to share CCR data early in 2014.

As the lenders made changes to cater for the 14-day grace period, further issues were raised regarding the definition and management of data elements within the prescribed framework.

The most contentious of these related to reporting of RHI, brought to a head with FOS Determination 422745. The consequences of the Determination are yet to be played out but has already further delayed sharing of CCR data by early mover organisations by between 3 and 12 months.

There is now a very real chance that CCR data with RHI may never be shared at all.

CCR is symptomatic of the complex issues in regulating availability of private sector data. On one hand, large incumbent lenders such as the major banks are reluctant to share their customer data with other lenders[10] while on the other hand new marketplace lenders are actively lobbying for access to bank data[11].

While Australia has been slow to embrace CCR, New Zealand has made significant advancements in CCR with both consumers and participating lenders beginning to reap benefits. New Zealand CCR legislation was enacted in April 2012, two years before Australia, and they now have around 65% of CCR data being shared among lenders[12].

There are a number of reasons why the pace of CCR has been faster in New Zealand, four of which are significant:

New Zealand	Australia
The New Zealand consumer credit market is dominated by one lender – a structure that encourages second tier lenders to share their data – (ie against “the common enemy”)	The Australia consumer credit market is dominated by four major banks lender which consider their data to be a source of competitive advantage.
Important operational elements are contained in the Credit Reporting Code in New Zealand rather than the Privacy Act making them easier to amend and manage as interpretation and realities emerge.	Specific data elements as well as disclosure and use requirements are prescribed in the Privacy Act. Ability to make changes and interpret legislation in rapidly changing consumer, data and technology environment is difficult.
The principles of reciprocity are less complex than those in Australia and did not constrain early movers to contribute their data.	Australian Principles of Reciprocity and Data Exchange (PRDE) are complex and have been subject to much debate among industry stakeholders.
New Zealand implemented legislation in April 2012 without a transition period. Lenders, regulators and consumers were left to deal with issues in flight with real cases.	Australia provided a 15 month transition period between legislative approval in December 2012 and implementation in March 2014. Issues have been debated about hypothetical issues with little insight into real cases.

5. Impediments to implementation of CCR

The complexity of the legislation, credit reporting code, principles of reciprocity and data standards has created a very high cost environment for data sharing, especially for large incumbent lenders. Despite almost 15 years of debate and crafting of the data sharing rules for CCR, there remains many areas that have not been adequately resolved and many others where changing consumer behaviours and understanding of actual data inconsistencies across the industry has resulted in uncertainty. The recent FOS determination about repayment history information[13] is an example of the many and varied “booby

traps" faced by lenders dealing with CCR. Compliance and protection of reputation are major concerns for most big lenders so they will be reluctant to enter the CCR minefield while issues remain outstanding.

Large incumbent lenders such as major banks, have been accused of deliberately not sharing their data because it is a source of competitive advantage. While there is some truth in this statement, the cost of supply and managing data together with uncertainties about a number of issues means the cost of participating in CCR largely outweighs the benefits – it is not commercially viable in the long run. Additionally, incumbent lenders argue that they have made considerable investment in managing and maintaining credit data for many years. By providing this data to competitors, the value of their data asset will diminish with no compensating increase in value. Incentives for large lenders to continue investing in credit data and infrastructure are questionable if these types of assets were likely to be transferred back to market.

Proponents of credit data sharing point to benefits in terms of reduced losses and increased credit across the credit market[14]. However, in the long run these benefits do not accrue to the incumbent lenders. In a competitive market, the marginal price benefit of better credit assessment will ultimately accrue to the borrower and not the lender[15].

In Australia's oligopolistic market where major banks hold around 70% of consumer lending, there is little commercial incentive for them to share information with other lenders, particularly if the cost and compliance risk of sharing information is high relative to benefits. The cascading effect is that only the smallest lender has commercial incentives to share data.

The rigid legislation, standards and consequences of non-compliance surrounding CCR data sharing in Australia has created a very difficult and complex environment for lenders. The costs to develop systems that comply with the regulatory and legislative requirements of the new credit reporting regime are high. At the same time, they face uncertainty about how the rules will be interpreted and applied. Faced with these realities, it is more cost effective for incumbent lenders to "do nothing" in relation to CCR and deploy resources to investments that offer better returns or deal with more pressing regulatory demands.

6. NCCP credit data deficiencies

Recognising the consequences of over-reliance on data-driven predictive models by lenders, regulators in many countries have introduced a range of responsible lending obligations[16]. Principally these measure are aimed at ensuring a lender considers a borrower's capacity to repay as much as their willingness to repay. Australia's responsible lending obligations were introduced as part of NCCP in 2010 which required lenders to review loan serviceability more comprehensively than previously.

Among other requirements, the responsible lending obligations require lenders to make reasonable inquiries about the consumer's requirements and objectives, make reasonable inquiries about the consumer's financial situation, and verify the consumer's financial situation[17].

While many lenders argued that they were already meeting these obligations, the effect of the legislation was that they needed to be able to demonstrate and evidence compliance with the legislation. Much of the data required to support compliance was not available in digitised format (eg payslips, expenses) or not readily accessible from systems (eg tax assessment notices, multi-bank statement data, loan repayment data).

The responsible lending obligations under NCCP resulted in higher cost back-office processing, longer times to decision, high drop-out rates through the application process and general irritation amongst lenders and their customers. Lenders continue to grapple with ways of making this process more efficient through digitisation. The advent of distributed computing (the internet of things) and software as a service has provided a range of technical solutions.

Serviceability generally comprises three items: Income, Expense and Loan Commitments – there are a number of ways in which these areas have been addressed by data solutions:

Income	Expense	Commitments
Bank statement data purportedly can address income verification but evidence to date is mixed. OCR techniques are being trialled for capturing salary information. Methods to obtain customer financial transaction data online (eg superannuation, payroll) have emerged	Expense models such as HPI[18] and HEM[19] used in lenders models are regularly questioned because of their generalised approach to estimating expenses. Sharing and codifying bank statement data is emerging as a mechanism to support estimation of expenses.	Bank statement data is considered to be a partial solution but relies on the borrower disclosing details of all bank accounts. Loan commitment data from CCR remains unavailable. Disclosure by the borrower is the primary method of understanding loan commitments.

Attempts to leverage data to improve the accuracy and efficiency of serviceability have raised new concerns. There are a number of examples where third parties including Fintechs have provided solutions to support consumer controlled data sharing (eg Yodlee, Mogo). While these emerging technologies are being developed, privacy and consumer advocates are actively opposing potential solutions that threaten consumer protection; one of which is access of bank statement data using impersonation techniques. At the same time, criminal opportunists continue to expand their methods of identity theft, cyber fraud and falsifying information.

The lack of verifiable serviceability data continues to exacerbate the asymmetry of information between lenders and borrowers, adding unproductive costs to the economy.

7. Reporting of Consumer Credit Defaults

One of the less recognised adverse consequences of the changes to the Privacy Act implemented in March 2014 is the diminished number of consumer credit defaults being reported by lenders to Credit Reporting Bodies. Reporting of consumer credit defaults (known in the industry as “Default Listing”) is recognised across the world as having an important role to play in credit markets.

The threat of Default Listing is often a warning sign for a borrower that they are approaching the threshold of their borrowing limit and act as a prompt for them to seek assistance to address their financial situation. Used responsibly, the Default Listing process can prevent a borrower from reaching advanced stages of financial difficulty.

The Default Listing itself makes lenders aware that the borrower has suffered financial difficulty and that it needs to perform a greater degree of diligence before offering or suggesting additional credit. Used

appropriately, the Default Listing process protects both the lender and the borrower from adverse outcomes.

Implementation of amendments to the Privacy Act placed more requirements on lenders before they could report a default to a Credit Reporting Body including a new sequence of notices that need to be sent to the customer. The cost and complexity in meeting these requirements has led to more conservative interpretation of a consumer credit default by lenders resulting in less defaults being reported to Credit Reporting Bodies.

As a result, consumers who would not have previously obtained lending now getting access to credit. A large proportion of these consumers are now in financial difficulty and either in arrears with or on a hardship plan with their lender.

A study has recently been commissioned for FIMA to assess the potential impacts of diminished default reporting. Interim results of the study suggest that around 15,000 consumers per month may no longer be reported as being defaulted due to changes in the Privacy Act. The FIMA study suggests that this has been a partial factor in increasing arrears rates and personal insolvencies over the past twelve months.

Unless this issue is addressed, it is likely that there will be a continued increase in the number of consumers impacted as well as an increase in arrears rates of lenders.

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[10] Disrupters in battle for access to credit data; 2nd August 2015; Australian Financial Review

[11] Priorities for Reform of the Australian Financial Services Industry; 24 February 2016; Fintech Australia

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[13] FOS Determination 422745 dated 21st April 2016 is an example of rulings that considerably alter the way that lenders report and use CCR.

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[19] https://www.melbourneinstitute.com/miaesr/publications/indicators/hem.html