FULL PICTURE?

Australia is on the cusp of making major changes to its credit reporting regime, but whether the new system will be better for brokers' clients is still up for debate. **ANDREA CORNISH** investigates

Australia's credit reporting system is facing a major overhaul and in some minds, the changes are long overdue. Unlike developed economies such as the US and the UK, the current regime in Australia only reports 'negative' data – such as the fact that a loan application was submitted (but not whether it was accepted or rejected), defaults of greater than 90 days and bankruptcy. The source of the debt and the size of the default make no difference on the credit report – missing mortgage payments is as detrimental as failing a store credit card. Negative records stay on a borrower's credit report for up to seven years – even if the bill has been paid in full.

On the other side of the coin, someone who has applied for credit and never used it has just as good credit as someone who has dutifully paid their mortgage for 10 years. Credit reporting agencies store their naughty lists, and then sell the information – credit reports – to anyone keen on lending money.

But since 2004, the credit industry has been lobbying for change. Dun & Bradstreet, one of the reporting agencies spearheading the campaign, describes the current system as being outdated and claims Australia's credit reporting laws provide an "incomplete picture of a borrower's true risk profile".

However, the real catalyst for change was the *National Consumer Credit Protection Act*, according to the law firm Minter Ellison. A fundamental feature of the *NCCP Act* is a requirement for credit providers to collect and verify information about a loan applicant's financial position, which is an underlying component of the loan 'unsuitability assessment' that all credit providers

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must investigate before entering into a credit contract. As such, the credit industry has been pushing for a privacy reform which will allow more comprehensive reporting to help them better understand a borrower's financial position.

After much review, the government released an exposure draft of the credit reporting reforms to the *Privacy Act* in February this year. Under the proposed changes, an individual's credit file would now contain a greater amount of information to give lenders a more comprehensive picture of the potential borrower. The revised 'comprehensive reporting' scheme includes five new areas of information: the type of each active credit account a person holds; the dates in which the account was opened and closed – if it was closed; the amount of credit available; and information about repayments. The new scheme has since been referred to the Senate Finance and Public Administration where it is currently under review.

ADVANTAGES

According to Dun & Bradstreet, comprehensive credit reporting holds several advantages for both lenders and borrowers, such as:

- reduced default rates
- improved access for under-served demographics to the mainstream credit system
- greater market competition
- enhanced responsible lending practices
- greater ability for borrowers to 'shop around' for credit cards

Veda Advantage defended the new reporting scheme against criticisms that the system would deny credit to worthy borrowers. Spokesperson Chris Gration says there is nothing "draconian or big brother" about the law and claims the comprehensive credit reporting would only deny credit to borrowers unable to service a loan, which reflects the intent of NCCP legislation.

"Comprehensive credit reporting very significantly improves the capacity of the lender to work out if a consumer can afford the loan," Gration explains.

ACCC investigates new credit data provider

The ACCC is reviewing the possibility of a credit reporting service provider that is partly owned by the major banks.

Under the proposal, the four major banks will have a 4% stake in Experian Australia Credit Services. Britain's Experian group will own 76%, while Citigroup and GE join the remaining shareholders. The joint venture would provide consumer and business credit information to lenders.

Competitors such as Veda Advantage and Dun & Bradstreet have raised concerns about the proposal.

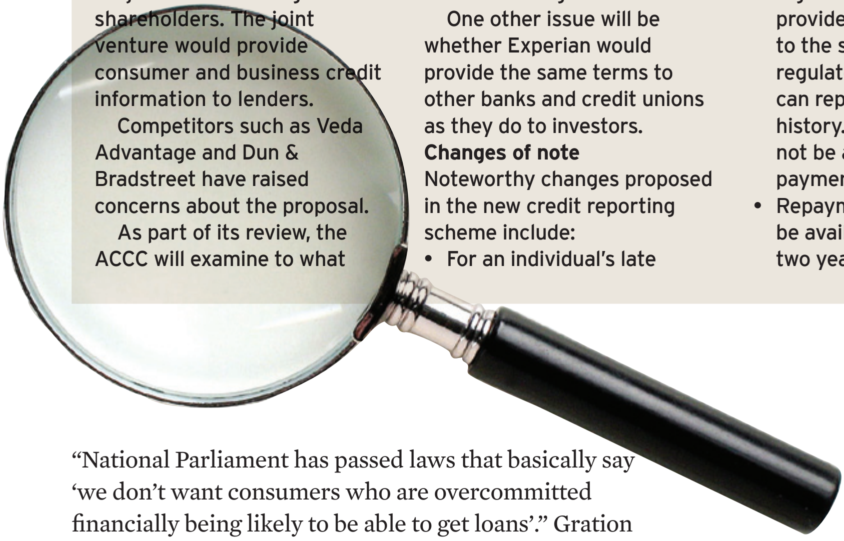
As part of its review, the ACCC will examine to what extent Experian could prevent rivals' access to credit data and how this would affect competition. It will also investigate rival agencies' access to their customers. The terms of the joint venture allow investors to use rival agencies; also, it is expected investor banks will continue to supply data to rival agencies.

One other issue will be whether Experian would provide the same terms to other banks and credit unions as they do to investors.

Changes of note

Noteworthy changes proposed in the new credit reporting scheme include:

- For an individual's late payment history, late payments will only be recorded by banks and lenders in terms of payment cycles 'missed' – which are measured monthly.
- If you miss a utilities bill repayment, this will not negatively affect the borrower under the new legislation as utilities providers do not have access to the system. Only NCCP regulated credit providers can report or use repayment history. (This information will not be available alongside payment history.)
- Repayment history will only be available for the last two years.



"National Parliament has passed laws that basically say 'we don't want consumers who are overcommitted financially being likely to be able to get loans'." Gration also says there is an advantage in comprehensive credit reporting for borrowers with good repayment histories, pointing out that those borrowers could be able to demand rate discounts.

Home Loan Experts director Otto Dargan also sees potential in the new scheme for rate discounts. "If Veda Advantage gives every credit file a score, similar to the US's FICO score system, then borrowers can use this as a bargaining chip when shopping around for a rate," he says. "Several lenders have already shown an appetite for 'rate for risk' lending by offering discounts for low-LVR loans. I expect these same lenders will consider a credit score-based interest rate as well. If the current system remains where the banks do not use a score from Veda, and instead generate their own score, then there is still the potential to have a rate for risk system similar to the one already used by non-conforming lenders or Esanda with vehicle finance. However, because every lender would have their own scoring system, this would be less transparent to consumers and so would be more difficult to market."

Dargan also says the new reporting system will make it harder for borrowers to commit "soft fraud". "In the current market it is too easy for borrowers to hide their existing debts," he states. "If positive credit reporting can help lenders identify undisclosed debts or past repayment problems then this will help the entire industry."

The new system may even encourage Australians to manage their finances better, Dargan says. "In the US, most people are well aware of what information is taken into account by the FICO score system, and so they actively manage their finances to try to achieve a better score," he observes. "There are even people who brag about their credit score or want to see their fiancée's score before getting married. At the moment, very few Australians even know what credit scoring is. If Australians become aware of how the scoring system works then they may try to make their payments on time, every time, in order to increase their score."

The Mortgage Planner Group's principal Darryl Benn is also looking forward to the changes, as he believes it will provide a better outcome for borrowers. "The current system is based purely on negative reporting and I have had concerns with agencies for a number of years as they have, on many occasions, unfairly jeopardised a consumer's capacity to borrow."

A number of clients have been burned through no fault of their own, Benn says. "I recall loans being refused when one telco listed all accounts as in default when they went into liquidation and the consumer couldn't actually pay them. When it came to LMI they just wouldn't listen."

Weighing it up

ADVANTAGES

- Reduced default rates
- Improved access for under-served demographics to the mainstream credit system
- Greater market competition
- Enhanced responsible lending practices
- Greater ability for borrowers to 'shop around' for credit cards

DISADVANTAGES

- Protection of privacy and controls over data access and usage
- Data reciprocity
- Data quality
- Complaints handling and dispute resolution standards
- Governance and oversight framework

Benn says he's had clients who had excellent credit histories, lost their jobs and went into default. Despite regaining employment and clearing their debts, they continued to be penalised for years. Benn also argues that clients should not be rejected based on the number of enquiries they've made. "If a person does not proceed with those enquiries, they should be removed."

> "The current system is based purely on negative reporting... I've had concerns for a number of years" – **DARRYL BENN**

DISADVANTAGES

But the new system is not without its detractors. Potential drawbacks flagged by lenders were:

- protection of privacy and controls over data access and usage
- data reciprocity
- data quality
- complaints handling and dispute resolution standards
- governance and oversight framework

Oasis Mortgage Group's Graham Reibelt recently came out swinging against the new regime, stating that it would empower lenders enormously and impact the majority of clients' credit worthiness in a negative way. He also suggested brokers would be pushed into the non-conforming space as a result.

"If lenders do a bit of an audit, then they can uncover an awful lot of information that hasn't been disclosed fully," he warns. "A customer may have understated the credit limit on their credit card, or fallen behind on a store card, but are not always a bad credit risk. We don't always need or want the whole truth, particularly when the information isn't of material importance. It's a bit like your wife asking, 'does my bum look big in this?' "

Credit reporting lawyer Joseph Trimarchi of Joseph Trimarchi & Associates says the new reporting system may catch out clients who are on the borderline for lenders and could penalise borrowers who were late making payments, but not yet listed in default.

According to Dargan, the new system could limit access to credit – at least in the beginning. "Banks will take time to adjust, and will start off by being conservative," he predicts. "However, after this initial period, the banks may consider lending to customers who have adverse listings as long as they have a good track record of behaviour with their other accounts. It can help separate someone who has had a one-off problem from someone who can't handle their finances."

CHANGE FOR BROKERS

Resi CEO Lisa Montgomery acknowledges that the new reporting scheme could prompt brokers to adjust their interview process. "If the borrower discloses past credit issues early in the loan discussion, it may prompt the broker to bring forward the request for a credit report. Again though, this will depend on whether all financial institutions embrace positive credit reporting."

But Dargan is confident brokers will change their interview practices. "Many brokers will carry out a credit check as part of the interview or will request customers to order a copy of their credit file prior to the meeting. You can't accurately recommend a loan if you don't know anything about the customer's credit history." MPA