

EXPANDING THE CREDIT REPORTING SYSTEM – A SUMMARY OF CONSUMER CONCERNS

Consumers' Federation of Australia, July 2003

1. Introduction

The Australian Finance Conference (AFC) has been arguing for some time for the introduction of a US-style “positive credit reporting system” into Australia. The Consumers Federation of Australia (CFA) understands that the AFC has prepared a submission to the Government on the need for change. However, to date, there has been little, if any, public discussion on the wider implications of such a change.

Such discussion is needed now, before the Government makes any policy decisions on this issue. To facilitate discussions, CFA has prepared a summary of its main concerns.

2. Background

Australia's credit reporting system is implemented through the Privacy Act (Cth) 1988 and associated Code of Conduct. Under these instruments, an individual's credit information file can include “negative” information (eg. defaults, judgments, bankruptcies, and “serious credit infringements”), as well as personal details, credit applications, and explanatory notes on remedied defaults or other matters.

In contrast, in the US, a credit report can include a much broader range of information about individual accounts, including information on outstanding balance, credit limit, date account approved, date of last activity, and payment history.¹

Proponents for introducing a US-style credit reporting system in Australia assert that it would improve risk assessment for lenders; enable pricing to more accurately reflect risk; reduce the incidence of fraud and misinformation by borrowers; and reduce the chance of borrower overcommitment.

However, consumer advocates are skeptical about the size of any such benefits, and believe that they are unlikely to outweigh the potential risks for consumers. Consumer advocates are also mindful of the high value that consumers place on their privacy, particularly in relation to their financial information.²

¹ Staten, Michael and John M Barron “The value of comprehensive credit reports: Lessons from the US experience”, p. 11 (undated).

² Over half of the respondents (59%) to a recent survey said that they would prefer to keep their financial details private. When asked what the one piece of personal information that consumers felt most reluctant to hand over, financial details topped the list (40%). See “Privacy and the Community”, prepared by Roy Morgan Research for the Office of the Federal Privacy Commissioner, July 2001, p. 10-11.

3. Significant and systemic failures in the current reporting system

There are a range of failures and problems with the current credit reporting system, and consumer advocates will actively oppose expansion whilst these issues are unremedied.

(i) *Reports are inaccurate*

Despite the various legislative obligations imposed on credit providers and credit reporting agencies to ensure that credit information files are accurate and complete,³ credit files often include inaccurate information, including:

- Defaults for an account that the consumer has never opened;
- Defaults where the amount is not in fact owed;
- Double listings of defaults; and
- “Clearouts” listed where there is no evidence of an intention to defraud.

In part, these inaccuracies can arise because credit providers are not obliged to prove to the credit-reporting agency, or to an independent third party, that an alleged default or other information is valid. The use of “fuzzy matching” techniques by credit reporting agencies,⁴ or the failure to attempt to recover the alleged debt before listing⁵ can compound the risk of inaccuracies.

(ii) *There is no effective way to remedy inaccuracies*

Under the current system, there is a lack of clarity about the process for resolving complaints about incorrect information, and the options if a complaint to Baycorp or the credit provider is ignored or unresolved. Existing complaints processes are inefficient and slow, and inaccurate information can remain on the file for a lengthy period of time.

The legislation does allow consumers to request that a note to be added to their file, explaining that the information is disputed. However, credit applications and credit reports are often assessed automatically, and there is no scope within this process for reviewing any explanatory or additional notes on the file. The effectiveness of the process for dealing with inaccurate or disputed information is therefore negligible.

Another problem for consumers trying to resolve disputes is that Baycorp does not belong to an independent industry dispute resolution scheme, and neither do many of the credit providers that access credit reports.

³ For example, see Privacy Act 1988 (Cth) ss. 18E(8), 18G(a)

⁴ For example, matching rules that are used when Subscribers access the database allow for “possible matches” to be returned to a Subscriber where input data matches closely, but not exactly, with existing file data.

⁵ Under s. 18E(1)(vi) of the Privacy Act, a default cannot be listed until the consumer is at least 60 days overdue in making a payment and the credit provider has taken steps to recover the whole or any part of the credit outstanding.

(iii) *Access to the credit reporting system is not sufficiently controlled*

A further issue with the current system is that the number and type of businesses that can access a consumer's financial details has increased dramatically in recent years. Telecommunications companies, utility companies, doctors and lawyers, and other businesses that defer payment for at least 7 days can access the credit reporting system.⁶

However, many of these "credit providers" list very small defaults on credit reports, and appear to take little care to ensure that the information listed is correct. They often also use their access to the credit-reporting database to facilitate debt collection (i.e. they threaten "if you do not pay my bill, I will lodge a default on your credit record").⁷

Even businesses that do not defer payment for 7 days can effectively access credit files. There is nothing to prevent any business from demanding a copy of a consumer's credit file before providing goods or services to that consumer. This is already happening in the context of applications for residential tenancy.

(iv) *There is ineffective regulatory oversight*

The Office of the Federal Privacy Commissioner ("the Office") has powers to investigate complaints and make determinations or orders in relation to credit reporting matters. However, in practice, the Office has a very poor record in complaint handling in terms of processes, fairness, and time taken to resolve credit-reporting matters. In particular, consumer advocates are not convinced that the Office has implemented an adequate framework for monitoring compliance or identifying systemic problems.

(v) *Non-compliance with Information Privacy Principles*

There are a number of inconsistencies between the *practice* of credit reporting and the Information Privacy Principles in the Privacy Act. For example, principle 1 requires that information must be collected for a lawful purpose, and principle 9 requires that the information be used only for relevant purposes. However, many so-called credit providers are using their access to the credit reporting system for debt collection, despite the specific prohibition in the Privacy Act (see (iii) above).

Principles 7 and 8 place obligations on record-keepers to ensure that information is accurate, up to date, and complete. However, the numerous problems observed by consumer organisations suggest that practical commitment to these principles is limited.

4. Increasing the number of consumers in default

Proponents of positive credit reporting argue that its introduction will enable credit providers to lend more money. For example, a US study suggested that, for a given set of

⁶ Determination No 1 of 2003 (classes of credit providers).

⁷ This is despite the fact that debt collection activity is specifically excluded from the credit reporting system. For example, see Privacy Act 1998 (Cth) ss. 11B(4E) and 11B(7).

data files, and for the same default rate (4%), the US model would approve 76.5% of consumers for a loan, while the Australian model approves only 57% of consumers.⁸

However, there is no information to suggest that lack of credit availability is a real problem for Australian consumers. Instead, consumer advocates are concerned that if lending increases, the number of consumers in default will also increase. In turn, this will lead to increased financial hardship for individuals, and further stretch the resources of community agencies, including financial counsellors and emergency relief agencies.

5. Increasing reliance on credit scoring

Lenders can use the information collected in the credit reporting system to create an individual credit score, and this score is then used in increasingly automated assessments of credit applications.

Obviously, if the credit reporting system is expanded, the range of factors that can be used to create a credit score will also increase, and, according to credit providers, the accuracy of the credit score in predicting the risk of loss *to the lender* may increase. The extent to which credit providers examine an individual's actual income, expenses, assets, and credit performance, may subsequently decrease.

However, credit scoring is generally based on average results, and does not necessarily reflect an individual's ability to repay, nor whether providing the credit will cause unreasonable financial hardship to the borrower. Greater reliance on credit scoring may therefore lead to reduced increased financial hardship for borrowers, even if the risk to credit providers is decreased.

6. Conclusion

The current credit reporting system is not serving consumers well. Substantial reform is needed, particularly in relation to accuracy and completeness of information, access to the credit reporting system, complaints handling and regulatory oversight. Consumer advocates will strongly oppose any proposals to expand the scope of the credit reporting system whilst these issues remain unresolved.

Consumer advocates also have serious concerns about the risks for consumers in moving towards a US-style credit reporting system. In particular, whilst a move might decrease the risks for credit providers, consumer advocates are concerned that it will increase financial hardship for consumers.

Any proposal to expand the credit reporting system should therefore be subject to a full and independent assessment, and should not be implemented unless and until the existing and potential problems that consumers have with the current system are resolved.

⁸ Staten and Barron, op.cit. p. 17.