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Open banking

Comprehensive Credit Reporting (CCR)

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On 1 July 2018 a core component of Australia's emerging open banking regime, Comprehensive Credit Reporting (CCR), will become mandatory. CCR, otherwise known as 'positive reporting', enhances the credit information provided by lenders and credit reporting bodies. This has the potential to enhance differentiation of customers based on risk.

It will lead to increased competition for low risk customers, increased pricing for high risk customers, enable more informed lending decisions by credit providers, and reduce information imbalances between lenders and borrowers.

The context

Back in 1997 the final report of the second Financial System Inquiry, the Wallis Report, recommended a complete review of the costs and benefits of positive credit reporting[i]. But up until March 2014, Australian privacy legislation only allowed negative credit reporting. Credit providers - which include banks, other financial institutions, utilities and telecommunication companies - voluntarily supplied a limited set of information to credit reporting bodies.

The contents of a credit reporting file were limited to the number of credit inquiries, overdue or missed payments, court judgements and bankruptcy orders which had been made over the previous seven years[ii]. This provided limited information that a lender could use to assess a customer's risk profile.

From 12 March 2014, Australia's privacy legislation was amended and financial institutions were encouraged to voluntarily adopt CCR. Although all four major banks reported they were on track to share data in 2018, they have worked to different timelines[iii].

- **National Australia Bank** had said it would start positive reporting in February 2018 with personal loans, credit cards and overdrafts[iv].
- **Commonwealth Bank** said it would start reporting home loans by the end of 2018[v].
- **Westpac** intended to join that regime by mid-2018 but was not specific about products[vi].
- **ANZ** had been planning to begin reporting in the second half of 2018[vii].

After revisions to previous timelines for adoption of CCR that banks had communicated, and frustrated that 'not a single major bank' would be participating in CCR before December 2017[viii], the Government announced on 9 May 2017 that it would mandate CCR if credit providers were not reporting at least 40% of their data by the end of 2017, the minimum target recommended by the Productivity Commission.

On 2 November 2017, with less than one per cent of data reported, the Australian Treasurer then announced that the government would legislate for a mandatory CCR regime by 1 July 2018.[ix]

Levelling the playing field

One of the Government's primary objectives in mandating CCR is to enable new entrants and smaller lenders to assess potential customers' borrowing capacity. This could result in a significant benefit as these entities gain access to additional information that was previously held by each of the four major banks.

Under CCR, a reciprocal approach to information sharing will operate, with what the information lenders receive, based on what they have provided. There is no established mechanism for the information sharing to occur under CCR. Initially the mandated CCR regime will only apply to the four major banks, who will need to provide 50% of their credit data by 1 July 2018, rising to 100% by July 2019. This will provide market participants with richer data sets and the ability to price based on the information that has been reported.

The challenges

CCR has potential challenges for both large and small organisations including cost, data security, and the ability of credit reporting and customer information systems to accurately capture and report the information mandated. It has been estimated that rolling out CCR will cost the banking industry up to $0.5 billion. Smaller entities intending to participate in CCR, may need to invest in their pricing and analytics' capabilities, to be able to generate value from the additional information.[x]

Why is CCR being introduced?

The Final Report of the 2014 Financial System Inquiry (the Murray Report) noted that the core objectives of CCR should be to 'reduce information imbalances between lenders and borrowers, and facilitate competition between lenders' and 'improve access to and reduce cost of credit for borrowers'[xi].

This was echoed in the May 2017 Productivity report, Data Availability and Use, which noted that:

'Comprehensive credit reporting seeks to address the information asymmetry between lenders and borrowers — that is, the situation of borrowers typically having more information on their creditworthiness than lenders, leading to instances where relatively creditworthy applicants are denied credit or priced out of the market while less creditworthy applicants are able to access credit, potentially at an inefficiently low interest rate'[xii].

In our *Open banking: a seismic shift* article, we highlighted that empirical evidence suggests that CCR reduces the likelihood that originated loans will default, a positive for both lenders and borrowers[xiii].

Access to high quality credit information leads to better credit decisions and an improved credit environment for lenders and borrowers, and represents the first step to open banking.

What's different in the information reported?

Although reportable data that could be shared under positive reporting may be referred to as 'comprehensive', it is deceptively prescriptive. Currently negative information reporting only discloses defaults and enquiries. This presents practical challenges when conducting credit checks, most critically in identifying whether or not a credit inquiry listed on file resulted in an account being opened.

Full participation in CCR, by 1 July 2019, involves sharing five elements:

1. Date account opened
2. Credit limit of the account
3. Type of credit
4. Date account closed
5. Repayment history over the previous 24 months[xiv].

Negative Reporting
Credit enquiries
Credit payment
Serious credit infringements

Positive Reporting
Credit enquiries
Credit payment defaults
Serious credit infringements
Date accounts were opened and closed
Credit limits
Types of credit accounts
24 months of repayment history

[xv]

Credit account information such as type of credit, account open and closed dates, and credit limits, can be shared by all credit providers, financial services companies and telecommunications and utility companies. Repayment information can only be provided by and shared with licensed credit providers, entities that hold an Australian Credit Licence (ACL)[xvi].

These changes, when fully implemented, will bring Australia's credit reporting regime in line with other OECD countries.

Who are the winners and losers?

The third report of the review of the four major banks, reiterated why the government was mandating CCR:

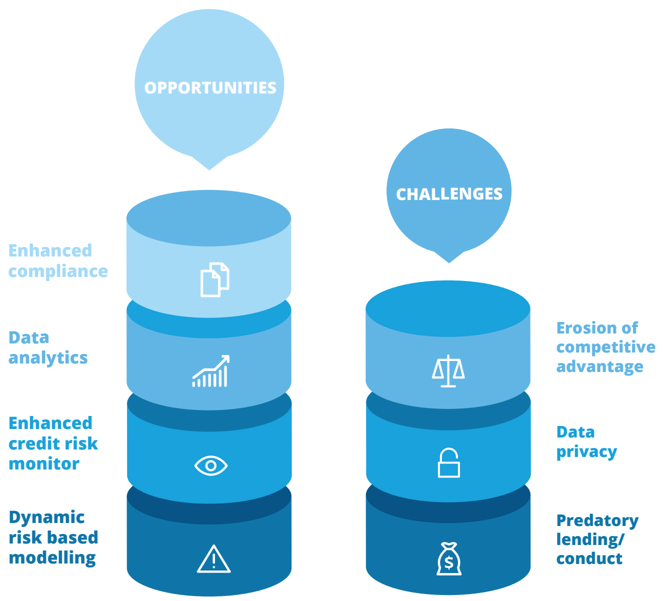
'The CCR system gives financial institutions access to a deeper, richer set of data, encouraging competition for small businesses and retail customers with positive credit histories. In addition, the CCR system allows financial institutions to better serve customers, and assess their borrowing capacity.'[xvii]

Greater access to positive credit enables smaller lenders, and potentially new entrants including fintechs and techfins, to compete more effectively, and may lead to the emergence of niche lenders focused on customers with a particular risk profile.

In response, it is likely that banks will change their risk pricing models to use this information, leading to greater price discrimination based on credit risk.

As 'the information asymmetry between lenders and borrowers', referred to by the Productivity Commission[xviii] is removed, customers with strong credit histories are likely to see more competitive pricing and a drop in rates. However, customers without positive credit information and less creditworthy customers, are likely to experience an increase in interest rates, reflecting their higher risk. Some may be unable to access credit at all, at least from mainstream lenders.

While CCR is expected to increase the competitiveness of smaller lenders, it also provides an opportunity for larger lenders to drive individualised and tailored offerings through enhanced and dynamic pricing and packaged deals.



The opportunities

A snapshot of the opportunities includes:

Better compliance and suitability assessment
Industry players will be able to gain a better understanding of the customer with verifiable credit information which will help lenders meet their responsible lending requirements and enable them to better determine the suitability of certain products.

Data Analytics
The additional information captured will enable improved data driven insights for those financial institutions with strong data analytics capability.

Enhanced credit quality information
The additional information could result in improved clarity over asset quality which could lead to a lower cost of capital.

Risk based pricing models
Lenders are likely to explore the introduction of more dynamic, risk-based pricing of products.

Empower the development of new products and services
Industry players, with deeper insights about customer behaviours, can develop new products and services or improved service delivery. An example of this could include the ability to more quickly identify a potential late payment of a loan, preventing customers from moving into default at an earlier stage of the payment process.

There will also be some challenges:

Privacy considerations
The industry will need to meet privacy requirements, including obtaining appropriate consents and permissions where appropriate, to be able to realise the benefits of CCR and open banking. The privacy of customer data is more important than ever to ensure that unencrypted data is not being shared, or that data is not being shared with an unauthorised party.

Conduct
The enhanced understanding of the customers' credit positions will both enable and require compliance with responsible lending requirements.

How does this impact the customer?

Consumer groups are concerned that although enhanced credit information might be advantageous for customers with goodcredit histories, vulnerable customers risk being targeted by lenders with business models that involve offsetting the high risk of delinquency, by charging higher fees and rates. There are also concerns that some consumers may avoid seeking financial hardship assistance because of the disclosure of information regarding the repayment arrangements. It is important to understand how amended repayment amounts, agreed with the customer, will be disclosed and treated by credit reporting bureaux.

What are the other considerations?

As with any new rules and regulations focussed on customer outcomes, dealing with the additional requirements for credit and customer information as part of CCR will require organisations to review their processes and systems. As a starting point, lenders will need to:

- Review existing credit reporting arrangements
- Identify current credit lending processes impacted
- Determine if systems have the capability to provide the required reporting information and
- Establish the mechanisms for information to be shared with credit reporting bodies and third parties.

A number of organisations have focused on tactical investments in data, many of which are still ongoing. Open banking, including CCR, has the potential to enable them to adopt a more strategic framework for these investments.

The major banks have acknowledged that migration to CCR is complex and will require significant investments in data, technology, security, process change and CCR reporting capability. [xix]

Lenders will need to be able to answer the following questions about the information being shared:

1. Is the information in our systems about our customers and their payments accurate and complete?

2. Can we obtain a single view of customer that can be used from various product systems to meet the regulatory requirements?

3. Do we have appropriate records of customers' consents and permissions for the use of their data and if not, can we obtain this prior to 1 July 2018?

4. Do we have processes in place to ensure that the customer information that is gathered is secure and protected?

5. Do we have processes in place to ensure that customers have been correctly advised how their information will be shared?

6. Are we only using information for the purpose for which a customer has given consent or for a purpose which is otherwise permitted by law?

7. Are we confident that the counter-party with which the customer information is being shared is the correct counterparty and this information is not being used for another purpose?

8. Are our processes for extracting and sharing data efficient given legacy systems?

9. Can we automate the provision of information about our customers and their payments from our systems rather than having to run costly manual processes?

The last word

CCR has been hailed as a 'game changer for both consumers and lenders' that will increase competition and access to finance and, for borrowers, lead to 'a better deal on your mortgage, your personal loan or business loan'[xx].

Given its political genesis, financial institutions' implementation of CCR is likely to be keenly observed. Financial institutions will want to ensure they have made adequate investments in the technology, data and processes required to support the change, and that they have adequately considered the strategic, conduct and privacy risks accompanying this change.

Notes

[i] Murrary, David, "Financial System Inquiry Final Report," 2014.

[ii] Deloitte Access Economics, "The Benefits of Broadening Access to Credit," May 2008.

[iii] House of Representatives, Standing Committee on Economics, Review of the Four Major Banks (SCE's Third Report), 7 December 2017. See also https://www.aph.gov.au/Parliamentary_Business/Committees/House/Economics/FourMajorBanksReview3/Report

[iv] National Australia Bank, 'NAB announces start to Comprehensive Credit Reporting', Media release, 9 October 2017and Mr Antony Cahill, COO, NAB, Transcript, 20 October 2017, p24, as noted in the SCE's Third Report op cit pp16-17

[v] Commonwealth Bank of Australia, 'CBA confirms support for Comprehensive Credit Reporting (CCR), Media release, 9 October 2017, and Mr Ian Narev, CEO, CBA, Transcript, 20 October 2017, p40, as noted in the SCE's Third Report op cit pp16-17 (NB in the Third Report Mr Narev was incorrectly noted as CEO of ANZ)

[vi] Mr Brian Hartzer, CEO, Westpac, Transcript, 11 October 2017, p35, as noted in the SCE's Third Report op cit p16

[vii] Mr Shane Elliott, CEO, ANZ, Transcript, 11 October 2017, p39, as noted in the SCE's Third Report op cit p17

[viii] SCE's Third Report op cit p19 para 2.87

[ix] Morrison, Scott, Mandating comprehensive credit reporting, Media Release 2 November 2017. See also http://sjm.ministers.treasury.gov.au/media-release/110-2017/

[x] Bristow, Mark, NAB and CBA lead Big Four in CCR, 10 October 2017. See also http://www.ratecity.com.au/personal-loans/news/nab-cba-lead-big-four-ccr

[xi] Murrary, David, "Financial System Inquiry Final Report," 2014.

[xii] Productivty Commission Inquiry, "Data Availability and Use," March 2017

[xiii] Miller, M, "'The Value of Comprehensive Credit Reports: Lessons from the U.S. Experience', in Credit Reporting Systems and the International Economy", 2012

[xiv] S. Johnson, "Consumer Lending- implication of new comprehensive credit reporting," Financial institutions and management advisory, July 2013.

[xv] Equifax, "What is Comprehensive Credit Reporting (CCR)?," Equifax, 2017. [Online]. Available: https://ccr.equifax.com.au/what-is-ccr. [Accessed 15 January 2018]

[xvi] Equifax, 2017 op cit

[xvii] SCE's Third Report op cit p15 para 2.67

[xviii] Productivty Commission Inquiry, "Data Availability and Use," March 2017

[xix] SCE's Third Report op cit pp15-19

[xx] Morrison Media Release op cit

Refer to the Mandatory Comprehensive Credit Reporting draft legislation at this link https://treasury.gov.au/consultation/c2018-t256276/. The government is expecting submissions to the draft proposal by 23 of February 2018.

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