# FRONTRUNNERS WINNERS IN TRANSITION TO CCR

Modelling the transition of the Australian market's transition to comprehensive credit reporting suggests that the early movers will come out on top.

**IT'S BEEN FIVE** months since Australia caught up with the rest of the OECD by legislating for comprehensive credit reporting (CCR).

Lenders are now considering how and when they will participate in CCR. Modelling the scenarios of the Australian market's transition to CCR suggests that those who move early are positioned to gain from the transition, or at least mitigate against loss.

International experience has shown businesses that hold back participation in CCR are, over time, at risk of attracting lower quality credit applicants and increased risk exposure. Conversely, early adopters who contribute comprehensive data in the initial phase of CCR will see benefits that rise sharply as other players come into the data pool.

What is clear from locally based studies and international experience is that CCR is good for consumers, lenders and credit bureaus. Sharing CCR data results in more accurate and fairer lending decisions.

## The scale of change

CCR data use and disclosure is not mandatory and the transition is a very substantial change for both lenders and credit bureaus. For example, in the present negative reporting environment a credit file is updated on average 1.4 times a year. By comparison, in a mature CCR environment, this will increase updates to two to three times per month – a potential 15 to 20 fold increase.

When we combine this with the Privacy Act's very high standards regarding data accuracy, consumers' rights of access and correction, and the fact that 80 per cent of today's lending decisions rely on some form of automated process, we are looking at a very substantive change indeed for lenders and credit bureaus.

Quite simply the scale of the transition means it will take time.

## The nature of a transition to CCR

As CCR is not mandatory, lenders need to make a decision about if and when they will join CCR by providing and receiving data.

As part of making this choice, lenders need to be aware that the principles of reciprocity will apply – lenders can only use and access data at the level at which they supply data; that is, negative only, partial, or comprehensive. Further, they must provide data on all their portfolios in order to see all other comprehensive data – there is however a permitted transition time for providing all data once a lender commences supplying.

Beyond this, lenders then face a set of decisions that are aligned to any major business transformation – benefits, costs to achieve, technology constraints, risks of acting/not acting and the compliance obligations regarding lending processes i.e. National Consumer Credit Protection Act (NCCP).

We are presently in a period of transition to CCR, where in the absence of participation, theories abound about who will participate, when, and which portfolios first. What is clear is that different organisations will transition at different times.

This fact is confirmed by what we have observed internationally:

- There will always be a subset of large players who are later contributors of their data
- In the end every major lender transitions to CCR
- Those players who move early and make CCR part of an overall growth strategy (rather than just a project) achieve the best outcomes.

## Modelling the transition to CCR

To achieve an optimal outcome in the CCR transition 'game', participants must also consider the relationships between the players who contribute data.

Modelling prepared for Veda demonstrates a scenario that reflects the market share and dynamics of the Australian retail credit market. It looks at how Australia's tier one lenders, which hold around 70 per cent of lending accounts, will move to CCR, and the likely response of other market players.

The core basis of the modelling is that better information for credit decisions means greater accuracy. In its purest form it allows lenders to adjust targeted accept and bad rates as a means to increase profit while also enabling improved rates of automation.

Lenders with more room to move on these and related variables (sub and near prime and monoline businesses) have more to gain by attracting better quality applicants, possibly at the expense of tier one lenders who have decided not to participate.

Significant advantages arise from being a pro–active adopter. The modelling (see graph) indicates that incorporating CCR into strategy could see up to a $2 million per month increase in profitability through better customer selection and profitable market share growth. This benefit will vary by credit provider and by portfolio. Higher risk unsecured credit will derive most benefit from CCR.

The potential losses for those who do not participate come from lending to higher risk customers and decreased market share due to adverse customer selection. The analysis indicates that a bottom line impact on a tier one lender's profitability could be as much as $8 million per month while their participation is delayed. The scenario deteriorates quickly for late comers once industry data sharing reaches critical mass. The later that data is contributed and the fewer the non–contributors that remain outside the shared data pool, the greater the impact.

The key points that have emerged from the modelling are:

- Major banks may have less incentive to supply CCR data if only small lenders are sharing data. However, when tier 2 lenders contribute and critical mass is achieved, there will potentially be a significant negative impact on tier 1 lenders (especially for unsecured products).
- There is likely to be a delay to major banks' participation until late 2015 – other constraints such as technology may also force this scenario.
- The value of the data to the small lender outweighs the benefit to the major bank.
- There is uplift for all players but it is more pronounced for early adopters or for those with higher risk portfolios.

The optimal time to transition varies according to the type of lender and their business strategy. However delaying possibly exposes them to profit deterioration.

## New Zealand Transition Update

CCR has been permissible in New Zealand since 1 April 2012. Veda is New Zealand's market leading credit bureau, facilitating the industry transition, and the first to achieve critical mass of CCR data (March 2014). Today in New Zealand, Veda reports on more than 3.8 million customer accounts, 55 million repayment history records and $104 billion in total credit limits.

Interestingly, when compared to the modelling, this first wave of CCR participation was driven from major banks along with retail finance players. The players demonstrated an understanding of the benefits and supplied data for all portfolios from the start. These early adopters foresaw a range of opportunities to move ahead of the market.

Key benefits were:

- Move first and gain market advantage
- Differentiate offerings and business processes
- Drive efficiencies in early collection activities
- Gathering data for future analytical and scorecard purposes

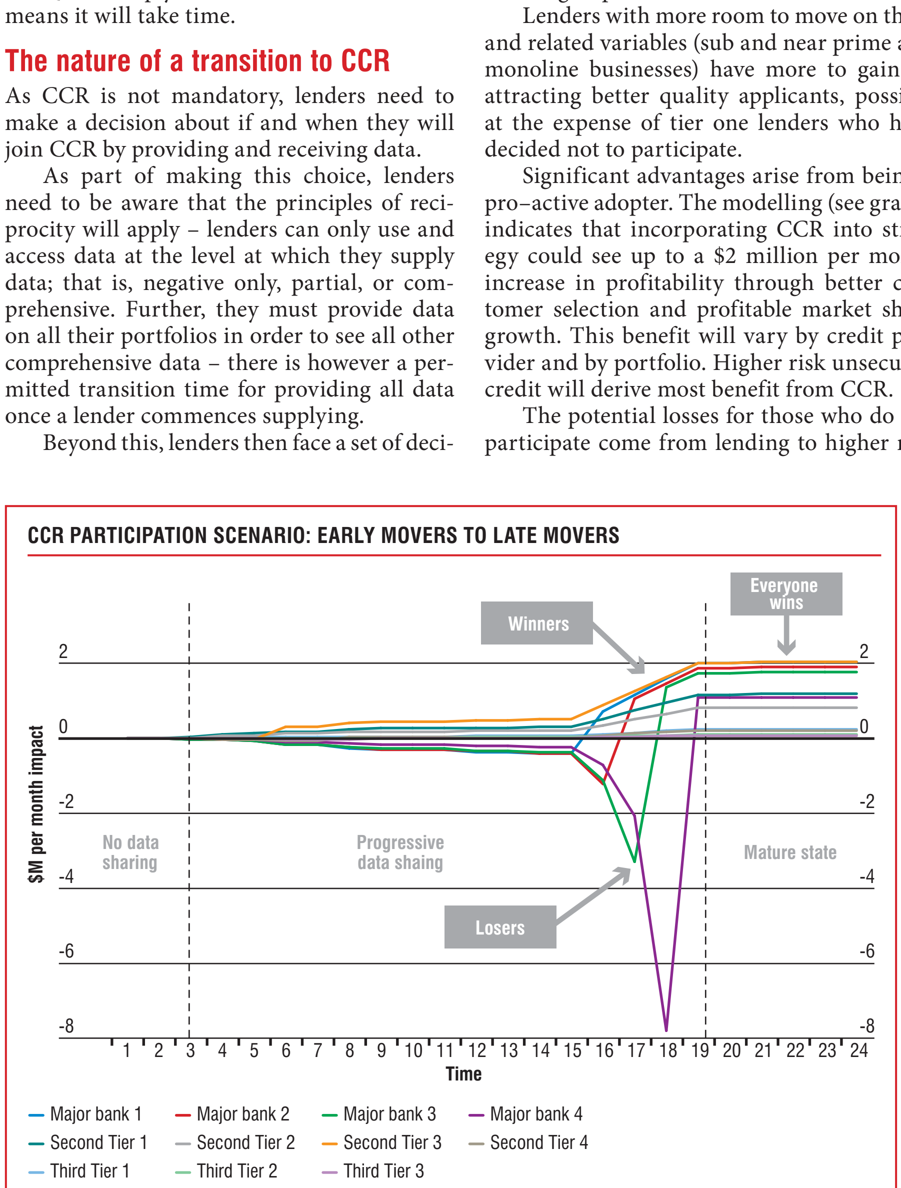
## Where to now in Australia?

The industry has a significant transition ahead and organisations who act on CCR as part of their strategy will benefit the most from the change.

The richness of the present negative data and the sheer weight of new comprehensive data means CCR will be adding value to credit decisions with much less than 50 per cent industry participation. At that point, the game will be on.

*Angus Luffman, Veda's General Manager, Consumer Risk was joined by Stephen Johnson, Consultant, at Veda Advisory Services.*

CCR PARTICIPATION SCENARIO: EARLY MOVERS TO LATE MOVERS




Source: FIMA 2014

International experience has shown businesses that hold back participation in CCR are,over time, at risk of attracting lower quality credit applicants and increased risk exposure.

Angus Luffman, General Manager, Consumer Risk, Veda