
Incentives for Sharing Positive Data in Bilateral and Multilateral Settings

Economic opinions on specific questions asked by
Gilbert + Tobin in the context of ARCA's application for
authorisation of the PRDE

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EXECUTIVE SUMMARY

1. The Australian Retail Credit Association Limited (ARCA) is seeking authorisation on behalf of itself and current and future signatories in relation to certain provisions of the Principles of Reciprocity and Data Exchange (PRDE), which is a multilateral framework for the exchange of credit-related personal information between signatory credit providers (CPs) and signatory credit reporting bodies (CRBs).
2. The exchange of credit-related personal information involves the contribution by CPs of information concerning the behaviour and credit histories of their customers to CRBs, the aggregation and consolidation of that information by CRBs in central databases, and the supply by CRBs to CPs of credit reporting information and other services that assist CPs in their assessments of the credit risks of potential customers.
3. Until March 2014, only information relating to payment defaults, credit inquiries, court judgments and bankruptcies (collectively referred to in the industry as “negative” information) could be collected and exchanged. From March 2014, amendments to the *Privacy Act 1988* allow the collection and exchange of “positive” information. The exchange of positive as well as negative information is referred to as comprehensive credit reporting (CCR).
4. Gilbert + Tobin, on behalf of ARCA, has asked that Charles River Associates (CRA) prepare this independent expert economic report containing opinions on two specific questions, which can be summarised as follows:
 - a. First, given the likely incentives and disincentives that CPs face in Australia when deciding whether to contribute positive data to CRBs, will it be possible to establish an effective system of CCR primarily on the basis of *bilateral agreements* between CRBs and CPs?
 - b. Second, given the market structure in Australia, are there sufficient economic and commercial incentives for CPs and CRBs to establish an effective *multilateral framework* for CCR without reciprocity, consistency obligations and some form of enforcement mechanism?
5. Regarding the **first question**, in our opinion it will not be possible to establish an effective system of CCR in Australia primarily on the basis of *bilateral agreements* between CRBs and CPs. The reasons for our opinion can be summarised as follows.
 - a. **Reciprocity issues.** The principle of reciprocity is a fundamental requirement for CPs to be willing to share positive data. However, CPs have incentives to “under-contribute”, i.e. fail to observe reciprocity by supplying CRBs with less information than they receive. Meanwhile, CRBs have conflicting incentives, including incentives to negotiate agreements with CPs that do not require full reciprocation or fail to enforce reciprocity in relation to particular CPs, as each CP agreement represents additional revenue to the CRB. Large CPs, in particular, may be able to insist on receiving more information than they provide into the system. Aware of the unilateral incentives of each CP to under-contribute and the conflicting incentives of CRBs, CPs will be reluctant to share positive data with CRBs under bilateral arrangements unless CRBs can guarantee that the principle of reciprocity will be observed and enforced. However, in a setting of purely bilateral arrangements it is unlikely that

CRBs in Australia will establish mechanisms that will provide CPs with confidence that reciprocity will be observed and enforced.

- b. **Potential for an uncompetitive market structure to develop.** A setting of bilateral arrangements has the potential to result in a situation in which one CRB obtains a dominant position with respect to CCR. The dominance may arise naturally and may be exacerbated by the use of exclusive agreements. This would not be an effective system of CCR, as a dominant CRB would be able to charge higher prices for credit reporting information and provide lower quality services (including lower quality value added services such as scorecards and other analytics) than if the market was competitive with multiple CRBs having more equal sized pools of data.
 - c. **Potential for fragmentation.** Alternatively if a dominant CRB does not emerge, then it is likely that the industry will suffer from fragmentation where some CPs contribute positive information to one CRB and others contribute positive information to other CRBs. In this event, CPs would need to purchase credit reporting information from all major CRBs in order to obtain a comprehensive picture for each consumer, with additional costs of doing so. If small CPs cannot afford the additional costs of purchasing information from multiple CRBs and integrating that information into their internal systems, their ability to lend responsibly and also their ability to compete with larger CPs will be compromised. If responsible lending expectations mean that small CPs must purchase and integrate information from multiple CRBs, small CPs will face higher costs, and the viability of some small CPs may be compromised. Consumers may also be harmed by the need to obtain credit reports from all CRBs in order to understand their full credit file picture and by the potential for inconsistency in terms of credit risk assessments by CPs.
6. Regarding the **second question**, in our opinion an effective multilateral framework for CCR is unlikely to be established without obliging parties to engage in reciprocal exchanges of information and some form of credible enforcement mechanism. It would be possible to establish a multilateral framework for CCR without the consistency obligations in the PRDE; *however* it is unlikely that this would be a fully effective system as such a framework would be likely to result in either the development of a dominant CRB or the fragmentation of the industry (i.e. several CRBs with different pools of information). By promoting greater consistency across the databases held by CRBs, the consistency obligations counter these tendencies.
7. The submission of Veda and the accompanying report of HoustonKemp appear mainly concerned with the consistency obligations in the PRDE. Veda and HoustonKemp argue that the consistency obligations will have adverse effects on small CPs and small CRBs and will lead to greater fragmentation of credit reporting. These concerns all rely on an assumption that there are significant incremental costs for small CPs of contributing positive data to additional CRBs beyond the first CRB to which the CP contributes. In our opinion, these incremental costs are not likely to be significant for most small CPs, and if they affect the behaviour of any small CPs, it is only likely to be a small proportion of them. On the contrary, small CPs are likely to benefit from the consistency obligations in a number of ways. Equally, as the incremental costs of contributing to additional CRBs are not likely to be significant for most small CPs (and as, at most, only a small proportion of small CPs would be likely to be affected) there should be no concerns for small CRBs or for greater fragmentation. On the contrary, small CRBs are likely to benefit and fragmentation is likely to be reduced if the consistency obligations are retained in the PRDE.

8. The focus of Veda and HoustonKemp on the effects of the consistency obligations on small CPs and small CRBs is puzzling, given that these concerns appear altruistic from Veda's perspective. Indeed, according to its own arguments Veda would be likely to *benefit* from the consistency obligations. At the same time, the submissions received by the ACCC in response to ARCA's application for authorisation suggest that on the whole small CPs themselves tend to be unconcerned by the consistency obligations, and small CRBs are either strongly in favour of the consistency obligations (Experian) or indifferent (TASCOL).
9. In our opinion, when balancing the incremental costs to CPs of contributing positive information to additional CRBs (which are unlikely to be significant except possibly for a small proportion of small CPs) against the risks of an uncompetitive market structure or fragmentation, the public benefit lies with the consistency obligations.

1. INTRODUCTION

10. The Australian Retail Credit Association Limited (ARCA) is seeking authorisation on behalf of itself and current and future signatories in relation to certain provisions of the Principles of Reciprocity and Data Exchange (PRDE), which is a multilateral framework for the exchange of credit-related personal information between signatory credit providers (CPs) and signatory credit reporting bodies (CRBs).
11. The exchange of credit-related personal information involves the contribution by CPs of information concerning the behaviour and credit histories of their customers to CRBs, the aggregation and consolidation of that information by CRBs in central databases, and the supply by CRBs to CPs of credit reporting information and other services that assist CPs in their assessments of the credit risks of potential customers.¹
12. Until March 2014, only information relating to payment defaults, credit inquiries, court judgments and bankruptcies (collectively referred to in the industry as “negative” information) could be collected and exchanged. From March 2014, amendments to the *Privacy Act 1988* allow the collection and exchange of “positive” information. Positive information includes information on consumer credit liabilities (CCLI)² and repayment histories (RHI).³ The exchange of positive as well as negative information is referred to as comprehensive credit reporting (CCR). In this report (consistent with the terminology used in the PRDE), “comprehensive” information refers to all negative and positive credit information about an individual and “partial” information refers to all credit information about an individual other than RHI.⁴
13. The two-fold purpose of the PRDE is to “create a standardised system of reciprocal exchange for partial and comprehensive information between PRDE signatories” and “improve the existing contribution of negative information by PRDE signatories”.⁵ ARCA considers that the obligations contained within the PRDE for which it seeks authorisation – specifically, obligations concerning reciprocity, consistency and enforceability – are

¹ Credit reports may also be provided by CRBs to consumers that wish to understand the credit reporting information held by the CRBs that relates to themselves. Note that the PRDE principally governs the *contribution* of data by signatory CPs to signatory CRBs. It does not mandate that a CP *obtain* information from any or all CRBs and it is not necessary to sign the PRDE to participate in an exchange of credit-related personal information with a CRB (although unless it is a signatory a CP will not be able to access signatory credit reporting information).

² CCLI includes the date a consumer's credit account was opened and closed, the CP name, the type of credit, the maximum amount of credit and terms and conditions that relate to repayment of the amount of credit.

³ RHI is information on whether or not a consumer has met an obligation to make a periodic (e.g. monthly) payment. The contribution of RHI and access to RHI information is restricted to Australian Credit Licence (ACL) holders, which excludes telecommunications suppliers and other utility suppliers.

⁴ See ARCA, *Principles of Reciprocity and Data Exchange (PRDE)*, Final Draft – Version 16, page 3. Since telecommunications suppliers and other utility suppliers are not permitted to contribute or access RHI information, these types of CPs can only participate at the “partial” information level.

⁵ ARCA, *Principles of Reciprocity and Data Exchange (PRDE): Submission in support of Application for authorisation*, 20 February 2015, pages 13-14.

“necessary to build confidence in the integrity of the system, to ensure the system operates effectively and to ultimately provide appropriate incentives for participation”.⁶

14. ARCA also considers that in the absence of the PRDE “the benefits of comprehensive credit reporting are unlikely to be realised in the foreseeable future” because “[t]he lack of reciprocity obligations, consistency obligations and enforceability of such obligations mean that there is insufficient incentive and confidence in industry participants to engage in comprehensive credit reporting.”⁷ In particular, according to ARCA the current system of bilateral arrangements is “unlikely to lead to significant exchange of comprehensive credit information, as they cannot assure CPs that their contribution of comprehensive credit information will not disproportionately benefit their ‘free-riding’ competitors” and “[e]ven if bilateral arrangements were to assert that data would be dealt with according to principles of reciprocity, they would lack the transparency and enforceability of an industry framework such as the PRDE”.⁸

1.1. Our instructions

15. Gilbert + Tobin, on behalf of ARCA, has asked that Charles River Associates (CRA) prepare this independent expert economic report containing opinions on two specific questions, which can be summarised as follows:
 - a. First, given the likely incentives and disincentives that CPs face in Australia when deciding whether to contribute positive data to CRBs, will it be possible to establish an effective system of CCR primarily on the basis of *bilateral agreements* between CRBs and CPs?
 - b. Second, given the market structure in Australia, are there sufficient economic and commercial incentives for CPs and CRBs to establish an effective *multilateral framework* for CCR without reciprocity, consistency obligations and some form of enforcement mechanism?

1.2. Our experience and qualifications

16. Dr Marsha J. Courchane is the Practice Leader of CRA’s Financial Economics Practice and is based in Washington DC. Dr Courchane consults regularly with CPs and CRBs in the United States. She has filed expert reports pertaining to questions on credit scoring in several litigation matters. Dr Courchane has a B.A., M.A. and PhD in Economics from Northwestern University.
17. Dr Geoff Edwards is a Vice President in CRA’s European and Asia Pacific Competition Practices and is based in Sydney. Dr Edwards is a specialist in competition and regulatory economics with more than ten years of economic consulting experience in industries including banking, financial data, financial clearing, software, pharmaceuticals, telecommunications, broadcasting, transport, food production and manufacturing. Dr Edwards has a Masters in Economics and a PhD from the University of California, Berkeley, as well as first class honours degrees in economics and law from the Australian National University.

6 Above note 5, page 5.

7 Above note 5, page 31.

8 Above note 5, page 31.

1.3. Report structure

18. The remainder of this report is structured as follows:
 - a. In Section 2, we discuss the PRDE and its key provisions, including the rationale for these provisions.
 - b. In Sections 3 and 4 we provide our opinions on the two questions that we have been asked, together with our reasons. These sections also include some observations on the arguments of Veda and HoustonKemp in relation to these questions.

2. THE PRDE AND ITS KEY PROVISIONS

19. A presumption underlying the PRDE is that the development of CCR in Australia would be desirable for a number of reasons. These reasons are described in some detail in ARCA's submission in support of the application for authorisation⁹ and in the KPMG report that accompanied the application.¹⁰
20. The rationale for the PRDE is stated on pages 4 and 5 of ARCA's submission in support of its application for authorisation. According to ARCA:

the intention of the PRDE is to create an open, transparent and standardised system for the management, treatment, exchange and acceptance of CCLI and RHI among signatories. To achieve these outcomes, the PRDE relies on provisions that create obligations of reciprocity, consistency and enforceability, as described in more detail below. These obligations, set out in the context of the multi-lateral framework provided for by the PRDE, are necessary to build confidence in the integrity of the system, to ensure the system operates effectively and to ultimately provide appropriate incentives for participation. The PRDE also aims to improve the existing exchange of negative information amongst CPs and CRBs.¹¹

21. In essence, the rationale for the PRDE is to facilitate CCR in a multilateral framework. As indicated in the above quote, ARCA considers the obligations of reciprocity, consistency and enforceability to be necessary in order to build confidence in the system, ensuring the system's effectiveness and encouraging CPs and CRBs to participate.
22. The context for the PRDE is a situation in which ARCA considers that it is unlikely that effective CCR will occur unless there is a multilateral framework like the PRDE because "[t]he lack of reciprocity obligations, consistency obligations and enforceability of such obligations mean that there is insufficient incentive and confidence in industry participants to engage in comprehensive credit reporting."¹² In particular, ARCA considers that the current system of bilateral arrangements is:

unlikely to lead to significant exchange of comprehensive credit information, as they cannot assure CPs that their contribution of comprehensive credit information will not disproportionately benefit their 'free-riding' competitors. Even if bilateral

⁹ Above note 5, Sections 5.2 – 5.5.

¹⁰ See KPMG (2015), *Report to the Australian Retail Credit Association: The benefits of enhanced credit data exchange*, January 2015, pages 16-23.

¹¹ Above note 5, page 5.

¹² Above note 5, page 31.

arrangements were to assert that data would be dealt with according to principles of reciprocity, they would lack the transparency and enforceability of an industry framework such as the PRDE.¹³

23. In the following sub-sections we consider the nature of and rationale for the key provisions of the PRDE, namely: reciprocity; enforcement; transparency; standardisation; and the consistency obligations.

2.1. Reciprocity

24. The concept of reciprocity is the idea that each CP should only draw out of a CRB's pool of credit reporting information the same types of information that the CP has contributed. Reciprocity obligations are widely considered to be essential for the effective implementation of CCR where there are private CRBs. This is because, in the absence of reciprocity, a CP that contributes its own valuable information on the credit risk of its customers has no guarantee that others will also contribute, and if the CP is rational it will prefer not to share its information with others on that basis as doing so may give competitors access to valuable information on the CP's best customers with nothing in return.
25. To elaborate, the sharing of credit information between CPs (particularly positive credit information) may give rise to what is referred to as a Prisoners' Dilemma.¹⁴ The figure below is a simple heuristic illustration of the situation that may exist in the context of sharing of credit information between two equally sized CPs. The "payoffs" in the figure can be thought of as the profits for each CP – higher payoffs, therefore, are preferred to lower payoffs.

Table 1: Simple Heuristic Illustration of Prisoners' Dilemma Payoffs

CP 1 \ CP 2	Don't Share	Share
Don't Share	(1 / 1)	(3 / 0)
Share	(0 / 3)	(2 / 2)

¹³ Above note 5, page 31.

¹⁴ The Prisoners' Dilemma is a well-known game-theoretic paradox. In the Prisoners' Dilemma, two prisoners are awaiting trial for crimes that they are alleged to have committed together. Prosecutors offer each of them a deal that involves a longer prison sentence for both if they both betray each other than if they both stay silent, and freedom for one and an even longer sentence for the other if the first betrays the second and the second stays silent. The following figure illustrates the payoffs (in prison terms) in a Prisoners' Dilemma, with lower payoffs being preferred to higher payoffs.

Prisoner 1 \ Prisoner 2	Betray	Silent
Betray	(2 years / 2 years)	(0 years / 3 years)
Silent	(3 years / 0 years)	(1 year / 1 year)

It can be seen from the figure that there is a "dominant strategy" for each prisoner to betray the other, meaning that for each prisoner it is better to betray regardless of what action the other prisoner takes. For example, if Prisoner 2 will betray, then Prisoner 1 will do better by also betraying (2 year jail term) than by staying silent (3 year jail term). Similarly, if Prisoner 2 will stay silent, then Prisoner 1 will do better by betraying (freedom) than by also staying silent (1 year jail term).

This leads to an equilibrium (shaded in grey) in which both prisoners betray each other, whereas both would be better off if they were somehow able to coordinate to both stay silent. In other words, the dominant strategies lead to an equilibrium that is sub-optimal for both prisoners. They are unable to reach the mutually beneficial outcome (both remaining silent) because they are unable to coordinate to overcome their dominant strategies.

26. If both CPs share (bottom right corner), they may both benefit from being able to assess credit risks of customers better than if they were to rely on their own information alone (top left corner).¹⁵ However, if one CP shares and the other doesn't (e.g. the bottom left corner), the first CP does worse than if it didn't share and the second CP does better than if both shared, since the second CP will have better information on the credit risks of customers than the first and therefore a competitive advantage. In this game, both CPs would be better off if sharing occurs than if no sharing occurs, but they both have a "dominant strategy" not to share, meaning that each CP is better off not sharing regardless of what action the other CP takes (i.e. whether the other CP shares or does not share). Absent some mechanism to overcome this, the equilibrium will be sub-optimal for all. The mechanism required to overcome this is the principle of reciprocity *together with* transparency and a trusted enforcement mechanism.
27. The payoffs in the game will depend on the number and the sizes of the CPs. Small CPs may be willing to share data without reciprocity guarantees as long as the CRB can offer them *some* additional data that will improve their decision making, as they may have little to lose in terms of competitive advantage by sharing the limited data that they control. Large CPs, however, may lack incentives to share credit information, even if reciprocity can be guaranteed. For example, particularly for positive information, the costs of sharing proprietary information on a large customer base (which can be expected to lead to increased competition for the CP's best customers) may outweigh the gains from obtaining better information on other customers and more complete information on its own customers.¹⁶ In other words, the payoff for a large CP in the top left corner of the figure may be greater than the payoff it can expect in the bottom right corner. Therefore, there is a possibility that sharing of positive information by large CPs may not occur, regardless of the system that is put in place for the sharing of this information (unless, of course, it is a system based on mandatory sharing). In the remainder of this report, we proceed on the assumption that the largest banks in Australia will have incentives to share their positive

¹⁵ Note that sharing will tend to increase competition between CPs and this competition will tend to dissipate rents. Therefore, for a Prisoners' Dilemma to arise (i.e. for the payoffs from both sharing to exceed the payoffs from both not sharing) sharing must in some way increase the total potential rents to be earned by the parties. This might be the case where sharing allows loans to be made that would not otherwise be made or where sharing allows CPs to improve the quality of their credit portfolios by better assessing and managing credit risk.

¹⁶ A CP has complete information on the accounts its own customers have with it, but the overall default probabilities of its customers depend on the performance of its customers with respect to all of their debts, not only those with the CP.

information if reciprocity can be guaranteed.¹⁷ This assumption is necessary so that we can sensibly consider the questions that we have been asked. Nothing should turn on this assumption, however. If large CPs would not have incentives to share their positive information even with guaranteed reciprocity, then neither bilateral arrangements nor a multilateral arrangement would deliver an effective system of CCR.

28. It is well accepted throughout the credit reporting industry in Australia that the principle of reciprocity is fundamental for the sharing of positive credit information to occur. This is not in dispute between ARCA and Veda, nor between ourselves and HoustonKemp. According to Veda, it is “supportive of CCR and of the need for an industry framework embodying principles of reciprocity to operate in conjunction with the legislative mechanisms that give effect to CCR”,¹⁸ “system changes, reciprocity and transparency in compliance are all preconditions to the effective implementation of CCR”¹⁹ and “[r]eciprocity is a fundamental underlying principle which is understood by all industry participants”.²⁰ Veda’s position on reciprocity is perhaps best summarised by the following statement: “Reciprocity is essential for CCR, but the obligations in the PRDE go beyond what is required.”²¹
29. Before we move on, it is important to note that reciprocity is likely to be more important for positive information than for negative information. First, positive information is intrinsically more valuable to CPs than negative information. Negative information only allows a CP to identify a consumer that has had a prior default or other negative event. Positive information can substantially improve lending decisions in a number of respects. Positive data enables lenders to predict defaults better by examining the extent of the consumer’s indebtedness and payment behaviour and also identifying any marginal delinquencies that are not recorded as defaults. Positive data also enables lenders to identify consumers that have previously defaulted as lower risk if they have a good record of positive information

¹⁷ We consider that it is likely that the largest CPs in Australia will have incentives to share their positive information if reciprocity is guaranteed. We understand from discussions with ARCA and industry players that all of the four largest CPs have been closely involved in the development of the PRDE and commenced internal projects to prepare for CCR in anticipation of the PRDE. Once a certain number of smaller CPs begin to share positive data, larger CPs are likely to find that it is worthwhile also to participate. Although the largest CPs may take the longest to join the system, we anticipate that in time they will. It is also worth observing that the largest CPs will be aware that if CCR does not develop voluntarily (whether via bilateral agreements or a multilateral arrangement) then it may be mandatorily imposed on them with terms over which they have less control. Recommendation 20 of the *Final Report of the Financial System Inquiry* contemplates legislation to mandate participation in CCR if voluntary participation is not adequate. Adverse selection and financial regulation may also play roles here. If a CP does not participate in CCR when others do, the first CP will end up with a deteriorating credit portfolio as they will be less discerning in their risk assessments for new customers and their management of existing customers and they may also become recognised by consumers as a lender of last resort (again, as they will be less discerning regarding consumer credit risks). There is also a likelihood that, once CCR is established, it will be viewed as inadequate from a responsible lending perspective for CPs to operate without reference to CCR databases. In this regard, see the ASIC submission, page 2, which notes that what constitutes “reasonable steps” to verify a consumer’s financial situation may change once CCR becomes available. Responsible lending obligations in the United States typically require that lenders make credit decisions with regard to the borrower’s income, financial obligations and ability to repay, and CCR significantly enhances the ability to make such assessments.

¹⁸ Veda, *Submission to ACCC on PRDE*, undated, page 1, paragraph 3.

¹⁹ Above note 18, page 6, paragraph 26.

²⁰ Above note 18, page 7, paragraph 31.

²¹ Above note 18, page 6, paragraph 27.

on other loans or in the time since the default. Another important difference is that while there is negative data only for some consumers, there is positive data for every consumer that has a credit account with an Australian Credit Licence (ACL) holder, which is the vast majority of the Australian adult population. This allows more accurate pricing of credit to the vast majority of consumers and may enable loans to be written that would otherwise be rejected due to lack of information. Since positive information is more valuable than negative information, CPs are likely to be more reluctant to share this information in the absence of reciprocity.

30. Second, CPs may have incentives to have negative information in relation to their customers distributed widely across multiple CRBs even without reciprocity. These incentives do not apply to positive information. For example, the sharing of negative information can be used as a borrower disciplining device. If borrowers are aware that defaults on payments will be broadcast throughout the industry and impact on the borrower's ability to obtain further loans from other CPs, borrowers will have greater incentives to repay loans.²² Also, if the negative information causes the CP to want to offer higher interest rates to the borrower, the CP will want other CPs to be aware of the negative information, or else other CPs will (mistakenly) offer more attractive interest rates to the borrower, taking business away from the first CP. These two reasons may well outweigh the incentive to keep negative information proprietary for competitive advantage.

2.2. Enforcement

31. The principle of reciprocity, on its own, is not enough for CPs to share positive data with each other. The principle of reciprocity, on its own, means only that CPs should undertake to supply their own information in order to receive the same types of information from other CPs. As the payoff matrix in the Prisoners' Dilemma illustrates, each CP will have an incentive to deviate from an undertaking to share data, as it will get a higher payoff from withholding its own data from the pool if other CPs are contributing. This incentive remains even once CPs have agreed "in-principle" to reciprocity – e.g. even if CPs have signed up to the PRDE with its reciprocity provisions or even if CPs have reached "in-principle" agreements for reciprocity in bilateral arrangements with CRBs.
32. At the same time, CRBs have conflicting incentives. On the one hand, they have incentives to persuade CPs that they will observe reciprocity and ensure that other CPs observe reciprocity, as CPs will otherwise be reluctant to share their information with the CRB. On the other hand, CRBs have incentives to reach agreements with CPs that do not require full reciprocation or fail to enforce reciprocity in relation to particular CPs, as each CP agreement represents additional revenue to the CRB. The larger the CP, the greater its importance to the CRB, and the more likely that it will be able to under-contribute without fear of sanction by the CRB.
33. Critical to overcoming the Prisoners' Dilemma, therefore, is not only reciprocity, but also an enforcement mechanism that gives confidence to CPs that any attempts to deviate from reciprocity will be identified and rectified, and any persistent deviations will be punished. Without an enforcement mechanism that has the confidence of CPs, the principle of reciprocity lacks substance and sharing of CCR information is unlikely to occur. This is the

²² See Jorge Padilla and Marco Pagano (2000), "Sharing default information as a borrower discipline device," *European Economic Review*, 44(10), pages 1951-1980.

rationale, therefore, for the enforcement mechanism in the PRDE.²³ This is particularly important in Australia where a number of CPs are large, with shares of around 15%-25% or more of lending by value, as shown in Table 2 below.²⁴ Large CPs are likely to have bargaining power with CRBs and an ability to negotiate deviations from a CRB's reciprocity principle.

Table 2: "Big Four" Shares of Household Loans and Advances (March 2015)

Household Loans and Advances					
	Housing: Owner-occupied	Housing: Investment	Credit cards	Other	Total
ANZ	17%	13%	20%	30%	16%
CBA	27%	27%	28%	18%	26%
NAB	19%	14%	14%	19%	17%
Westpac	21%	32%	23%	16%	24%
Big Four Total	84%	85%	84%	84%	84%

Source: CRA calculations based on data from Australian Prudential Regulation Authority, *Monthly Banking Statistics*, March 2015, Table 2

34. It is useful to note, at this point, that *effective enforcement mechanisms* accompanying the principle of reciprocity are commonplace around the world where private CRBs exist.²⁵ For example, in one of the seminal academic papers on credit information sharing, Pagano and Jappelli (1993) surveyed 14 OECD countries and reported that:

*[i]n all countries where lenders (banks, finance companies, or retailers) share information, the operation of credit bureaus has common features, **the main ones being the principle of reciprocity and the related sanctions**. A lender is entitled to access only the type of information that he is willing to contribute to the bureau. [...] In all cases, failure to comply with the rules (for instance, by providing*

²³ It might be useful here to return to the example of the prisoners presented in footnote 14. Suppose that after the prosecutors presented them with the payoffs for the different outcomes of the game, the prisoners met and agreed that they would both stay silent. This "in-principle" agreement would be worthless, without anything more, as both would still find that their dominant strategy would be to betray the other. If, however, there was some serious consequence attached to betrayal (e.g. if a prisoner that betrayed the other in order to walk free could expect to be executed by other gang members) then the cooperative "stay silent" outcome could become the equilibrium. In the same way, when it comes to the exchange of credit information, a credible enforcement mechanism is just as important as the principle of reciprocity itself.

²⁴ These shares may overstate the shares of demand for credit reporting information that the largest four banks represent. For example, the APRA statistics do not include lenders that are not authorised deposit-taking institutions (ADIs), such as finance companies and telecommunications and other utility suppliers. Also, these shares are based on value rather than the volume of loans: larger CPs are likely, on average, to have loans of higher value than smaller CPs. Volume shares are likely to approximate better demand for credit reporting information. Nonetheless, we consider it likely that the largest four banks have shares of lending by volume that are, individually, substantial, and that each of these large banks represent significant revenue streams for Australian CRBs. We note that industry participants have estimated for us that around 75% of consumer credit-related personal information is generated by the largest four banks. This figure is likely to correspond to their combined demand for credit reporting information from CRBs.

²⁵ Public CRBs tend to be characterised by mandatory requirements on CPs to contribute credit-related personal information, which has the effect of imposing reciprocity.

late or inaccurate information) is sanctioned by the denial of further access.²⁶ [Emphasis added.]

35. In a later paper, published in 2002, the same authors illustrate the inextricable link between the principle of reciprocity and enforcement mechanisms.

*Credit bureaus are exposed to a conflict of interest, especially when they are owned by the lenders themselves: each lender would like to exploit the information provided by other lenders without disclosing his own. **This explains why sanctions are invariably threatened to any credit granter who fails to supply data or provides inaccurate information. Sanctions range from fines to loss of membership and hence denial of access to the bureau's files.** In other words, credit bureaus are based on the principle of reciprocity, which is generally stated in the contractual agreement between the bureau and credit grantors.²⁷ [Emphasis added.]*

36. More recently, in 2012, an OECD Discussion Paper reported that:

*it is often not possible to have an independent credit bureau in countries that do not already have a rich history of credit information sharing – lenders may be reluctant to share their information with a third party due to lack of trust. In these instances, and when information sharing should arise on its own, a consortium between lenders tends to develop where they share ownership of the credit bureau. In a few instances the bureau has been created and managed by a business association, such as a chamber of commerce, and participating lenders pay annual fees to access the data [...]. Reciprocity is the key component in both the credit bureau managed directly by the lenders and the credit bureau managed by a business and industry association – those who wish to participate in the scheme must also contribute their own information on creditors. **There are often sanctions for not supplying data or for supplying data with significant errors – non-compliant lenders can face fines or even expulsion from the bureau.**²⁸ [Emphasis added.]*

37. And:

*The basic principles within codes of conduct generally cover reciprocity, data format, frequency and quality. Typically, signatory members are subject to the rule of reciprocity, meaning that if they wish to obtain information from the bureau's database, they must also contribute their own credit data. Furthermore, the codes of conduct generally stipulate a common data format, a minimum reporting frequency and minimum data quality requirements (IFC 2006). **Violations of these principles tend to result in penalties which are also outlined in the code of conduct. In extreme cases, members may be subject to expulsion from the bureau.**²⁹ [Emphasis added.]*

38. In a number of countries there are mandatory regulatory or legislative requirements for CPs to contribute credit-related personal information to CRBs, which has the effect of ensuring

26 Marco Pagano and Tullio Jappelli (1993), "Information Sharing in Credit Markets," *The Journal of Finance*, Volume XLVIII (5), December 1993, pages 1,693-1,718 at 1,705.

27 Tullio Jappelli and Marco Pagano (2002), "Information sharing, lending and defaults: Cross-country evidence," *Journal of Banking and Finance*, 26 (2002), pages 2017-2045 at 2021.

28 OECD, *Discussion Paper on Credit Information Sharing*, 2012, page 8.

29 Above note 28, page 14.

reciprocity. In other countries, where contributions are voluntary, the industry has found ways to enforce the principle of reciprocity in order to give CPs the confidence they require to participate.

39. To give a specific example, South Africa has a system for the exchange of consumer credit information that includes a service level agreement (SLA) entered into between the Credit Providers Association (CPA) and the Credit Bureaux Association (CBA).³⁰ The “cornerstone” of the CPA is reciprocity³¹ and the CPA is tasked, among other things, with monitoring and managing the quality of information contributed by its members to CRBs. The SLA includes provisions that allow for transparency and enforcement of reciprocity. Under the SLA, the CPA is to hold monthly meetings with CPA and CBA members to address compliance issues. CPA members have obligations that include to submit identical data to all CBA members. Obligations of CBA members include to report to the CPA on instances of non-submission by CPs, dates of submission, number of records received and the percentage of records rejected, and to suspend a CP’s access to data on receipt of written notification of suspension from the CPA.
40. In the United Kingdom, the Steering Committee on Reciprocity (SCOR) manages a set of guidelines called the Principles of Reciprocity (PoR),³² which were prepared following extensive industry consultations during the 1990s. The fundamental principle of the PoR is that “subscribers receive the same credit performance level data that they contribute, and should contribute all such data available”.³³ The PoR include both a compliance process³⁴ and a complaints process with enforcement as a last resort.³⁵
41. According to SCOR:
- The credit reference agencies include compliance with the Principles of Reciprocity in their client contracts and they have a responsibility to ensure that they only supply data in accordance with the Principles.*
- Members of the credit reference agencies should ensure that compliance with the Principles of Reciprocity forms a part of their own internal audit procedures. SCOR, through the credit reference agencies, will seek confirmation of compliance with the Principles of Reciprocity from each data sharer or user.*³⁶
42. The PoR itself states similarly:

30 South African Credit Providers Association (CPA), *Service Level Agreement between Credit Providers Association (CPA) and the Credit Bureau Association (CBA)*, V1.1, 16 October 2010.

31 See <http://www.cpa.org.za/>.

32 Steering Committee on Reciprocity (2014), *Information Sharing: Principles of Reciprocity*, Version 36 (final), September 2014.

33 This quote is taken from <http://www.scoronline.co.uk/principles/>, accessed on 19 May 2015 at 3pm.

34 Above note 32, Section 11.12, page 60.

35 Above note 32, Section 11.13, page 61.

36 This quote is taken from <http://www.scoronline.co.uk/principles/>, accessed on 19 May 2015 at 3pm

Contracts between CRAs and subscribers must reflect [the PoR and other relevant legislation] for compliance. In addition, it is expected that CRAs will only provide these data to other companies in accordance with the PoR.³⁷

43. The PoR include the possibility of the ultimate sanction for non-compliance: denial of access to data. Section 10.1.7 of the PoR addresses the question of what happens if members do not adhere to the PoR by stating:

The CRAs, as suppliers of the data, will work with the member to ensure that they do comply. If they refuse or there is a dispute the matter may result in an appeal to SCOR and/or access to the data ceasing.³⁸

44. In the United States, while agreements between CPs and CRBs are bilateral and there is no multilateral enforcement mechanism for reciprocity, reciprocity and consistency in the contribution of credit information has been a matter of regulatory oversight and commentary from time to time³⁹ and CPs are aware that widespread failures may lead to regulatory or legislative intervention. This regulatory oversight has contributed to maintaining a reasonably effective system of CCR. Nonetheless, and although it has one of the most lauded credit reporting systems in the world, the United States has experienced many instances of strategic incomplete data provision by CPs.⁴⁰ It is worth noting that the United States is less prone to having issues with reciprocity because it tends not to have CPs with the same bargaining power as the large CPs in Australia. However, it has experienced issues with lack of reciprocity nonetheless.

45. The observations of Staten and Cate are worth reproducing:

*One solution to the non-reporting problem would be for the bureaus to tackle the problem by adopting reciprocity codes. That is, they could dictate as part of their subscriber agreements that what a creditor doesn't report, it can't see on any purchased reports. Together with pricing incentives, this could encourage full-file reporting. However, competition among the three repositories for large creditors (especially large purchasers of prescreening services) renders this approach ineffective. For example, what repository will turn away business from Capital One (the large credit card issuer) if it fails to report account limits, when Capital One in recent years has purchased pre-screening services for as many as one billion credit card solicitations annually? **The bottom line is that reciprocity***

37 Above note 32, page 1.

38 Above note 32, section 10.1.7, page 35.

39 See, for example, Federal Financial Institutions Examination Council (FFIEC), *Consumer Credit Reporting Practices, Advisory Letter*, 18 January 2000. In this letter the main agencies that oversee the behaviour of financial institutions in the United States (the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA) and the Office of the Comptroller of the Currency (OCC)) identified a tendency for large credit card providers to not report credit lines and high credit balances and for sub-prime lenders to not report any loan information including RHI, and expressed an expectation that financial institutions "strive to resolve issues related to consumer credit reporting in a manner that supports both the safety and soundness of institutions' credit risk management and consumer access to credit".

40 See, for example, Robert B. Avery, Paul S. Calem and Glenn B. Canner (2004), "Credit Report Accuracy and Access to Credit," *Federal Reserve Bulletin*, Summer 2004, pages 297-322. The authors of this paper detail extensive issues of under-contributing as well as inaccurate and inconsistent contributing. See also Michael E. Staten and Fred H. Cate (2004), "Does the Fair Credit Reporting Act Promote Accurate Credit Reporting?" Joint Centre for Housing Studies, Harvard University, February 2004, pages 47-50.

agreements can and will be altered as the repositories compete for large customers. A solution might be to give the industry trade association the power to adopt reciprocity codes for the entire membership and withhold services from those that do not comply. This would likely require some special antitrust exemptions, but could reduce the non-reporting problem. It seems to be the most promising avenue for preventing further erosion in file quality due to strategic non-reporting.⁴¹ [Emphasis added.]

46. The enforcement mechanism in the PRDE is contained in Clauses 65-101. It consists of various escalating stages. If, within 30 calendar days of the respondent CP or CRB receiving a report of (alleged) non-compliant conduct, the dispute is resolved and any non-compliant conduct is rectified, then the dispute is closed and the matter will not go beyond the reporting and respondent parties (Stage 1 dispute). If a Rectification Plan is entered into within the first 30 calendar days, but the non-compliant conduct will not be resolved within that time frame, there will be referral to the PRDE Administrator Entity (Administrator), which is required to make the Rectification Plan available to all signatories, giving signatories an opportunity to object to the Rectification Plan (Stage 2 dispute). If there is no Rectification Plan entered into within the first 30 calendar days, and there is no agreement that the conduct is compliant (Stage 3 dispute), then the dispute will be referred to the Industry Determination Group (IDG). If either of the parties to the dispute reject the recommendation of the IDG, the dispute will be referred to an Eminent Person, whose decision is binding and final. The possible compliance outcomes include the issuing of a formal warning to the respondent, the issuing of a direction to the respondent with which it must comply, and, in the worst case, requiring the respondent to contribute and obtain supply of credit information at a lower tier for a period.
47. It is our understanding, based on conversations with ARCA, that this enforcement process has been developed in consultation with the industry, has the confidence of CPs (both ARCA and non-ARCA members) and is seen by CPs in general as a marked improvement over the ability to enforce reciprocity in the current setting of bilateral arrangements. In its standard agreement, Veda provides that it may withhold or suspend use of its services if Veda believes that the CP is not complying with its obligations under the agreement (which includes reciprocity in relation to CCLI and RHI), and requires the CP to agree to provide access to its systems and/or documentation so that Veda can check the CP's compliance with the agreement.⁴² However, there are no provisions or procedures that allow for a CP to challenge the compliance of other CPs or compel Veda to investigate and enforce reciprocity.
48. A key difficulty with a setting of purely bilateral agreements is that a complainant CP is not a party to the bilateral agreement between the CRB and the CP that is alleged to have failed to comply, and cannot enforce that agreement directly. Correspondingly, one of the

⁴¹ Michael E. Staten and Fred H. Cate, "Does the Fair Credit Reporting Act Promote Accurate Credit Reporting?" Joint Centre for Housing Studies, Harvard University, February 2004, pages 49-50. See also page 53, where the authors make the following recommendation:

Congress could also amend the antitrust laws to allow the credit reporting industry trade association the flexibility to promote uniform reporting requirements and reciprocity agreements for all members, so as to more directly impose a cost on a furnisher who chooses to withhold data.

⁴² Veda, *Information Services and Solutions Terms of Supply*, March 2014, clauses 7.3 and 9.2.

key advantages of a multilateral setting like the PRDE is that all CPs have obligations to each other and CPs can pursue enforcement directly through a multilateral process.

2.3. Transparency

49. The transparency provisions in the PRDE also play an important role. These give CPs confidence that they will be able to *identify* deviations from the principle of reciprocity.
50. In particular, the Administrator will report to all CPs the tier levels of all signatories and any changes to those levels (Clause 104).⁴³ This will allow CPs to track the contribution tier level of other CPs. At the same time, Clause 16 ensures that for each tier level that a CP nominates, it must contribute information at that level across all of its consumer credit accounts for all of its credit portfolios, subject only to limited exceptions. Moreover, Clause 29 requires that all “eligible credit information” be contributed. Therefore, if one CP sees that there is, for example, no mortgage repayment history from a second CP in the credit reports (or if the amount of mortgage repayment history being observed in credit reports is somewhat less than the second CP’s market share of mortgages would suggest there should be) it can challenge this through the enforcement mechanism.
51. The transparency that the PRDE provides to CPs is very different from the situation that exists in a setting of purely bilateral agreements between CPs and CRBs. In such a setting, one CP may have limited insight into the types of information that another CP is providing. This makes it difficult for the first CP to understand whether the second CP is respecting the principle of reciprocity. For example, if a CP observes that another CP’s RHI data never appears in credit reports, the first CP may not know whether that is because (a) the second CP has an agreement with the CRB to supply and receive only negative information and CCLI data and is *complying with reciprocity*, or (b) the second CP has an agreement with the CRB to also receive RHI data and *reciprocity is not being observed*. Similarly, if a CP observes that a second CP’s mortgage information never appears in credit reports, the first CP may not know whether that is because (a) the second CP has an agreement with the CRB to supply and receive only non-mortgage information and is *complying with reciprocity*, or (b) the second CP has an agreement with the CRB to receive mortgage information, but is not supplying mortgage information, and *reciprocity is not being observed*.
52. The PRDE also provides CPs with transparency with regard to enforcement stages and outcomes. For example, any Rectification Plan in relation to a Stage 2 dispute must be made available to signatories by the Administrator within three business days of the Administrator receiving the Rectification Plan, and any signatory may object to the Rectification Plan within seven calendar days (Clauses 71 and 72). For a Stage 3 dispute, the Administrator must make a de-identified report of the dispute available to signatories within three business days (Clause 74). At the conclusion of any Stage 3 dispute, the Administrator will report to signatories identified reports of the Industry Determination Group’s recommendations or the Eminent Person’s decision (Clause 103). These transparency clauses give CPs a level of confidence in the enforcement mechanism. This transparency is in contrast to the transparency available regarding disputes in bilateral arrangement settings, where one CP has no transparency regarding the enforcement of an agreement between another CP and a CRB.

⁴³ Clause 57 provides that a CP must notify the Administrator once it is fully complying with its contribution obligations (which must be within 12 months of becoming a signatory or nominating a different tier for contribution and supply).

2.4. Standardisation

53. The PRDE contains provisions that require signatories to provide and receive only data that complies with the Australian Credit Reporting Data Standards (ACRDS).⁴⁴ ACRDS is a set of standards for the reporting of credit information that has been developed by ARCA's Data Standards Working Group with industry input.
54. As far as we are aware there is general agreement in the industry that having a single standard format for the contribution of positive credit information is desirable. Different standards may be tolerable for the industry when only negative information is exchanged. Negative information is event based and the information is limited to indications of customer default, which means that the scope for divergences in reporting are limited. A much smaller percentage of borrowers have negative information than positive information and the default event occurs much less frequently. Standardisation is considerably more important for positive information, which is reported across all customers and on a periodic (e.g. monthly) basis, and implies a much larger set of information.
55. Standardisation reduces contribution costs. If CRBs were each to impose their own separate standards for data contribution on CPs, it may be costly for CPs to gather and contribute different information to each separate CRB. A single standard is likely to lower the costs of CPs that wish to have relationships with more than one CRB, as they will only need to prepare their information for contribution in one standard, which can then easily be contributed to multiple CRBs.
56. At the same time, a single standard allows for more consistent credit reporting information to be provided by CRBs to CPs. This will allow CPs more readily to compare information (within and across CRBs) and is again likely to reduce CP costs of using CCR, as CPs will not need internally to tailor and reformat credit-related personal information into a consistent format. In the absence of a single standard, a single CRB may receive information from multiple CPs that use different protocols for recording information, which may lead to inconsistent contributions. For example, different CPs may contribute different measures of performance into the same CRB (e.g. number of days overdue); some CPs may only contribute information on new accounts after six months while others may contribute after three months or after nine months; etc. The credit reporting information provided by the CRB may then contain inconsistencies depending on the CPs that contributed the credit information. Moreover, without standardisation multiple CRBs may require CPs to contribute credit information in different standards and may then supply credit reporting information based on those different standards. This may lead to significant difficulties and costs for CPs in terms of collating and interpreting information from multiple CRBs within the CPs' internal systems when trying to assess the credit-worthiness of potential customers, and could also pose significant costs for CPs in managing multiple

⁴⁴ For example, Clause 10 requires CPs to promise to contribute credit information in compliance with the ACRDS. Also, Principle 3 is titled "Service agreements between PRDE signatories will require reciprocity and the use of ACRDS" and underneath this principle, Clause 47 requires that services agreements "require CPs to use the ACRDS when contributing credit information to CRBs", Clause 48 requires CRBs to promise that they "will not accept contributed credit information from a CP unless the information is compliant with ACRDS or the CP has engaged [the CRB] to convert the contributed credit information into an ACRDS format" and Clause 50 requires CPs to promise that they will "comply with the ACRDS or alternatively [they] will utilise the CRB's service to convert [their] contributed credit information into an ACRDS compliant format".

CRB relationships. This could lead to fragmentation and an ineffective credit information system and ineffective competition among CRBs and among CPs.

57. Standardisation also enhances the quality of aggregative (de-identified) data used in research, as information from multiple CPs and CRBs can be pooled more readily.

2.5. Consistency obligations

58. The consistency obligations in the PRDE aim to ensure that there is consistency in the information that CPs *contribute* to each of the CRBs with which they have relationships. It is important to understand that the consistency obligations apply only with regard to the *contribution* of information by CPs, not to the information that CPs choose to *receive* from CRBs.
59. Clause 15 of the PRDE provides that a CP must contribute the same information to all CRBs with which it has a services agreement. Clause 15 can be thought of as a “most favoured nation” requirement on CPs to contribute equally to all CRBs with which they have relationships. The SLA between the CPA and CBA in South Africa is an example of a consistency obligation currently in place. It includes an obligation on CP members of the CPA to “submit identical data” to all CRBs covered by the SLA.⁴⁵
60. Clause 15 of the PRDE clarifies that a CP does not have to *receive* the same information from all CRBs with which it has a services agreement. Clause 15 also *does not require a CP to have a services agreement with every CRB*. It is useful to consider some examples of how Clause 15 would operate.
- a. If a CP has a services agreement with **only one CRB**, then Clause 15 does not have any operative effect. The CP may have a services agreement with the CRB at any tier level (negative, partial or comprehensive) and will have no obligation to contribute data to any other CRB. Clause 15 does not force a CP to establish a relationship with any CRB or with multiple CRBs.
 - b. If a CP has a services agreement with **two or more CRBs**, then Clause 15 operates to require the CP to *contribute* the same tier of information to each of those CRBs. For example, if a CP has a services agreement with CRB1 to receive comprehensive information and with CRB2 to receive only negative information, the CP must contribute comprehensive information to both CRB1 and CRB2. The CP is not, however, required to *receive* comprehensive information from CRB2 (although it may choose to do so).
61. In addition, Clause 16 of the PRDE requires CPs to contribute credit information consistently *across all credit portfolios* (subject to minor exceptions). This means that CPs must contribute at their nominated tier level (negative, partial or comprehensive) consistently to all CRBs with which they have a services agreement across all types of accounts that they hold (e.g. mortgages, credit cards, personal loans, etc.).
62. As Veda and HoustonKemp have observed,⁴⁶ an effect of Clause 15 is that a CP that may wish to have a *primary* relationship with one CRB for the receipt of partial (or comprehensive) credit reporting information and a *secondary* relationship with another CRB concerning only negative information, will have to contribute partial (or

⁴⁵ Above note 30, Clause 4(a)(i).

⁴⁶ See Veda submission, pages 9-11; and HoustonKemp report, pages 14-15.

comprehensive) information to both its primary and secondary CRBs. At the same time, Clause 16 precludes a CP from sharing all of its data (at its tier level) with one CRB and data only with respect to certain credit portfolios (e.g. only with respect to credit cards, but not mortgages) with another CRB.

63. ARCA's rationale for the consistency obligations is presented in its submission in support of its application for authorisation of the PRDE.⁴⁷ In essence, ARCA presents three arguments for the consistency obligations:
- a. Benefits for competition between CPs;
 - b. Benefits for competition between CRBs; and
 - c. Benefits for consumers.

2.5.1. Benefits for competition between CPs and for small CPs in particular

64. First, ARCA argues that by enabling small CPs to access a greater amount of credit information through any single CRB relationship, the consistency obligations *lower barriers to entry and expansion for small CPs*. ARCA states:

*without the PRDE's obligation to supply a consistent level of information to all CRBs with which a CP has a relationship, smaller CPs may face the higher costs of trying to establish multiple CRB relationships to obtain additional information. Therefore, they may receive less or incomplete information to make good lending and risk management decisions and compete with larger lenders.*⁴⁸

65. For example, suppose a small credit union based in Queensland would prefer to have a relationship with only one CRB and has a preference for Dun & Bradstreet's credit reporting information and associated services. Suppose also that a significant lender in Queensland supplies its negative data to all CRBs, but supplies its positive data only to Veda. Suppose further that access to the positive data of the significant lender is important information for the small credit union in order to compete on a level playing field with the significant lender and other CPs in its local area. Without the consistency obligations, the small credit union would have to have a relationship with Veda in order to access credit reporting information that contains positive data contributed by the significant lender. With the consistency obligations, the significant lender would be required to contribute its positive data also to Dun & Bradstreet and the small credit union would be able to obtain the information that it needs through a single relationship with its preferred CRB.
66. In the absence of consistency obligations, if small CPs cannot afford the additional costs of purchasing information from multiple CRBs and integrating that information into their internal systems, their ability to lend responsibly and also their ability to compete with larger CPs (that have a greater ability to integrate information from all CRBs) will be compromised. If responsible lending expectations mean that small CPs must purchase and integrate

⁴⁷ ARCA submission, pages 25-27.

⁴⁸ ARCA submission, page 25.

information from multiple CRBs,⁴⁹ small CPs will face higher costs, and the viability of some small CPs may be compromised. The consistency obligations increase the likelihood that small CPs will be able to obtain sufficient information to compete against larger CPs and lend responsibly through a single CRB relationship.

2.5.2. Benefits for competition between CRBs

67. Second, ARCA argues that the consistency obligations *lower barriers to entry and expansion by small CRBs, prevent discrimination between CRBs and facilitate competition between CRBs*.⁵⁰
68. Credit information markets are characterised by network effects. Network effects arise when one person's use of a service increases the value of the service for other users. Telephony is the quintessential example of a service with network effects, as the more people have telephones, the more valuable it is to have a telephone. Similarly, there are network effects associated with credit information pools: the more CPs that contribute data to (and receive data from) a CRB, the larger is the data pool (or "network") of that CRB and the more valuable it is for other CPs to have a relationship with that CRB. All else equal, CPs will prefer to have a relationship with the CRB that has the largest pool of information.⁵¹
69. An effect of the consistency obligations will be that small CRBs are likely to have access to more data to include in their pools, which will mitigate the network effect advantages of large CRBs and enhance the ability of small CRBs to compete with large CRBs to attract CPs.
70. To be clear, where CPs have a relationship only with one CRB, there will be no impact of the consistency obligations. However, where CPs have relationships with two or more CRBs, the consistency obligations will mean that these CRBs will receive the same data from that CP into their pools. As we have explained in Section 2.1 above, and as Veda and HoustonKemp have also noted,⁵² it may be that many CPs have incentives to have negative information on their own customers distributed widely across multiple CRBs. These CPs may wish to maintain relationships with multiple CRBs for this purpose. Multiple relationships may be relatively cheap for the CPs to maintain as they may only be *contributing* data to multiple CRBs (which is generally free to do apart from any internal costs for CPs associated with contributing data), not purchasing credit reporting information from more than one CRB. The effect of Clause 15 is that these CPs will be required also to contribute the same positive data to each of these CRBs.
71. This contrasts with the situation without the consistency obligations, where CPs may contribute more information to one CRB than to others with whom they have relationships.

⁴⁹ In this regard, we note that the Australian Securities and Investments Commission (ASIC) observes that if there were a lack of consistency regarding contribution of credit information by CPs to CRBs, ASIC "would expect a credit provider to consider whether it was necessary to obtain credit reporting information from more than one credit reporting body in order to properly verify a consumer's financial situation" and "this would result in an increase in costs to the credit provider": ASIC submission, page 2.

⁵⁰ ARCA submission, pages 25-26.

⁵¹ This is confirmed by Veda and HoustonKemp. For example, HoustonKemp state that "smaller CPs that choose to participate in CCR will opt to acquire the services of the CRB that has the strongest database" (HoustonKemp report, page 20). See also, Veda submission, page 14.

⁵² See Veda submission, pages 2 and 9-11. See HoustonKemp report, page 16 (and also footnote 42 on page 7).

This is more likely to result in an uncompetitive outcome in which one CRB develops a superior database of positive information and then benefits from network effects that may “tip” the market towards that CRB.

72. The consistency obligations also prevent a CRB from offering inducements to CPs with the effect that the CRB obtains exclusivity in the supply of positive data from CPs. The PRDE does not preclude a CP from choosing to deal with only one CRB for *all* of its credit information requirements.⁵³ However, if the CP chooses to have multiple CRB relationships (e.g. so that the CP can have its negative data distributed widely), it will not be possible for one CRB to induce that CP to enter an exclusive relationship with regard to CCLI and/or RHI information. This further protects competition among CRBs by limiting the scope for one CRB to use exclusivity arrangements to obtain a superior database that may lead, again via network effects, to the creation of a position of dominance in the provision of credit reporting information and other CRB services.
73. By countering the tendency for unequal data pools to develop and for network effects then to lead to an uncompetitive market structure, the consistency obligations are designed to maintain the focus of competition among CRBs on the supply of credit reporting information and other services to CPs, including competition on price and with respect to the quality of the services that the CRB’s provide (rather than competition to obtain CPs data per se in order to acquire a larger dataset than competitors). ARCA’s submission identifies a number of dimensions in which competition is expected to proceed if CRBs have access to more consistent data from CPs.⁵⁴ These include improved analytical products, additional data sets, assistance with integration between the CRB’s credit reporting information and the CP’s internal systems and consulting and other services that may improve a CP’s credit risk management capabilities.

2.5.3. Benefits for consumers

74. Third, ARCA argues that consumers will benefit from the consistency obligations as credit reports produced by CRBs are likely to contain more complete pictures of consumers’ credit histories, consumers will have less need to obtain reports from all CRBs to see their full credit file picture, and consumers will encounter less inconsistency in terms of credit risk assessments by CPs.⁵⁵
75. In the United States, which is characterised by a system of bilateral arrangements, concerns have been raised for consumers regarding significant inconsistencies in reporting across the three main CRBs.⁵⁶

⁵³ Note, however, that the PRDE prohibits exclusive arrangements between signatories. For example, Clause 6 requires signatory CRBs to promise that its services agreements will not prevent CPs from contributing credit information to other CRBs and Clause 51 more generally provides that CRBs “must not impose constraints to restrict a CP from contributing credit information to another CRB”.

⁵⁴ ARCA submission, page 26.

⁵⁵ ARCA submission, pages 26-27.

⁵⁶ See Consumer Federation of America (2002), *Credit Score Accuracy and Implications for Consumers*, 17 December 2002. See also Michael E. Staten and Fred H. Cate (2004), “Does the Fair Credit Reporting Act Promote Accurate Credit Reporting?” Joint Centre for Housing Studies, Harvard University, February 2004, pages 30-35.

76. While there may still be inconsistencies (e.g. if a consumer has a loan with a CP that only has a relationship with one CRB, the details of this loan will appear only on the reports of that CRB and only CPs that obtain reports from that CRB will take that information into account when considering the consumer's credit risk), Clause 15 should reduce these as each CRB will tend to have more information on the consumer.
77. Clauses 16 and 29 are also significant here as they require that all "eligible credit information" across all portfolios within the relevant tier (negative, partial or comprehensive) be contributed by CPs, and CPs are therefore not able to "pick and choose" (e.g. to supply credit card information, but not mortgage information). This will make credit reports more comprehensive within any tier of information and ensure that good credit histories across all portfolios are contributed.

3. OPINION ON QUESTION 1

78. The first question that we have been asked to provide our opinion on is the following:

[G]iven the likely incentives and disincentives that CPs face in Australia when deciding whether to contribute positive data to CRBs, will it be possible to establish an effective system of comprehensive credit reporting primarily on the basis of bilateral agreements between CRBs and CPs?
79. We have been asked to consider the following particular features of the Australian market when answering this question:
 - a. Market structure (i.e. the number of CRBs, the degree of concentration in the market, and the relative size of different market participants; and the number of CPs, the degree of concentration in the market and the relative size of different market participants);
 - b. The relevant regulatory environment (i.e. existing obligations under the *Privacy Act*);
 - c. How incentives and disincentives may operate differently when the information exchanged is positive credit information (as opposed to negative information); and
 - d. How incentives and disincentives may operate differently for large vs small CPs/CRBs.
80. In our opinion it will not be possible to establish an effective system of CCR in Australia primarily on the basis of *bilateral agreements* between CRBs and CPs. The full reasons for our opinion are contained in the following subsections, but these can be summarised as follows.
 - a. **Reciprocity issues.** The principle of reciprocity is a fundamental requirement for CPs to be willing to share positive data. However, CPs have incentives to "under-contribute", i.e. fail to observe reciprocity by supplying CRBs with less information than they receive. Meanwhile, CRBs have conflicting incentives, including incentives to negotiate agreements with CPs that do not require full reciprocation or fail to enforce reciprocity in relation to particular CPs, as each CP agreement represents additional revenue to the CRB. Large CPs, in particular, may be able to insist on receiving more information than they provide into the system. Aware of the unilateral incentives of each CP to under-contribute and the conflicting incentives of CRBs, CPs will be reluctant to share positive data with CRBs under bilateral arrangements unless CRBs can guarantee that the principle of reciprocity will be observed and enforced. However, in a setting of purely bilateral arrangements it is unlikely that

CRBs in Australia will establish mechanisms that will provide CPs with confidence that reciprocity will be observed and enforced.

- b. **Potential for an uncompetitive market structure to develop.** A setting of bilateral arrangements has the potential to result in a situation in which one CRB obtains a dominant position with respect to CCR. The dominance may arise naturally and may be exacerbated by the use of exclusive agreements. This would not be an effective system of CCR, as a dominant CRB would be able to charge higher prices for credit reporting information and provide lower quality services (including lower quality value added services such as scorecards and other analytics) than if the market was competitive with multiple CRBs having more equal sized pools of data.
 - c. **Potential for fragmentation.** Alternatively if a dominant CRB does not emerge, then it is likely that the industry will suffer from fragmentation where some CPs contribute positive information to one CRB and others contribute positive information to other CRBs. In this event, CPs would need to purchase credit reporting information from all major CRBs in order to obtain a comprehensive picture for each consumer, with additional costs of doing so. If small CPs cannot afford the additional costs of purchasing information from multiple CRBs and integrating that information into their internal systems, their ability to lend responsibly and also their ability to compete with larger CPs will be compromised. If responsible lending expectations mean that small CPs must purchase and integrate information from multiple CRBs, small CPs will face higher costs, and the viability of some small CPs may be compromised. Consumers may also be harmed by the need to obtain credit reports from all CRBs in order to understand their full credit file picture and by the potential for inconsistency in terms of credit risk assessments by CPs.
81. The following sub-sections elaborate on these points. The final sub-section provides some observations on the arguments of Veda and HoustonKemp in relation to this question.
- ### 3.1. Reciprocity issues
82. The problems for a setting of bilateral arrangements in relation to reciprocity should be apparent from our discussions of reciprocity, enforcement and transparency in Sections 2.1, 2.2 and 2.3.
83. As we have explained there, the principle of reciprocity is fundamental for CPs to be willing to share positive data. However, CPs have incentives to “under-contribute” – that is, fail to observe reciprocity by supplying CRBs with less information than they receive. By doing so, they stand to benefit from the information contributed by other CPs without giving away their own competitive advantage in the form of their own data.
84. Meanwhile, CRBs have conflicting incentives. On the one hand, CRBs have incentives to undertake to share a CP’s positive data only with other CPs that reciprocate, as otherwise CPs will be unwilling to share their positive data with the CRB. On the other hand, CRBs also have incentives to reach deals with CPs that do not fully reciprocate or to fail to enforce reciprocity in relation to particular CPs, as each CP agreement represents additional revenue to the CRB.
85. Large CPs, in particular, may be able to leverage from the significant revenue opportunity that they represent to CRBs either to insist on agreements that allow them to receive more information than they provide into the system, or (more subtly) to provide information that is incomplete, incorrect or delayed, without fear of sanction by the CRB.

86. Aware of the unilateral incentives of each CP to under-contribute and the conflicting incentives of CRBs, CPs will be reluctant to share positive data with CRBs under bilateral arrangements unless CRBs can guarantee that the principle of reciprocity will be observed and enforced. It is important to recall here that positive information is far more valuable to CPs than negative information,⁵⁷ and so CPs are likely to think much more carefully about whether the conditions are right for them to share this information. An enforceable commitment to reciprocity, together with transparency, is likely to be needed for this to happen.
87. In a setting of bilateral arrangements between CPs and CRBs without any multilateral framework, it is unlikely that CRBs in Australia will establish mechanisms that will provide CPs with confidence that reciprocity will be observed and enforced. As we explained in Sections 2.3 and 2.2, the lack of transparency that is an inevitable feature of bilateral arrangements is a key reason for this and the inability of one CP to enforce a bilateral agreement between another CP and a CRB is another. This is also in a context in which we understand (from conversations with ARCA and industry participants) that there is a lack of trust among CPs in Australia that reciprocity will be enforced in a setting of bilateral arrangements.
88. It may be possible for a system of bilateral agreements *directly between CPs* to develop (setting out the terms on which they would share information via CRBs), which would enhance transparency and may contain more effective enforcement mechanisms. However, this would begin to approximate a multilateral framework (as each CP would contract with multiple other CPs and these agreements are likely to be very similar). Moreover, if the industry were to proceed along these lines a likely outcome would be the fragmentation of CCR. Large CPs may reach bilateral agreements to share among themselves, but not with small CPs. Although some groups of small CPs may also reach bilateral agreements among themselves, small CPs would tend to be disadvantaged in this scenario compared to large CPs, as the datasets that small CPs would have access to would be much smaller.

3.2. Potential for an uncompetitive market structure to develop

89. Even if reciprocity issues could be overcome, a system of bilateral arrangements brings with it a risk that the CRB side of the industry will become concentrated and that a dominant CRB will develop in relation to CCR. This is a particular risk in Australia where there is already a dominant CRB with respect to negative information that has the ability to transfer that dominance into CCR (as we explain below).
90. As explained in Section 2.5, the sharing of credit information is characterised by network effects: the more CPs that contribute data to (and receive data from) a CRB, the larger is the data pool of that CRB and the more valuable it is for other CPs to have a relationship with that CRB. All else being equal, CPs will prefer to have a relationship with the CRB that has the largest pool of data.
91. In a system of bilateral arrangements, dominance may arise through the natural evolution of the market and the “tide” of network effects that will tend to favour the largest CRB in the market.

⁵⁷ See our explanation of this in Section 2.1.

92. Currently Veda has an estimated 85% share of the exchange of consumer credit-related personal information (in a context in which only negative information is exchanged).⁵⁸ The shares of Dun & Bradstreet and Experian have been estimated as approximately 14% and 1%, respectively.⁵⁹ Veda's high market share and its dominance⁶⁰ with respect to the exchange of consumer credit-related personal information derives from its longer history of credit reporting in Australia, its larger set of relationships and interfaces with CPs and its larger database.
- a. Veda was a monopoly provider of credit reporting information from the 1960s until 2003 when Dun & Bradstreet entered. As a consequence, Veda's brand name became synonymous with credit reporting in Australia, and although there are now three CRBs in Australia (Experian commenced operations in 2013), Veda likely still enjoys a *brand name advantage* and tends to be the primary (if not only) vendor for most CPs.
 - b. A second advantage that Veda holds is its *large number of existing relationships and interfaces* with the vast majority of CPs that purchase credit reporting information. The interfaces, in particular, represent a significant barrier to entry for other CRBs. Although the costs for CPs of contributing data to CRBs tends not to be significant, there are significant costs for CPs to receive and integrate information from CRBs into their automated internal systems. The vast majority of CPs with automated systems have existing interfaces only with Veda for the receipt of credit reporting information. To begin to receive information from other CRBs, a CP would need to make significant investments in its automated systems.
 - c. Since many CPs have a credit information relationship only with Veda, Veda benefits from having arrangements for the contribution of data from more CPs than any other CRB. It consequently enjoys an *advantage in terms of the breadth and depth of its database* (i.e. greater coverage of Australian consumers, and, on average, more information on each consumer).⁶¹ This naturally tends to reinforce Veda's attractiveness to CPs relative to CRBs with smaller databases.
93. When positive information is introduced to the market, Veda will not immediately have a greater pool of positive information than its rivals. However, the three forms of advantage

⁵⁸ See IBISWorld (2015), *Credit Agencies in Australia*, IBISWorld Industry Report N7293b, April 2015, page 17.

⁵⁹ See Dun & Bradstreet's submission dated 1 April 2015, page 1.

⁶⁰ Regarding dominance, we note the finding by the ACCC in 2011 that "the market for credit reporting services is currently dominated to a large extent by Veda, especially in relation to consumer credit reporting, and that there is one other significant provider, D&B, which has a relatively small market share": ACCC (2011), *Public Competition Assessment: Experian Australia Credit Services Pty Ltd – proposed joint venture*, 19 September 2011, page 9, paragraph 42.

⁶¹ We understand that both Dun & Bradstreet and Experian have substantially fewer CP relationships than Veda and that, consequently, less credit information is contributed to their databases. In addition to this, Experian is at a disadvantage compared to both Veda and Dun & Bradstreet with respect to the length of history of credit information in Experian's database. As stated in the HoustonKemp report for Veda, page 9: "Experian is a relatively new entrant, having only started operations in February 2013, and therefore holds more limited historical information in relation to consumer credit accounts". Also, on page 10: "the data held by Experian differs from that held by Veda and Dun & Bradstreet by virtue of the fact that it only began operations in Australia in February 2013. As a result it holds limited historical data relative to the longer established CRBs".

identified above are likely to lead to Veda extending its dominance from negative data into positive data. In particular:

- a. Veda's *brand name advantage* is likely to result in Veda being the vendor of choice for many CPs with respect to positive as well as negative information.
 - b. Veda's *larger set of existing relationships and interfaces* with CPs will represent a further significant advantage for Veda in CCR. Although existing interfaces would need to be upgraded so that positive information can be contributed as well as negative information, the costs to CPs of upgrading existing interfaces are likely to be less than the costs of establishing a relationship and an entirely new interface with another CRB. CPs that wish to obtain access to a pool of positive data will therefore, all else equal, be more likely to reach an agreement with regard to positive data with CRBs that they already have relationships and interfaces with than those that they don't. Veda's existing relationships and interfaces will therefore give it an advantage in reaching agreements with CPs for CCR.
 - c. Veda's *broader and deeper database* of negative information will remain an advantage that Veda can market alongside the positive information that it can supply. Moreover, Veda's brand name and larger set of CP relationships and interfaces are likely quickly to deliver Veda a *broader and deeper database* of positive information. This will naturally tend to be more attractive to CPs than more limited databases of other CRBs, and network effects are then likely to reinforce Veda's dominance.
94. The tendency towards extension of Veda's dominance from negative to positive information is likely to be exacerbated if Veda is able to enter into exclusive agreements with CPs. Since the predominant CP relationship is currently with Veda and Veda's database is the most valuable for CPs to access, it is Veda that is currently best placed to reach exclusive agreements with CPs.
95. A situation in which a single CRB finds itself in a dominant position with respect to the provision of credit reporting information would produce an ineffective system of CCR. A dominant CRB would be able to charge higher prices and provide lower quality services (including lower quality value added services such as scorecards and other analytics).⁶² The ability for CPs to "vote with their feet" and switch to rival CRBs would be constrained by the more limited pools of data available to those rivals and the costs of establishing interfaces (as well as inconsistent data reporting standards if standardisation does not exist). The harmful effects of this dominance are likely to be felt most by smaller CPs that have less bargaining power when negotiating with the dominant CRB.
96. As explained, the industry in Australia has a natural tendency towards CRB dominance in CCR, due to Veda's existing advantages over other CRBs. Measures to constrain that tendency, such as restrictions on exclusive agreements with CPs, would likely be of benefit to the industry overall, as these measures would reduce barriers to rival CRBs developing similarly comprehensive databases of their own, and maintain the focus of competition on

⁶² We note that the ACCC has previously found that the "market for credit reporting services is currently dominated by Veda, especially in relation to consumer credit reporting" and that "this lack of competition is reflected in pricing levels that are high in comparison to comparable overseas markets": see ACCC (2011), *Public Competition Assessment: Experian Australia Credit Services Pty Ltd – proposed joint venture*, 19 September 2011, page 9, paragraph 42.

price and the quality of value-added services provided by the CRBs. However, such measures are not likely to develop under a system of bilateral arrangements.⁶³

97. If the largest CPs (i.e. the largest four banks in Australia) were able to coordinate (which is far from certain), they may try to protect themselves from an uncompetitive market structure by contributing their positive data equally to all CRBs in the market and refusing to enter exclusive agreements with any CRB. However, even this may not prevent the market tipping and an uncompetitive market structure from developing. The largest four banks in Australia (CBA, NAB, ANZ and Westpac) have the potential to contribute only around 75% of consumer credit-related personal information.⁶⁴ Even if rival CRBs are assured of access to the credit information of the largest four banks, competition for medium-sized CPs is likely to be intense, with offers for exclusivity likely. At the same time, Veda is likely to be the preferred CRB for most of the medium-sized and smaller CPs. Together, medium-sized and small CPs represent a substantial portion of all credit information.⁶⁵ A credit reporting database that contains 90-100% of credit information will be viewed as considerably more valuable than one that contains 80-90%. Market tipping therefore remains a strong possibility.

3.3. Potential for fragmentation

98. Alternatively, if a dominant CRB does not emerge, then the likelihood is that the industry will suffer from fragmentation where some CPs contribute positive information to one CRB and others contribute positive information to other CRBs. In this event, each CRB will lack a comprehensive picture of the credit histories of consumers and CPs would need to purchase credit reporting information from all major CRBs in order to obtain a comprehensive picture for each consumer, with additional costs of doing so. As discussed in Section 2.5.1, if small CPs cannot afford the additional costs of purchasing information from multiple CRBs and integrating that information into their internal systems, their ability to lend responsibly and also their ability to compete with larger CPs (that have a greater ability to integrate information from all CRBs) will be compromised. If responsible lending expectations mean that small CPs must purchase and integrate information from multiple CRBs, small CPs will face higher costs, and the viability of some small CPs may be compromised. As discussed in Section 2.5.3, consumers may also be harmed by the need to obtain credit reports from all CRBs in order to understand their full credit file picture and by the potential for inconsistency in terms of credit risk assessments by CPs.

⁶³ Restrictions on exclusive arrangements would only arise if there were an investigation of such arrangements under competition law that led to the prohibition of such arrangements. This is highly uncertain.

⁶⁴ This figure is based on conversations we have had with industry participants. The figure excludes the RHI data generated by telecommunications and other utility suppliers (as this data cannot be contributed under CCR in Australia).

⁶⁵ The ACCC has previously found that CPs other than the CP investors in Experian (i.e. CPs other than CBA, NAB, ANZ, Westpac, Citigroup and GE Capital) "collectively represent a significant proportion of demand in Australia": ACCC (2011), *Public Competition Assessment: Experian Australia Credit Services Pty Ltd – proposed joint venture*, 19 September 2011, page 12, paragraph 63.

3.4. Observations on the arguments of Veda and HoustonKemp

99. Veda and HoustonKemp partially address question 1 when they suggest that there are “sufficient incentives to support reciprocity without a prescriptive PRDE”⁶⁶ (Veda) and that the PRDE is not necessary because the current “principles-based approach to reciprocity” through bilateral agreements is sufficient to “facilitate the exchange of positive credit information” (HoustonKemp).⁶⁷ In this sub-section we make a number of observations in relation to the arguments made by Veda and HoustonKemp in support of these statements.

3.4.1. The significance of free-rider concerns in the sharing of positive data

100. Veda argues that:

*a system of **negative** information exchange has arisen and has been implemented without any “standard legal framework” for reciprocity principles being established. Bilateral arrangements have been sufficient to foster reciprocity in data sharing under the current regime.*⁶⁸ [Emphasis added.]

101. Similarly, HoustonKemp argue that:

*if free-rider concerns were significant, one would not expect to see the widespread contribution of **negative** information [...] CPs currently contribute **negative** information to CRBs without any ability to determine whether other CPs that access that information also contribute the same.*⁶⁹ [Emphasis added.]

102. It is true that CPs currently contribute *negative* information without any transparency regarding whether other CPs that access that information are reciprocating with the same information. However, it is our understanding that negative information is currently under-contributed (i.e. only certain portfolio lines are contributed at the moment) and one of the benefits that ARCA and the majority of its members anticipate from the PRDE is that more negative data will be shared, as Clauses 16 and 29 of the PRDE require the sharing of data across all portfolios and all “eligible credit information” within those portfolios.
103. It is also our understanding from ARCA that there is considerable dissatisfaction among CPs regarding the lack of transparency around who is contributing what, and considerable suspicion among CPs that other CPs are “free riding” by not fully reciprocating – that is, contributing less data than they are receiving. We understand that this has generated considerable distrust regarding the current system.
104. Therefore, the suggestion by HoustonKemp and Veda that free-riding concerns are not significant in the existing bilateral arrangements system for negative data is not consistent with our understanding of how the system is currently operating and perceived by CPs.
105. In any event, how CPs act regarding negative information is unlikely to be predictive of how they will act regarding positive information. Even if CPs are happy to share negative information under an “in-principle” agreement or “general understanding” regarding reciprocity, they are likely to have very different incentives regarding positive information.

66 Above note 18, page 7.

67 HoustonKemp report, page 7.

68 Above note 18, page 7, paragraph 34.

69 HoustonKemp report, page 7.

- a. As explained in Section 2.1, positive information is considerably more valuable to CPs than negative information, and there will be a correspondingly greater reluctance to share it (particularly for large CPs that have information on large proportions of consumers) unless there is confidence that reciprocity will be observed and enforced.
 - b. As also explained in Section 2.1, free-rider concerns are likely to be less significant in the context of negative data than in the context of positive data, since CPs derive some benefit from the widespread dissemination of negative credit information concerning their customers, as this tends to reduce moral hazard of their customers⁷⁰ and also better informs rival CPs of the riskiness of customers that have defaulted. Therefore, CPs may be willing to have their negative data shared widely without reciprocity being guaranteed, for reasons that do not apply to positive data.
106. It is also possible that CPs initially agreed to share negative data with CRBs on the expectation that reciprocity would be observed and enforced, and a lack of trust in the system only emerged subsequent to them doing so (i.e. once they observed how the system actually worked). Assuming that distrust now exists for negative data, CPs are unlikely to contribute further (considerably more valuable) information under the same system.

3.4.2. The likelihood of CPs contributing under “in-principle” agreements

107. HoustonKemp also argue that “it is reasonable to expect” CPs to contribute their positive data using “a much simpler, in-principle agreement among market participants to a framework for reciprocity, ie, a general understanding”.⁷¹ They say that this is because (a) CRBs have strong incentives to include reciprocity obligations within their services agreements and there are low risks that CRBs would not adhere to these obligations and (b) CPs have strong incentives to share consistent positive information in order to develop a comprehensive database of positive information across the industry.⁷²
108. As discussed above, although CRBs have incentives to guarantee reciprocity to CPs, CRBs also have incentives to reach agreements with CPs (particularly large CPs) that do not observe reciprocity. These conflicting incentives are recognised by CPs and it is our understanding that they lie at the heart of the distrust that CPs in Australia have regarding the current system of bilateral agreements. We understand from ARCA and industry participants that CPs perceive the risk that CRBs will not enforce reciprocity as more than “low”, and that this has been a major driver for the development of the multilateral PRDE framework and the PRDE’s enforcement mechanism in particular.
109. As for CP incentives, we do not agree with HoustonKemp that “CPs have a strong incentive to provide CRBs with consistent, positive information across a large proportion of their credit accounts because of the benefits they will derive from the collective development of

⁷⁰ This point is recognised by HoustonKemp: see HoustonKemp report, page 16. However, when HoustonKemp attempt to suggest that there are lessons from how negative data is shared with how positive data would be shared in the absence of the PRDE, the point is relegated to a footnote: see HoustonKemp report, page 7, footnote 42. In our opinion this is a point that is likely to be quite significant in understanding whether the current system of bilateral agreements would be effective in the context of CCR.

⁷¹ HoustonKemp report, page 7.

⁷² HoustonKemp report, page 7.

a comprehensive database of positive information”.⁷³ To the extent that this statement suggests that CPs have altruistic motives to help create a “collective” public good, it is far too optimistic.

110. CPs may have incentives to share consistent positive information *if there is confidence that reciprocity will be observed and enforced*. However, the idea that CPs will act for the common good rather than in their own self-interest is fanciful. Each CP, individually, does not care for the development of a comprehensive database of positive information across the industry per se. If a CP is able to contribute less information than it receives (i.e. if reciprocity is not adequately enforced), it will take that opportunity. This is the Prisoners’ Dilemma described earlier.
111. In particular, when CPs are negotiating with CRBs they are likely to attempt to reach agreements that allow them to contribute less than others. Large CPs will tend to have sufficient bargaining power to achieve this. In this context, “in-principle” agreements for reciprocity and “general understandings” provide CPs with no comfort that reciprocity will be observed or enforced and will not solve the dilemma. In that situation, CPs will not be willing to share their positive information. As discussed, transparency and a credible enforcement mechanism are essential in order to generate trust in the system – “in-principle” agreements and “general understandings” in the context of non-transparent bilateral arrangements will not provide this.
112. As we observed in Section 2.2, the wealth of international experience with CCR attests to the importance of enforcement mechanisms. These are commonplace around the world, and the United States’ experience demonstrates that issues with reciprocity are prone to arise when clear enforcement mechanisms do not exist.

3.4.3. Interpretations of the UK situation

113. In pointing out that concerns raised by the Bank of England in relation to the contribution of positive information in the United Kingdom were raised in relation to markets for small and medium sized and commercial real-estate lending, rather than personal or consumer credit, and that CRBs in the United Kingdom have widespread access to personal and consumer credit data, HoustonKemp may be interpreted as suggesting that the United Kingdom is enjoying effective CCR under a system of purely bilateral agreements with only “in-principle” agreements for reciprocity. This, however, would ignore that in the United Kingdom CPs and CRBs operate under the multilateral framework of SCOR’s Principles of Reciprocity (PoR), which includes compliance and complaints provisions and provides for enforcement as a last resort (including the possibility of denial of access to data for CPs that do not comply).⁷⁴ This is much more than a system of bilateral agreements based on “in-principle” agreements or “general understandings”. Although CPs and CRBs in the UK are not required to execute a deed poll binding them to the PoR (as signatories to the PRDE must do), the SCOR and PoR nonetheless appear to have a coercive effect that has been sufficient to gain the confidence of UK CPs and generate a functioning system of credit information exchange in the UK.
114. Veda also points specifically to the United Kingdom when arguing that overseas experience demonstrates that no binding compliance or enforcement mechanism is needed for data

⁷³ HoustonKemp report, page 7.

⁷⁴ See our discussion of SCOR and the PoR in Section 2.2 above.

exchange to occur.⁷⁵ Although there may be debate over whether the UK system contains “binding” mechanisms, it is, once again, clear from the PoR themselves that they contain compliance and enforcement provisions that operate in a multilateral setting, with SCOR presiding over complaints, mediation between the complainant and respondent as a dispute resolution mechanism, and as a last resort, provision for SCOR to request the CRB to enforce the contractual obligations (including the PoR).⁷⁶ This is a long way from a situation in which there are simply bilateral arrangements between CPs and CRBs and an “in-principle” agreement or “general understanding” in relation to reciprocity.

115. Veda also claims that the overseas experience is that compliance mechanisms are not regularly used, and seems to infer from this that they are not needed.⁷⁷ In our opinion, compliance, complaint and enforcement mechanisms do not have to be used to be effective and important. It is their *existence* that provides CPs with confidence in the system, and indeed, if these mechanisms are effective, one should not expect to see many attempts to breach the principles. Veda’s argument is akin to an argument that, statistically, crime doesn’t happen all that often, so there is no need for a police force and a criminal justice system.

3.4.4. Evidence of CPs already contributing positive information

116. According to HoustonKemp, “Veda has indicated that it is currently engaging with [excised] CPs, both ARCA and non-ARCA members, in relation to arrangements for the supply of CCR services, some of which are currently supplying CCR data to Veda”.⁷⁸ HoustonKemp argues that this “suggests that free-rider concerns are not so substantial as to prevent the contribution of positive data by at least some CPs on the basis of a less formal agreement in relation to reciprocity”.⁷⁹
117. In our opinion some caution should be exercised before accepting this information on face value. Our understanding from ARCA and industry participants is that some CPs are contributing positive data to CRBs, however only a very small proportion of CPs are allowing their data to be shared with others and larger CPs are only contributing in the context of “pilot” programs in order to test how systems work with positive data (i.e. the data is “locked” so that it cannot be shared with other CPs).
118. As we explained in Section 2.1, small CPs may be willing to contribute positive data without strong guarantees of reciprocity as small CPs tend to have less to lose from sharing, but large CPs are likely to have different incentives. Therefore, while it may be that some CPs (particularly smaller CPs) might be willing to contribute positive information under less formal arrangements concerning reciprocity, without the participation of the largest CPs (the largest four of which together generate around 75% of consumer credit-related personal information) there will not be an effective CCR system.

⁷⁵ Veda submission, page 15, paragraph 54.

⁷⁶ Above note 32, Section 11.13, page 61.

⁷⁷ Veda submission, page 15, paragraphs 55 and 57.

⁷⁸ HoustonKemp report, page 7. See also the Veda submission, page 9, paragraph 39, which says likewise.

⁷⁹ HoustonKemp report, page 8.

4. OPINION ON QUESTION 2

119. The second question that we have been asked to provide our opinion on is the following:

[G]iven the market structure in Australia, are there sufficient economic and commercial incentives of CPs and CRBs to establish an effective multilateral framework for comprehensive credit reporting without:

- (a) obliging parties to engage in reciprocal exchanges of information;*
- (b) providing for consistency obligations; or*
- (c) including some form of enforcement mechanism.*

120. In our opinion an effective multilateral framework for CCR is unlikely to be established without obliging parties to engage in reciprocal exchanges of information and some form of credible enforcement mechanism. It would be possible to establish a multilateral framework for CCR without the consistency obligations in the PRDE; *however* it is unlikely that this would be a fully effective system as such a framework would be likely to result in either the development of a dominant CRB or the fragmentation of the industry (i.e. several CRBs with different pools of information). By promoting greater consistency across the databases held by CRBs, the consistency obligations counter these tendencies. The following subsections provide our reasons for this opinion.
121. Before turning to those reasons, we note that the obligations contained in the PRDE may avoid or mitigate many of the problems that have arisen in the development of voluntary systems of credit reporting in other countries. In the United States, for example, there has been a history of under-contributing by CPs, issues with timeliness (CRB reports are sensitive to the dates that CPs furnish information) and accuracy (including fragmented files or multiple files for particular consumers), and a lack of consistency in the information that CPs have reported to the three main CRBs.⁸⁰ Adopting a multilateral framework with enforceable reciprocity and consistency obligations during the initial development of CCR should spare Australia from experiencing these sorts of problems.

4.1. Reciprocity

122. In our opinion, obliging parties to engage in reciprocal exchanges of information (i.e. obliging parties to observe the principle of reciprocity) together with transparency and a credible enforcement mechanism (see below) is essential for the establishment of a multilateral framework for CCR in Australia. Reciprocity (with assurance that it will be observed and, if necessary, enforced) is the solution to the Prisoners' Dilemma discussed above, under which CPs have incentives not to share their data unless there is a mutual commitment to sharing among all CPs in the system and a credible enforcement mechanism. Without reciprocity and credible enforcement it is unlikely that large CPs will contribute positive data to CRBs.

⁸⁰ See Robert B. Avery, Paul S. Calem and Glenn B. Canner (2004), "Credit Report Accuracy and Access to Credit," *Federal Reserve Bulletin*, Summer 2004, pages 297-322 and also Michael E. Staten and Fred H. Cate, "Does the Fair Credit Reporting Act Promote Accurate Credit Reporting?" Joint Centre for Housing Studies, Harvard University, February 2004.

4.2. Consistency obligations

123. In our opinion it would be possible to establish a multilateral framework for CCR without the consistency obligations in the PRDE; *however* such a framework would be likely to result in either the development of a dominant CRB or the fragmentation of the industry (i.e. several CRBs with different pools of information). Each of these outcomes would raise costs for CPs and reduce the efficacy of the system compared to a situation in which the consistency obligations applied.
124. As explained in Section 2.5, network effects associated with credit information pools mean that, all else being equal, CPs will prefer to have a relationship with the CRB that has the largest pool of data. This may lead to the market “tipping” toward a single CRB if that CRB establishes itself as possessing the largest pool. In the absence of the consistency obligations, it is possible that Veda, which is the largest CRB today (and has advantages that will carry over from negative data sharing into positive data sharing) will establish a dominant position in CCR. Our reasons are explained in Section 3.2 above. As we explained there, not only is this the likely natural evolution of the market in the absence of the consistency obligations, but it may be exacerbated if Veda is allowed to enter into exclusive arrangements with CPs. Although perhaps less likely, it is also possible, in the absence of the consistency obligations, that the largest CPs (which all have shares of ownership in Experian) may decide to contribute their positive data only to Experian. This would again be likely to “tip” the market, but this time towards Experian. An industry characterised by a dominant CRB would produce a less effective system for the exchange of credit information than one in which a number of CRBs were to compete on a more level playing field, with more consistent pools of data.
125. The consistency obligations in the PRDE counter this tendency (although they do not eliminate it altogether, since the largest CRB may continue to have relationships with CPs that are entirely exclusive and that are not affected by the consistency obligations). As explained in Section 2.5, by countering the tendency for unequal data pools to develop, the consistency obligations represent an attempt to maintain the focus of competition among CRBs on competition on price and to supply the highest quality services to CPs (rather than to obtain the largest dataset).
126. An alternative possibility is that CRB dominance doesn’t arise, but instead the industry becomes highly fragmented as different CPs contribute their positive data to different CRBs (e.g. CP1 only to CRB 1, CP2 only to CRB 2, CP3 only to CRB3, etc.). We have already discussed the consequences of fragmentation due to inconsistent reporting across CRBs in Section 3.3 above. One consequence would be that the credit reporting information supplied by the various CRBs would tend to be devalued due to the inconsistencies.
127. Another consequence would be that there would be higher costs for the entire industry as CPs would need to obtain credit reporting information from multiple CRBs in order to obtain a complete picture of a consumer’s credit history, and would have the challenge and costs of integrating multiple reports into their internal systems in order to produce a coherent picture of the consumer’s credit risk. Alternatively, if CPs only purchase credit reporting information from a single CRB, the lending decision may be poorly informed. The risk of defaults would tend to increase, low risk borrowers may be denied loans, and there would be the broader implications of inefficient pricing of credit (averaged prices that mean that low risk borrowers subsidise high risk borrowers).
128. The cost burden would be proportionately greater (as a proportion of revenues) for small CPs. Small CPs that find that they cannot afford the costs of receiving and integrating

reporting information from multiple CRBs will compete on an uneven playing field with larger CPs that can afford to do so. We understand that currently large CPs tend to have multiple CRB relationships and small CPs often have only one relationship (at least with respect to receiving credit reports). This may not have significant consequences for competition between small and large CPs when the data concerned is only negative data. But when the data concerned is positive data, the implications for competition of small CPs experiencing less complete access to data than large CPs may be significant.

129. The impacts of fragmentation would extend beyond just the quality of CRB services, costs and the competitiveness of smaller CPs. Fragmentation may also harm consumers, as they would be more likely to need to obtain credit reporting information from all CRBs in order to understand their full credit file picture and they would be more likely to experience inconsistency in terms of credit risk assessments by CPs. More broadly, the impact that fragmentation may have on responsible lending (i.e. lending decisions may be made based on less information than might be the case if the consistency obligations were in place) may have consequences for macro-financial stability (as well as macro-prudential policy) and economic growth.⁸¹

4.3. Need for an enforcement mechanism

130. In our opinion, a credible mechanism to enforce the reciprocity and consistency obligations is necessary to provide CPs with confidence that reciprocity and consistency will be observed by signatory CPs and CRBs, and that any deviation will be quickly rectified, with sanctions available if rectification does not occur. Without such a mechanism, the entire system is likely to be undermined, for the reasons that we explained in Section 2.2. As we also noted in Section 2.2, sanctions for non-compliance with the principle of reciprocity are commonplace in credit reporting systems around the world, and where they do not exist, deviations from reciprocity tend to occur.
131. The need for a credible enforcement mechanism that has the confidence of CPs is particularly important in Australia where there are large CPs that would otherwise have significant bargaining power in their negotiations with CRBs, and where we understand that there is currently a lack of confidence and trust in the ability of CRBs unilaterally to enforce reciprocity.
132. We therefore agree with the statement of ARCA in its submission:

Without genuine consequences and sanctions that would affect a signatory's participation, non-compliance may not be viewed seriously and the PRDE would not provide other signatories with assurance of high levels of compliance, particularly in relation to the necessary elements of reciprocity and consistency discussed above.⁸²

⁸¹ For more on these considerations, see the KPMG report, pages 18-21.

⁸² Above note 5, page 27.

4.4. Observations on the arguments of Veda and HoustonKemp

4.4.1. Inconsistent arguments regarding CP incentives

133. HoustonKemp express an opinion that “CPs will have a strong incentive to provide the same positive credit information to all CRBs from which they acquire services”.⁸³ They draw on this opinion to argue that the consistency obligations are not necessary to reduce fragmentation of data. However, they appear to contradict this opinion when expressing concern for small CPs that would prefer to supply positive information to just one CRB and negative information to others.⁸⁴
134. The inconsistency might be explained if the opinion is one that relates only to large CPs, but then the opinion is weakened since it would not apply to small CPs. Even with regard to large CPs, HoustonKemp ignore the potential for CPs to be persuaded to enter exclusive arrangements with a CRB.

4.4.2. Concerns for small CPs

135. Veda and HoustonKemp argue that the consistency obligations (in particular, Clause 15) will have harmful effects on small CPs.⁸⁵ Indeed, this seems to be Veda’s main objection to the PRDE.⁸⁶ Veda and HoustonKemp argue that if the PRDE is authorised, some smaller CPs may not participate in CCR or may deal with only one CRB, due to the costs of having to contribute positive information to multiple CRBs.⁸⁷
136. These arguments rely on an assumption that there are significant incremental costs for small CPs of contributing positive data to additional CRBs beyond the first CRB to which the CP contributes. In our opinion, these incremental costs are not likely to be significant for most small CPs, and if they affect the behaviour of any small CPs, it is only likely to be a small proportion of them. Moreover, we consider that these incremental costs are highly unlikely to have the effect of causing smaller CPs to choose not to participate in CCR, given the significant benefits of CCR for a CP’s credit risk assessments and also the likelihood that responsible lending expectations will come to require the use of CCR. On the contrary, small CPs are likely to benefit from the consistency obligations in a number of ways, including (a) there would be a greater likelihood that they would only need to subscribe to credit reporting information from *one CRB* in order to compete against larger CPs and lend responsibly, (b) they are likely to have *greater choice* regarding which CRB to use as their primary CRB for the provision of credit reporting information and (c) they are likely to benefit from *greater competition* among CRBs. The following sub-sections elaborate on these points.

83 HoustonKemp report, page 11.

84 HoustonKemp report, pages 14 and 15.

85 See Veda submission, page 1 (paragraph 3), page 2 (paragraphs 7(b)-(d)), page 3 (paragraphs 9-11) and pages 9-13 (paragraphs 40-51). See HoustonKemp report, pages 14-17.

86 See, for example, paragraph 3 of the Veda submission, which identifies Veda’s “serious concerns” with the PRDE. These concerns are entirely about small CPs and their ability to compete with large CPs.

87 See Veda, pages 9-13 (paragraphs 40-51). See HoustonKemp report, pages 14-17.

The costs for small CPs of contributing to multiple CRBs

137. The concerns for small CPs expressed by Veda and HoustonKemp are based entirely on an assumption that there are “substantial”, “significant”⁸⁸ and even “prohibitive”⁸⁹ incremental costs for CPs in contributing positive information to more than one CRB.

138. Veda states:

Ideally, smaller CPs would be able to obtain positive data from one CRB and list defaults on three CRBs. CPs may also wish to obtain positive data from one CRB for enquiries, and other “negative services” (for example, negative account management information or pre-screening) from other CRBs (with attendant negative contribution obligations). This behaviour is most closely aligned to their incentives, but is effectively prohibited by the consistency provisions for which authorisation is sought, as the CPs would be required to contribute positive information to all CRBs with which they have relationships.⁹⁰

139. Veda also states:

It is Veda’s position that the consistency obligations in the PRDE impose substantial additional costs on smaller CPs, over and above those they would normally face. The requirement to supply CCR data at the same level to all CRBs (set out in paragraph 15) operates as a disincentive to smaller CPs to participate in CCR data exchange as the costs of providing and maintaining data would be too high.⁹¹

140. HoustonKemp provides further details:

It is possible that some smaller CPs will choose to participate in CCR but will opt to terminate the service agreements they currently have with one or more CRBs following implementation of the PRDE. This is because the up-front and on-going operating costs that small CPs will likely need to incur in fulfilling their obligations to multiple CRBs under the PRDE may be prohibitive. Although the incremental cost of providing the same information (ie, the same raw data file) to each additional CRB is likely to be quite small, other costs associated with dealing with multiple CRBs are likely to be substantial. Such costs include:

- the cost of investing in the infrastructure to establish a connection with the CRB – a connection must be established to each CRB with sufficient bandwidth for the volume of data that is required to be exchanged and storage space for the response files from each CRB; and*
- the cost of testing/validating and correcting or updating this data – under the Privacy Act CPs are obliged to take reasonable steps to provide data that is accurate, complete and up-to-date.*

We understand from Veda that whilst the ARCA data standard supports reporting of updates and corrections to positive credit information, CPs have indicated that they may need to report such information to CRBs via manual CRB-supported means such as the CRB’s website. This is because:

88 See HoustonKemp report, page 16.

89 See HoustonKemp report, page 14.

90 Veda submission, page 2, paragraph 7(c).

91 Veda submission, page 10, paragraph 42.

- *it is not commercially viable to develop data extract software for these updates or corrections; and*
- *the timeframe in which these updates or corrections are required to be provided does not fit within the monthly reporting cycle for the provision of positive credit information.*

Given this, the cost of reporting corrections and updates to two CRB's would be broadly twice the cost of reporting such updates to one CRB. Veda currently issues over [excised] correction notifications per annum to over [excised] credit provider customers under the current negative reporting regime. Under CCR, Veda estimates that it will issue over [excised] notifications per annum. Given the quantum of notifications that a small CP may need to deal with over the course of a year, the requirement to provide this information to more than one CRB will be prohibitive.⁹²

141. Neither Veda nor HoustonKemp provide evidence in support of the assumption that the “ideal” strategy of small CPs would be to obtain positive data from one CRB and list defaults on all three CRBs. While this may be the preferred strategy for some small CPs, it is far from clear that it would be the preferred strategy for all, or even for the majority. Even if it may be a preferred strategy for some small CPs, Veda and HoustonKemp assume that *there will be a CRB with a reasonably comprehensive pool of positive data*. However, the strategy would only be possible in the absence of the consistency obligations, and in that case the likelihood is either an uncompetitive CRB market structure (which would harm small and large CPs) or fragmentation of data across the three CRBs, in which case the preferred strategy of the small CPs may instead be to obtain positive data from *all* CRBs (particularly in light of evolving responsible lending expectations). In short, the Veda and HoustonKemp assumption regarding the “ideal” strategies of small CPs is not internally consistent.
142. Veda and HoustonKemp also do not provide any evidence in support of the quantum of the incremental cost of supplying positive information to additional CRBs, or the proportion that it would represent in a small CP's total costs of CCR.⁹³ Given that a CP would have significant costs of moving to CCR in any event,⁹⁴ the proportion represented by the incremental costs for small CPs of contributing positive information to additional CRBs

⁹² HoustonKemp report, pages 16-17.

⁹³ HoustonKemp assert on page 19 of their report that “the full costs of establishing a connection with [a second] CRB, providing positive information to it and correcting that information over time [...] could be in the region of \$100,000 or more”, but they do not provide any source for that estimate. In any event, the figure is misleading. HoustonKemp are describing the “full costs” for a CP that wants to obtain a “specific value-added service” from the second CRB. A large proportion of this cost is likely to be a cost that the CP would have to incur anyway to obtain that service (with or without the PRDE). The incremental cost of the consistency obligations in the PRDE – i.e. having to supply additional CRBs with the same information as the CP supplies to its primary CRB – is not considered by HoustonKemp, yet that is the relevant cost here. For the reasons explained in the text, the incremental cost of supplying standardised information to additional CRBs is likely to be small.

⁹⁴ We understand that there are significant costs for CPs in moving from negative reporting to CCR. Whereas negative reporting is event-driven when defaults occur, there are likely to be substantial technology costs for CPs in moving to reporting of CCLI and RHI on a periodic (e.g. monthly) basis. These are costs that will be incurred by CPs regardless of the framework that CCR occurs under (whether it is the PRDE or some other system). These costs are likely to represent a higher proportion of revenues for a small CP than for a large CP; however, at the same time, small CPs can anticipate a greater benefit from participation than large CPs as small CPs will gain access to significantly more additional data (beyond their own) than large CPs.

would be a relevant statistic. In our opinion this proportion is likely to be small, and for that reason alone the incremental costs are unlikely to determine a small CP's decision whether to participate in CCR. In any event, given the significant benefits of CCR for a CP's credit risk assessments and also the likelihood that responsible lending expectations will come to require the use of CCR, the incremental costs of contributing to additional CRBs are highly unlikely to have the effect of causing smaller CPs to choose not to participate in CCR.

143. To be clear, there are likely to be significant costs for a small CP of *receiving* credit reporting information from additional CRBs into the CP's systems.⁹⁵ However, the incremental cost of *contributing* positive data to additional CRBs should not be significant for most small CPs.
- a. Given that the information to be provided under the PRDE will be standardised according to the ACRDS standards, once a CP has prepared its information for one CRB, it should be a simple and inexpensive process to contribute the same information to other CRBs. Moreover, CRBs offer solutions that economically transform a CP's data into an ACRDS compliant format.⁹⁶ The CP can then distribute the transformed file to any or as many CRBs as it likes.
 - b. HoustonKemp mention the "cost of investing in the infrastructure to establish a connection with the CRB [...] with sufficient bandwidth for the volume of data that is required to be exchanged and storage space for the response files from each CRB". However, particularly for a small CP, the files that will be contributed and the response files that will be received will not be particularly large (perhaps ten Megabytes per file). Transfers between the CP and CRB should be possible by use of secure file transfers over the CP's existing internet connection (i.e. at no incremental cost).⁹⁷ Storage and backup of data is a trivial issue – small organisations commonly store and backup many Terabytes of data⁹⁸ and storage and backup of that quantity of data is very cheap. Small CPs should already have arrangements in place for storage and backup of a large quantity of data – indeed, storage and backup of the incremental amounts of data due to contributing to multiple CRBs may not even incur any incremental cost.
 - c. HoustonKemp also suggest that "the cost of reporting corrections and updates to two CRB's [sic] would be broadly twice the cost of reporting such updates to one CRB". Our understanding is that, under the ACRDS, most corrections and updates can be contributed electronically in the normal monthly cycle following identification of the

⁹⁵ To receive information from CRBs into a CP's systems the CP must incur significant costs in terms of IT investment to automate the transfer of complicated data fields into specific formats so that the information can be viewed on screens or used in internal data engines. This is not a cost that is affected by the PRDE's consistency obligations, as the consistency obligations only require CPs to *contribute* information to all CRBs with whom they have a relationship – they do not require the CP to *receive* information from all of those CRBs.

⁹⁶ See, for example, Veda's Smartdata solution: <http://www.risk-partnership.com/IRPdocs/Veda-CCR-Reporting-Smartdata.pdf>. According to the brochure at this link, because Smartdata has been "built to the national standard [...] a credit provider can use it to submit data to any credit bureau of their choice". Veda claims that Smartdata "is designed to reduce submission time and processes; as well as promote seamless data sharing between credit providers and credit bureaus".

⁹⁷ This would typically be on the basis of the SSH File Transfer Protocol (SFTP).

⁹⁸ One Terabyte is approximately 1 million Megabytes.

issues. For these corrections and updates there would be no incremental manual requirements and no incremental cost. In any event, there exist third party solutions that offer to help CPs to contribute corrections to multiple CRBs through a single point of contact.⁹⁹ It is true that a CP that contributes data to multiple CRBs can expect to receive multiple response files that detail corrections required by the CRBs. Different CRBs may identify different fields that require correction. Although there may be incremental internal costs for CPs in making additional corrections, ultimately this has the effect of improving the quality of data supplied by the CP, for the benefit of the industry as a whole. The task of aggregating multiple response files and prioritising the most urgent corrections can be outsourced to CRBs or third parties.¹⁰⁰

- d. HoustonKemp also mention the costs of “testing” the data. Although there would be additional costs for CPs of testing their contribution formats with additional CRBs, these are one-off costs incurred at the beginning of the relationship, and again solutions have been developed to minimise these costs.¹⁰¹
144. It is of course possible that *some* small CPs may have a preferred strategy of receiving CCR information from one CRB and contributing negative credit information to multiple CRBs *and* consider that the costs of contributing positive data to additional CRBs (small as they are likely to be, relative to the total costs of moving to CCR) means that they cannot afford to implement that strategy. If such CPs exist, they may decide to have a CCR relationship with one CRB and no relationship with any other CRB (as Veda and HoustonKemp have suggested).
145. However, in our opinion the proportion of small CPs that will be in this position is likely to be small, and the concerns for these CPs expressed by Veda and HoustonKemp should be evaluated with this in mind. Small CPs that would in any event have a relationship with only one CRB will not be affected. Other small CPs that wish to have relationships with multiple CRBs may yet do so, despite additional costs, particularly as these costs are not likely to be significant for most small CPs. Our opinion in this regard is also informed by the submissions received by the ACCC in response to ARCA’s application for authorisation: on the whole small CPs appear to be unconcerned by the consistency obligations.
- a. According to COBA (which represents 72 credit unions, 11 mutual banks and 6 mutual building societies) the majority of COBA members support Clause 15.¹⁰²

99 See, for example, Australian Credit Data (ACD) at: <http://www.australiancreditdata.com.au/#!about/cipy>.

100 For example, according to the brochure for Veda’s Smartdata solution (<http://www.risk-partnership.com/IRPdocs/Veda-CCR-Reporting-Smartdata.pdf>), add-ins allow CPs to “[c]reate reports on the response files that they receive back from each of the credit bureaus. This allows credit providers to prioritise their error-correction efforts.”

101 According to the brochure for Veda’s Smartdata solution (<http://www.risk-partnership.com/IRPdocs/Veda-CCR-Reporting-Smartdata.pdf>) Smartdata can reduce “the time it takes to develop and test” data submissions to CRBs. More specifically:

Smartdata automatically tests the submitted data to help ensure that it meets the formatting requirements. These tests also help to ensure that inter-field relationship requirements in the standards are met (e.g. the account holder was 18 years old on the date the account was opened). This capability helps ensure that the data conforms to the specification before it is sent to the credit bureaus, significantly reducing costs, maximising efficiency – and minimising time.

102 COBA submission, page 2.

Although some members have raised concerns with additional costs imposed on them by the consistency obligations, a number of members have said that any additional costs due to Clause 15 are not significant when compared to the broader costs of participating in positive credit reporting.¹⁰³ COBA also explains that the majority of COBA members currently have a relationship with only one CRB and are likely to continue this practice if Clause 15 is included in the PRDE “because data would be more consistent across CRBs”.¹⁰⁴

- b. The Australian Finance Conference (AFC) represents large and small finance companies. It lists 66 members in its submission and another 97 members of affiliated associations.¹⁰⁵ The AFC has expressed concerns regarding “the complexity involved in participation in the credit reporting system and compliance with its regulatory framework and the impact that this may have on a decision of a consumer credit provider on whether to be a signatory or not”.¹⁰⁶ However, these concerns appear to relate to the costs of complying with the ACRDS standards, the annual funding liability and the risk of breach and sanctions.¹⁰⁷ The incremental costs of contributing information to more than one CRB are not mentioned. Similar considerations would apply to the AFC membership as to the COBA membership. While some may be concerned about the incremental costs of contributing to additional CRBs, others are likely to consider that these costs are insignificant or irrelevant and that they stand to benefit overall from the consistency obligations. Certainly, for those that currently have a relationship with only one CRB (which may, as with the COBA membership, be the majority), there can only be benefits from the consistency obligations.

Small CPs are likely overall to benefit from the consistency obligations

146. Rather than be harmed, small CPs in general are likely to benefit from the consistency obligations in a number of ways. First, there would be a greater likelihood that they would only need to subscribe to credit reporting information from *one CRB* to gain a sufficient picture of the credit risk of consumers in order to compete effectively with larger CPs and lend responsibly. This would reduce the costs of small CPs compared to a situation in which they might need to have interfaces for the receipt of credit reporting information from multiple CRBs, and pay for multiple credit reports in relation to each customer. Second, they are likely to have *greater choice* regarding which CRB to use as their primary CRB, as CRBs will have more consistent databases. The choice may then become more about which CRB provides the best prices and the best services than about which CRB has the most information. Third, *greater competition* between CRBs in relation to price and service is likely to deliver better prices, higher quality and innovations in credit reporting services to small (and large) CPs.
147. Small CPs themselves appear to consider that they will benefit from more comprehensive and consistent data across CRBs and from having less need to obtain credit reporting

103 COBA submission, page 2.

104 COBA submission, page 2.

105 Australian Finance Conference submission, pages 3-6.

106 Australian Finance Conference submission, page 2.

107 Australian Finance Conference submission, page 2.

information from multiple CRBs. As mentioned, the majority of COBA members support Clause 15, and according to COBA this majority agree with ARCA that Clause 15 “will strengthen the quality of credit analytics and lead to more comprehensive and consistent data across the CRBs, benefitting both industry and consumers”.¹⁰⁸ The majority of COBA members also consider that Clause 15:

*would save them money because consistent data across the CRBs will benefit smaller providers who only have one relationship with a single CRB. Without clause 15, smaller credit providers may need to incur additional costs by signing up to multiple bureaus to get a full picture of credit information on record.*¹⁰⁹

4.4.3. Concerns for fragmentation

148. HoustonKemp also argue that the consistency obligations will increase the degree of fragmentation of credit information across CRBs.¹¹⁰
149. As with the concern for small CRBs, this concern rests on the assumption that there are significant incremental costs for small CPs of contributing positive information to additional CRBs. It also rests on an assumption that these costs will lead to substantially fewer CPs contributing negative information to multiple CRBs. As the incremental costs of contributing to additional CRBs are not likely to be significant for most small CPs, and, at most, only a small proportion of small CPs would be likely to be affected, this concern is not substantiated.
150. In any event, there is an inconsistency that arises here in HoustonKemp’s arguments. HoustonKemp argue that if small CPs are discouraged from having relationships with multiple CRBs, there will be fragmentation as Veda, Dun & Bradstreet and Experian will each have access to information from a “different pool of smaller CPs.”¹¹¹ Elsewhere, however, HoustonKemp argue that small CPs that face significant costs of contributing positive data to additional CRBs will choose to have a relationship only with the CRB with the “strongest database”.¹¹² Rather than fragmentation, CRB dominance appears the likely outcome if HoustonKemp’s arguments are to be consistent. The CRB that has the strongest database will be able to offer a comprehensive set of information to large and small CPs.

4.4.4. Concerns for small CRBs

151. Veda and HoustonKemp also argue that the PRDE will increase barriers to entry and expansion for small CRBs.¹¹³
152. Again, this concern depends on the assumption that there are significant incremental costs for small CPs of contributing positive data to additional CRBs, and the further assumption that these costs will cause a large number of small CPs to cease contributing negative data

108 COBA submission, page 2.

109 COBA submission, page 2.

110 HoustonKemp report, page 20.

111 HoustonKemp report, page 20.

112 HoustonKemp report, pages 18 and 20.

113 Veda submission, pages 13-14. HoustonKemp report, pages 13 and 20.

to multiple CRBs, reducing the available market for small CRBs. Again, as the incremental costs of contributing to additional CRBs are not likely to be significant for most small CPs, and, at most, only a small proportion of small CPs would be likely to be affected, this concern falls away.

153. When arguing that the consistency obligations will raise barriers to entry and expansion for “small CRBs” HoustonKemp exclude Dun & Bradstreet and Experian, despite Experian, in particular, having a very small share of the market at the moment.¹¹⁴ HoustonKemp appear to accept, however, that barriers to entry are already very high for CRBs.¹¹⁵ The ACCC has previously found that once there are three CRBs in the market there is limited scope for any further new entry as the market will already will have obtained a “critical mass” of CRBs.¹¹⁶ In that context, the concern for further entry and expansion beyond Veda, Dun & Bradstreet and Experian therefore seems a minor concern for an assessment of public benefits.
154. The smallest nationwide CRB (Experian) has expressed its support for the PRDE and the consistency principles in particular.¹¹⁷ We understand that there is currently one other CRB in Australia at the moment: the Tasmanian Collection Service (TASCOL).¹¹⁸ ARCA has informed us that TASCOL's credit reporting business is focused on only the negative data that it gathers as part of its debt collection business and that it does not intend to transition to CCR (regardless of the consistency obligations). Concerns for TASCOL would therefore seem misplaced.
155. It is also worth observing that, if one accepts that the additional costs to CPs of contributing positive data to multiple CRBs are not significant and are, at most, likely to affect the behaviour of only a small proportion of small CPs, then small CRBs stand to benefit from the consistency obligations if Veda and HoustonKemp are correct in suggesting that small CPs “ideally” would like to have relationships with multiple CRBs regarding negative data. If small CPs have these incentives, then a small CRB will benefit from the consistency obligations as the consistency obligations will require those CPs to supply the small CRB with the same amount of positive information as they supply to their primary (large) CRB. This will be far more valuable to a small CRB than a relationship that involves only the contribution of negative data.

4.4.5. Veda's motivations for opposing the consistency obligations

156. The focus of Veda and HoustonKemp on the effects of the consistency obligations on small CPs and small CRBs is puzzling given that these concerns appear altruistic from Veda's perspective. Indeed, according to its own arguments Veda would be likely to *benefit* from the consistency obligations. For example, Veda argues that the “most likely” result of the consistency obligations will be that small CPs will choose to have a relationship with only

114 According to the Dun & Bradstreet submission (page 1), Dun & Bradstreet has a market share of 14% and Experian has a market share of just 1%.

115 See HoustonKemp report, page 20.

116 See ACCC (2011), *Public Competition Assessment: Experian Australia Credit Services Pty Ltd – proposed joint venture*, 19 September 2011, page 9, paragraphs 46 and 51.

117 Experian submission.

118 See <http://www.tascol.com.au/credit-reporting/>.

one CRB¹¹⁹ and that this would be the CRB with the “strongest database”.¹²⁰ This is most likely to be Veda. The consistency obligations would also work to Veda’s advantage if, as Veda and HoustonKemp argue, they were to raise barriers to entry and expansion by small CRBs.¹²¹

157. In our opinion, a more likely motivation for Veda opposing the consistency obligations is a concern that the consistency obligations will tend to constrain Veda’s ability to transfer its dominant position in negative credit reporting information into a dominant position in CCR (as we explained in Section 4.2).

4.4.6. Conclusion on the costs and benefits of the consistency obligations

158. In our opinion, when balancing the incremental costs to CPs of contributing positive information to additional CRBs (which are unlikely to be significant except possibly for a small proportion of small CPs) against the risks of an uncompetitive market structure or fragmentation, the public benefit lies with the consistency obligations.

119 Veda submission, pages 11 and 12, paragraph 46 and Figure 3.

120 Veda submission, page 14, paragraph 52(a)(ii). See also the HoustonKemp report, pages 18 and 20.

121 Veda submission, pages 13-14. HoustonKemp report, pages 13 and 20.