A new relationship with consumer credit

Australia's relationship with consumer debt (mortgages and other credit) presents a conundrum. Its dramatic growth over the past decades has been one of the engines powering our economy, stimulating money creation, consumption and wealth accumulation.

Unfortunately, this is not fundamentally what consumer credit is for. At a basic level, its purpose is simply to help borrowers balance the peaks and troughs of income and expense. Macro-economic stimulus is corollary, and ours has come at a cost. Household balance sheets are stretched to unprecedented levels.

Yet we don't quite know what to do, or what might happen to the economy if it all stops. So we keep going – finessing challenges as they emerge, whilst trying to avoid mistakes. Of course we could do worse, and many of the world's economies do. But we can also do better, and that leads us to revisit the industry's basic, fundamental purpose.

In the housing credit market, lenders have the opportunity to move away from the sales-focused paradigm of market share and growth. Home lending requires better risk selection, streamlining and efficiency. For non-housing credit, there is room to undo decades of adverse selection and bring low-risk customers back into the market, but only with a different proposition and economic model.

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This will require changes to business models, offer and customer experience to make them, as we recommend, simpler, smaller and more deeply connected to customers' lives:

- **Simpler:** Many lenders could benefit from drastically reducing the products they offer, the features from which customers may choose, and the variety of fees they charge. Simpler products resonate with customers, and help distributors understand, accurately explain and confidently recommend products. More transparent risk profiles can help lenders price more accurately, improving economics and enabling investment back into an improved customer proposition.
- **Smaller:** Households need to become less leveraged, which will likely require a mortgage market to be smaller, or at least grow only modestly for a long time. Lenders can reinforce existing muscle in the fundamental banking disciplines of risk selection, pricing and portfolio management, and especially cash flow analysis. However, if there is room for material growth, it may be in non-mortgage consumer credit. The evidence of adverse selection suggests there may be an unserved segment of low-risk customers who would value the convenience of amortising large one-off expenses if the cost were not prohibitive.
- **More deeply connected:** A deeply connected credit provider delivers a compelling experience to customers, building engagement, traffic and volume. Data-driven insights about customer behaviour, preferences and constraints can be used to further optimise service delivery, reduce cost, and invest the savings back into the customer experience.

Behavioural economics also needs to inform each touchpoint with customers, creating products that work with human decision-making processes and for the customer's own benefit, rather than anyone else's.

This report addresses each of these points, which are summarised in Exhibit 1.

Interested in reading more?

Continue reading our Hot Topic publication here.

Exhibit 1: The future of consumer credit in Australia

Where are we at?

01

Four key drivers of change

- Macro-environment constraints
- Responsible lending
- Data and technology
- New competition

What does this mean?

02

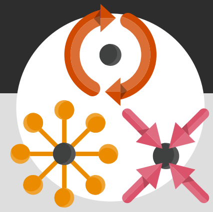
Opportunities for housing and non-housing

- House lending requires greater risk selection, streamlining and efficiency
- Non-housing consumer lending offers reasonable growth opportunity

The way forward

03

The credit industry we really want



- Simpler
- Smaller
- More deeply connected