Demystifying Veda Score 1.1

Have your clients hit a wall through credit scoring? *John Dickinson* from Clean Credit explains the ins and outs of how much these scores can mean

How is it that a seemingly insignificant credit listing can stop your client from getting a loan?

It can be difficult to accept that something as small as a paid default to a phone carrier listed years ago can still have the capacity to cause so much trouble for people trying to secure credit. After all, such a listing may not at all represent your client's current financial position or reflect an appropriate risk profile.

To better understand this we need to look at how credit scoring actually works.

Veda Advantage, Australia's largest credit reporting agency, has made significant changes to how a credit report is presented and in turn assessed by credit providers. One such change is known as Veda Score 1.1 and in its most basic form relates to an overall credit score that is affected by a person's credit activity and behaviour. Everything from credit enquiries, credit applications and even change of address can affect a person's credit score.

Veda's Score 1.1

The real purpose of the Veda Score 1.1 is to provide to a potential credit provider a single highly visible means of assessing risk. Credit scores begin at -200 and finish at 1,200; the lower the score the higher the risk is considered to be.

According to Veda Advantage, a credit score of 200 represents odds of 1:1 which means the applicant has a 50% chance of having an adverse event on their credit file within the next 12 months. For every additional 100 points, the odds double, meaning the applicant has less chance of having an adverse event on their credit file.

This chart reflects how Veda Advantage relates a credit score to risk:

Veda Score 1.1	Good:bad odds	Chance of adverse event in the next 12 months
100	0.5:1	67%
200	1:1	50%
300	2:1	33%
400	4:1	20%
500	8:1	11%
600	16:1	6%

Let's take a close look at this. Say your client has a credit score of 300; according to this scoring system they have a 33% chance of having an adverse credit event in the next 12 months. Even a credit score of 400 still reflects a 20% chance. Where do you think a credit score would need to be close to before a credit provider starts saying yes?

I'm sure many of you are thinking that a person would have to have a terrible credit history to have a credit score of around 300, but think again.

Let's look at a real example. A person has a credit score of 390 that is due primarily to a small, paid telecommunication default recorded two years ago. According to the Veda Advantage credit scoring system, this score indicates to a credit provider that this person has over a 20% chance of having an adverse credit event in the next 12 months. Do you think this person would have trouble getting approved? You bet.

To demonstrate what affect even a small credit issue can have on a credit score, what will happen after the same default is removed from the credit report? The credit score moves from 390 to 577. That's 187 points, and most importantly to a credit provider the risk of this person having an adverse credit event in the next 12 months has moved from over 20% to well under 10%. That's all that is required to turn a decline into an approval.

Applying the score

The purpose of this exercise is not to demonstrate that in the right circumstances negative credit listings can be removed from a credit file, but to show you the affect that even one small, seemingly insignificant credit event can have on a person's credit score.

I'm sure that many credit providers themselves feel the way credit scoring operates is a broad brush approach and as a result many people don't qualify for finance when in reality they would prove to be reliable and credit worthy. The reality is that credit providers subscribe to organisations such as Veda Advantage to help them determine risk, and not applying these principles to their risk assessment processes would defeat the purpose from their perspective. Given this, credit scoring and the problems it can produce are a fact of life and are very much here to stay.

I hope this helps you to better understand how credit scoring operates and why what may appear to be an insignificant credit event can cause so much trouble for you and your clients.

John Dickinson is the director of Clean Credit, a member of the newly-launched Credit Repair Institute of Australasia (CRIA).

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SCENARIO CENTRE

▶ Want to be a hero? You can, with a 'construction rescue'

Every day, people start building without finance approved only to run short of funds towards the end of the construction. What follows is often a financial nightmare as they discover that traditional lenders are reluctant to lend on incomplete residences. However, MKM Capital says when this scenario does crop up, there are options available for residentially-secured, end-stage construction projects.

Operations and marketing manager Michael Watson says the lender has a 'Construction Rescue' package designed just for these types of client situations. "Basically, if the construction has reached fixing stage, which is around 90% complete, MKM will lend against the 'as is' value. If construction is not this far progressed, we will still lend against the underlying land value," Watson explains.

Options available in such scenarios are often dire. They include selling the incomplete property at a significant discount, extending the construction period for months or years to complete the construction using cash-flow, or entering into a joint venture to construct for a share of end profits. Watson says the MKM product can be owner-builder, low-doc, as well as non-conforming and credit impaired, capturing a wide market that the majors won't touch.

"Provided they can service the end debt, it's NCCP compliant in every way," he says. For clients in tricky situations, the 'construction rescue' could be the lifeline that clients need.

"These borrowers are highly motivated to complete the property and will sell or refinance immediately after it is complete. I'm not aware of any other lender willingly operating in this space. Brokers have told us this is the kind of solutions-based lending they need," Watson says.

Ezy Capital broker Matthew Watts says being able to put clients into the MKM facility, complete the property and then refinance is "very satisfying"."The client achieves their goal, and we've assisted them with a transaction they'd thought was impossible," he says.