

> **BRYAN O'CONNELL FAIBF** IS MANAGING DIRECTOR OF B@NKFIN CONSULTING PTY LTD A COMPANY WHICH SPECIALISES IN PROVIDING STRATEGIC AND MARKETING CONSULTANCY SERVICES TO BANKS, FINANCIAL SERVICE PROVIDERS AND INFORMATION TECHNOLOGY COMPANIES. EMAIL [bryanoc@aibf.com](mailto:bryanoc@aibf.com)



# GIVING CREDIT WHERE CREDIT'S DUE

THE FACE OF CREDIT REPORTING IS CHANGING RAPIDLY AND MUCH OF IT HAS TO DO WITH THE INCREASING RELIANCE OF BANKS AND OTHER CREDIT PROVIDERS ON CREDIT BUREAUS TO PROVIDE SOPHISTICATED SERVICES, SAYS BRYAN O'CONNELL.

Like the overall banking and financial services industry, credit reporting services and bureaus have gone through a metamorphosis as banks and financial service clients demand better products and a higher level of service.

Credit reporting services, which are provided through independent credit bureaus, are crucial for financial service providers in providing credit facilities to their customers.

The demands on these bureaus are growing rapidly, consolidation is taking place and new challenges are emerging. Their services must be highly sophisticated, accurate, instantaneous, technologically advanced and have scale capability.

Two of the largest providers of these services in Australia and New Zealand, Data Advantage and Baycorp NZ, have recently merged to form the largest provider of credit reporting and related services in the region.

There have been a number of changes in credit markets that have affected both credit and service providers. These include increased regulation such as the Uniform Consumer Credit Code and the Privacy Act, the propensity of consumers to deal in credit for household and other needs, the use of technology in the credit process and the financial institutions' greater focus on credit management.

Today, the credit market is creating concerns for banks, with ramifications for credit reporting services and bureaus. The biggest worry is the stress being placed at the margin on households as Australians gear up with their borrowings to higher global levels.

This is particularly the case with unsecured personal and credit card lending, says Westpac general manager consumer risk Chris Smith.

"The consequence is that that the bank places more reliance on the credit bureau, although not solely, to provide meaningful information about customer behaviour and in order to discharge its responsibilities under Section 70 of Uniform Credit Code" says Smith.

According to Keith McLaughlin, chief executive of the newly merged group Baycorp Advantage, many of the changes have resulted in a significant maturing of the market place and the acceptance of credit as a way forward.

"The role of the credit bureau is to act as a trusted intermediary between credit providers and the general public - it is a custodian of private and confidential information," he says.

"In addition, the bureau provides the capability for credit providers to assess risk, make better business decisions and it creates liquidity in the financial sector and the economy."

McLaughlin believes there are two types of consumers: "those who believe that they should have what they want today and pay for it over a period of time and those who say, we won't have it until we have saved up the money to pay for it."

"There has however been a strong swing away from the latter to the former as consumers take comfort from the fact that interest rates and inflation are under control."

It seems that many consumers want the immediacy of having consumer items today rather than having to wait for their savings to pay for what they want. Credit therefore has become a commodity rather than an exception.

"In addition, there has been a migration of credit," McLaughlin says. "Hire purchase and the use of security over household furniture was dominant ten years ago, but today we see more unsecured lending, particularly with commodity items.

"Also, we have seen an increase in the use of credit cards and loyalty cards which allow consumers to gain diversity and immediacy of credit."

However, as Westpac's Chris Smith points out, there are some misconceptions about credit card lending growth relative to mortgage lending.

"The statistics show that as a proportion of household indebtedness and of household income servicing, the main growth in indebtedness has been in mortgage lending," he says.

Whatever the form of credit, however, the indebtedness trend has driven the demand for credit reporting services through bureaus. Answers must be given upon request and they must enable banks and financial institutions to make very quick and accurate decisions.

### What banks need

The needs of today's market goes well beyond the provision of credit files. The emphasis is now on integrated systems to address a broad range of business issues, all supported by technology and automation.

For banks, accuracy of the data is an absolute key requirement and goal. The institution must be able to find out about the existence of other obligations that the borrower may have, as well as when customers have paid off their borrowings in the past.

To date, Chris Smith says that credit information, whilst quite good, tends to have been incomplete as it is based only on negative information about defaults, rather than including evidence of a customer's good behaviour. In fact, under Australian laws, credit bureaus are only allowed to provide negative information - they have no ability to include positive behaviour information.

In addition to being accurate, Chris Smith says, the information must be timely and provided electronically and automatically on request. In the future, it is expected that banks will demand fully automated, self-service credit. For example, when the customer applies for a limit increase on his credit card, the system will assess the credit score and risk, dial out to the credit bureau to get a credit report, make other checks and give the answer.

According to Keith McLaughlin, Australia and New Zealand have adopted value-added services such as decision-making and scoring tools to meet client demands for more intelligent data.

"Credit reporting is just the core product, the market is now looking for the smarts that we add to facilitate quick decisions on their behalf and reduce the cost of approval," he says.

McLaughlin says financial institutions need the bureau to be flexible enough to serve them in any location.

"Essentially they want one interface to a regional player that can provide consistent speed and information, that will go through their decisioning tools irrespective of where the customer is residing," he says. "This is what drove the merger between Data Advantage and Baycorp NZ."

Technology is another key requirement. Chris Smith likens the technology requirements to an EFTPOS network - both sides must be automated, with the data sent in a standardised message format from the bureau's electronic file to the bank.

McLaughlin agrees on this need for consistency. "We are an organisation that listens and responds to our clients' needs and issues. Increasingly, we are able to deliver information in a wide range of ways to better match the specific needs of our clients and provide them with added value for money. We also look to provide a more efficient and effective means of assessing risk," he says.

### Moving to positive reporting

In Australia, privacy laws mean that credit providers can only provide information about an individual's defaults, that is, negative reporting. Westpac's Smith believes the term positive reporting is an anathema to the privacy lobby and believes the



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industry will make no progress to change the law if that term is used - rather the focus should be on ensuring the information is accurate by including the ability to report good behaviour.

However, positive reporting has been successfully implemented in a number of other countries, so expect it to emerge on the agenda for future privacy law reform.

Some of the positive reporting issues were raised recently by Dr Michael Staten, director of the Credit Research Center at Georgetown University's McDonough School of Business in Washington DC. On a recent visit to Australia, Staten claimed Australian lenders and consumers were missing out on significant benefits by not utilising positive reporting.

Staten says that based on results of credit bureaus in the US, the more information available about a borrower's current and past credit profile, the greater the ability of the scoring models to separate the good risks from bad.

Many studies have demonstrated restrictive reporting environments make it harder to make the right decisions. Borrowers and lenders are constrained in their activities and this ultimately impairs the growth in consumer spending and consumer manufacturing industries.

Keith McLaughlin says that positive reporting is almost universally accepted and is a powerful tool that benefits both the credit provider and the consumer.

"A good positive profile is a very valuable asset - you can go out and buy what you want without having to go through a lot of checks," he says. "It enables credit providers to recognise and reward good customers and to avoid cross subsidisation."

"At the moment there's a heavy amount of cross subsidisation - that is, good payers get no preferential payment over someone who is continually in default."

"Positive reporting will enable credit providers to tailor products and pricing to customers of value to their organisation."

### **Kiwis lead the way**

New Zealand is now legally in a position to undertake positive reporting. However, the experience so far is that credit providers are reluctant to share positive data with third parties, probably because organisations have invested heavily in identifying creditworthy customers.

McLaughlin believes the reasons for this are that it is new and clients just aren't used to it. They also question the motive in disseminating such information. The key message is to reassure them that sharing positive data will create greater value for their business, he says.

Ultimately, the regulatory and other hurdles should melt away once the benefits are realised. Institutions exposed to the northern hemisphere markets which are used to sharing positive information should be the first to appreciate the benefits and be more likely to push for changing the law in Australia.

Developments in Asia are also likely to put pressure on a change in Australia where many countries allow positive reporting according to David Grafton executive director of Baycorp Advantage. In addition, Grafton believes that a number of these countries are accelerating the development of their credit reporting services and there is a risk in the future that they will move ahead of Australia and New Zealand.

### **Bridging the Tasman and beyond**

One of the growing issues for major banks and financial service providers is the fact that their businesses straddle the Tasman. One answer to this is to establish a TransTasman bureau providing a seamless service. As the population

becomes more transient, there is a need to meet this trend by providing increasingly streamlined consumer credit reports.

"Clearly, credit providers want to grant credit to good risks," McLaughlin says. "If we can establish a good risk, irrespective of where customers have been living for the last four years or how often they have moved, we can add value."

Despite the advances, credit bureaus will need to be more proactive and anticipate their bank clients' needs than they have in the past. It is clear that banks and financial institutions are looking for consistency across geographic regions and that there is a need to cater for the changes in their structures.

In the meantime, banks will keep the pressure on credit bureaus to keep building their skills and broaden the services that are required to meet the growing complexity and demands of credit reporting. ■

# Baycorp Advantage Profile

## **Manage the risk, manage the profit**

Customer management is now recognised as an important risk management issue. Only by knowing:

- > who you want to transact with and why;
- > setting up appropriate terms of trade;
- > understanding how that customer is likely to behave;
- > monitoring their actions; and
- > having debt recovery mechanisms in place

can you expect to gather and protect the best returns from every relationship you enter into.

Baycorp Advantage unites two of Australasia's most important business support companies: Baycorp, the leading information solutions and debt recovery provider in New Zealand; and Data Advantage, the leading supplier of credit-related decision support services, data and software in the Asia-Pacific region.

The new company offers you access to the largest and most sophisticated single source of business intelligence in Australia and New Zealand. We are committed to assisting you to liberate the potential of your business through market leading combinations of information and technology.

