



Credit Reporting Systems: State of Development Worldwide and Insights for Latin America

WHCRI Launch Workshop

CEMLA Headquarters
Mexico City, Mexico
August 24-25, 2004




Margaret Miller
Senior Economist
Financial Sector Network

1



World Bank Work on Credit Reporting

- Legal reform
 - ▶ Legal framework for credit reporting, bank secrecy, consumer protection
- Regulatory Reform – effective regulation
- Public Credit Registry Data for Bank Supervision, relevance for Basel II
- Promoting Credit Information for Marginal Borrowers
 - ▶ Small and Medium Enterprises
 - ▶ Microfinance
- Public Database Modernization
- Education and Outreach (consumers, judiciary, media)



World Bank Research on Credit Reporting Systems

- **Surveys of public and private credit registries worldwide, survey of financial institutions regarding their use of credit information – ongoing starting from 1999. Information available in Doing Business publications & our website.**
- **Book “Credit Reporting Systems and International Economy” edited by Margaret J. Miller, MIT Press, 2003. Now being translated to Chinese & Spanish.**
- **Research in 2004 includes: bank secrecy & credit reporting, microfinance & credit information sharing, credit reporting & financing constraints, value of sharing information on SME loans, use of information in credit registries for Basel II.**

http://econ.worldbank.org/programs/credit_reporting/ ₃



Credit Reporting Systems

Presentation structure

- **The Role of Credit Reporting Systems in Financial Markets**
- **Public vs. Private Credit Reporting**
- **Elements of a Robust Credit Reporting System**
- **Conclusions**



The Role of Credit Reporting Systems in Financial Markets

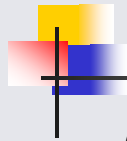
5



The Role of Credit Reporting Systems in Financial Markets

- Reduce asymmetric information between borrowers and lenders
- Allow lenders to more accurately evaluate risk and avoid adverse selection
- Strengthen incentives for borrowers to repay, reducing moral hazard
 - ▶ Increase the cost of default
 - ▶ Provide an incentive for good borrowers: Reputation Collateral

6



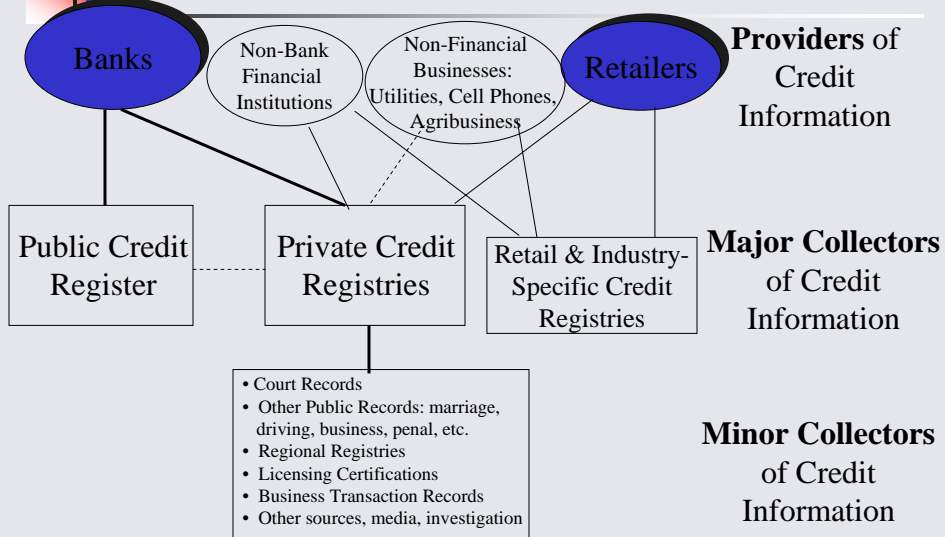
Financial Information Infrastructure: Primary Institutions & Sources of Data

- Consumer Credit Reporting Firms & Registries
- Commercial Credit Reporting Firms & Registries
- Corporate Registries
- Ratings Firms
- Microfinance Credit Bureaus
- Industry Specific Databases (insurance, property management, utilities, cell phones, agricultural commodities, etc.)
- Other Public Data (public databases, Chambers of Commerce / Better Business Bureau, media)

7



Organization Chart for a Credit Reporting System



8



Information in credit reports

- The heart of the credit report is the detailed payment history it provides
 - ▶ Positive payment history empowers good borrowers, creates reputation collateral
 - ▶ Negative payment data encourages honoring obligations

Lender	Account No.	Date Opened & Date Reported	Credit Limit & Past Due	Payment History
B of A	XXXX	1-1-2000 6-1-2004	\$5,000 \$0	30 day - 1

9

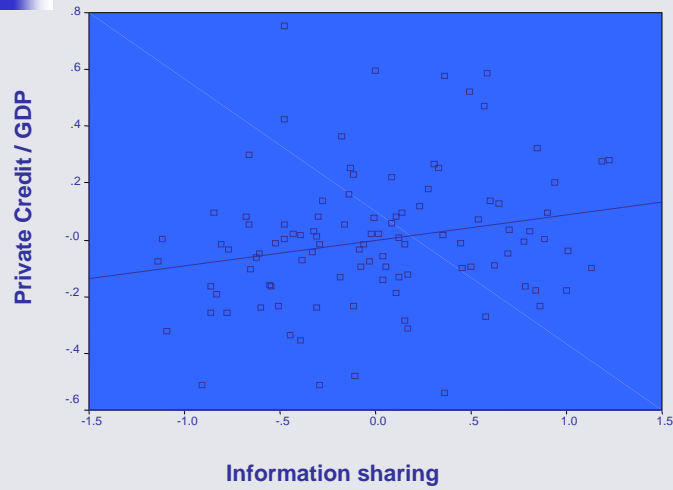


Empirical Evidence of the Importance of Credit Registries for Credit Markets

- Jappelli & Pagano (1999)
 - ▶ relationship between registries characteristics (age, type of data) and credit / GNP
- Barron & Staten (2003)
 - ▶ greater availability of information reduces default rates, improves access to credit
- Kallberg & Udell (2003)
 - ▶ data from D&B has greater predictive power than firm financial statements
- Love & Mylenko ('03), Galindo & Miller ('01)
 - ▶ Firms in countries with better credit information are less credit constrained – rely less on internal funds

10

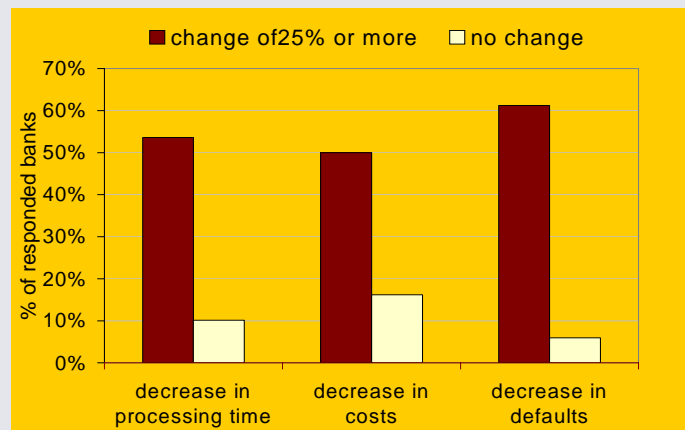
Macro view: Credit information sharing expands lending



Note: Charts are partial scatterplots controlling for GNI, growth, inflation, rule of law, legal origin. Relationships are statistically significant at 5% level. Source: Doing Business project, International Financial Statistics

11

Banks: Efficiency gains from using credit registry information

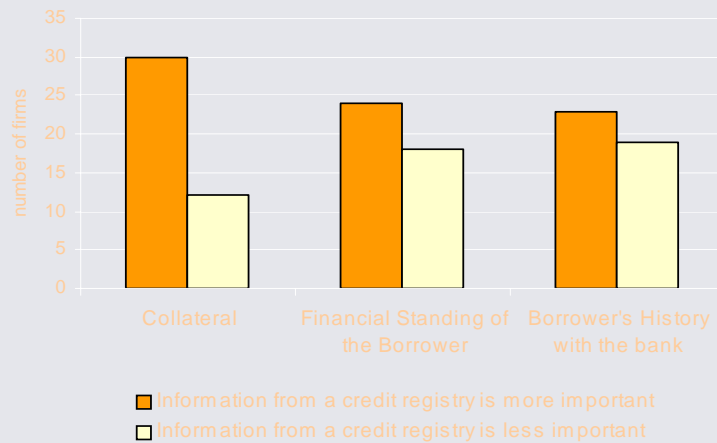


Based on the results of 2001-2002 survey of banks in 34 countries, World Bank

12



Banks: importance attached to credit reporting

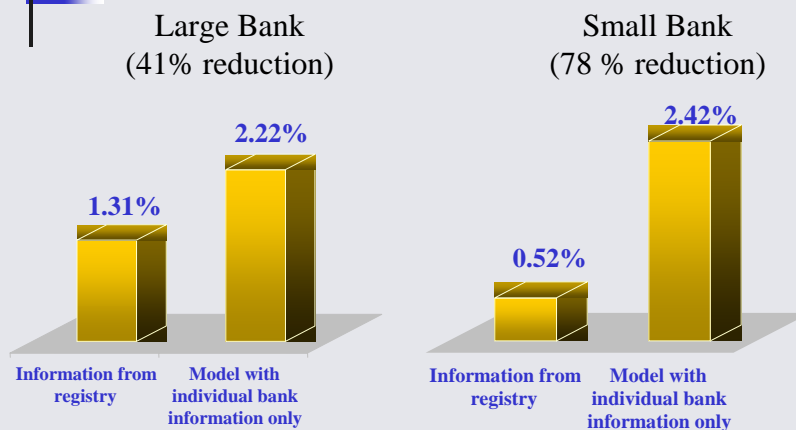


*Based on survey of banks in Latin America 1999-2000, World Bank

13



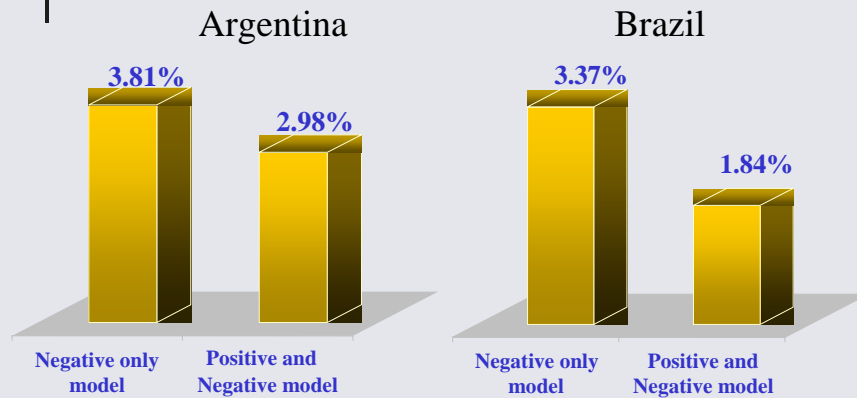
Banks: Credit bureau data reduces default rates



Estimates are based on information on large loans from public credit registry in Argentina for a selected large and a small bank. Graph represents predicted default rates at 40% approval rate. Based on Majnoni, Miller, Mylenko and Powell (2003) "Public Credit Information Systems: Evaluating Available Information" World Bank

14

Banks: Use of positive information results in lower default rates



Estimates are based on information on large loans from public credit registries in Argentina and Brazil. Graph represents predicted default rates at 60% approval rate. Based on Majnoni, Miller, Mylenko and Powell (2003) "Public Credit Information Systems: Evaluating Available Information", World Bank

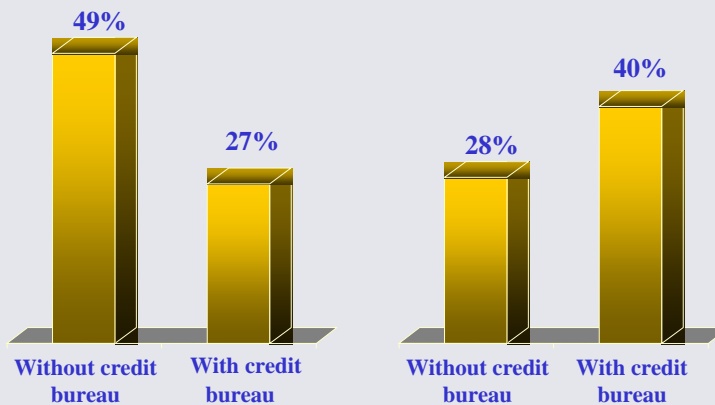
15

Firms: Private credit registries reduce financing constraints

Estimates based on data from 5000 firms in 51 countries

% of small firms reporting high financing constraints

Probability of obtaining a bank loan for a small firm



Source: Love and Mylenko (2003), full text available at http://econ.worldbank.org/programs/credit_reporting/

16

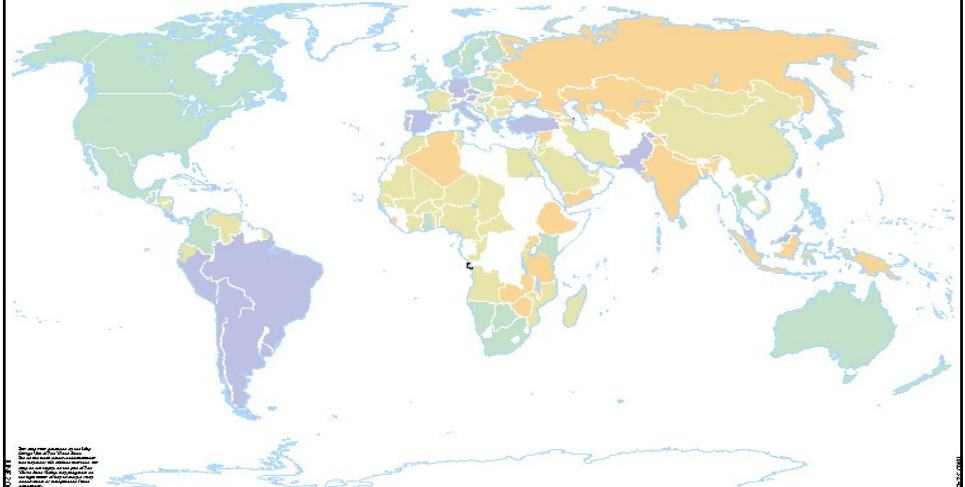
Comparing Public and Private Credit Registries



Today credit registries operate in over 100 countries

PRESENCE OF CREDIT REGISTRIES

- BOTH PCR AND PRIVATE CREDIT REGISTRY EXIST
- ONLY PCR EXISTS
- ONLY PRIVATE REGISTRY EXISTS
- NO PCR OR PRIVATE REGISTRY EXISTS
- NOT IN THE DOING BUSINESS SAMPLE



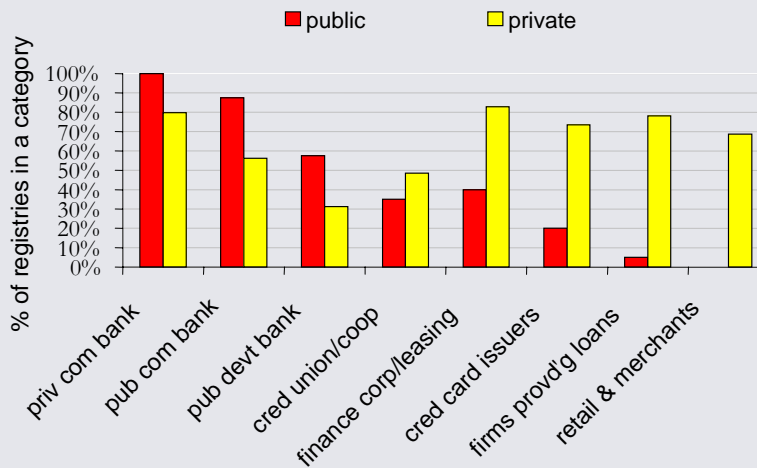
© 2005 International Country Guide Ltd. All rights reserved. This publication is intended as a general guide only. It is not intended to constitute an offer of any financial product or service. It is not intended to be relied upon as a basis for investment decisions. The information contained herein is subject to change without notice.

Public vs. Private Credit Registries

<u>Feature</u>	<u>Public</u>	<u>Private</u>
Purpose	Bank supervision & credit checks for lenders	Credit checks for lenders
Source of information	Supervised institutions (banks)	Varied sources (banks, retailers, telecoms)
Participation mandatory?	Yes	No
Positive Info?	Yes	In some cases
Minimum loan size	In some countries	No
Fee for service	No charge or minimal charge	Yes
Basis for operations	Government Regulation	Contract

19

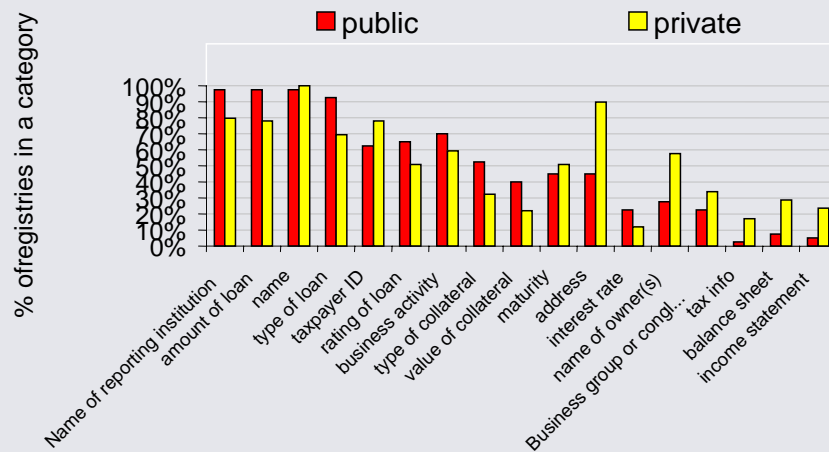
Who submits information to public and private registries?



20



Firm data collected by public and private registries




21



Comparing Public and Private Credit Registries

- Data sources are typically more limited for public registries, distribution of data is also more limited
- Public credit registries have fewer resources (staff, funding, technology) than private credit reporting firms
- Public credit registries do not offer value-added services such as credit scoring
- Public credit registries offer limited consumer attention

22



Comparing Public and Private Credit Registries

- **Public credit registries (PCRs) can compel banks to report, including even positive data – especially important in economies with concentrated financial systems**
 - ▶ **Public credit registries can assemble a more complete picture of credit in the regulated financial sector**
- **PCRs can operate where the legal environment is inhospitable for private ventures**
- **PCRs may engender additional confidence, depending on country experiences**
- **PCRs provide data for bank supervision**


23



Emerging elements of “good practice” Public Credit Registry (PCR)

- **Clear objectives for PCR**
 - ▶ **consult with financial institutions, private credit reporting firms**
- **Complement, not compete, with private firms**
- **Focus on larger loan sizes**
- **Provide customer service if data is distributed to financial system**

24



III. Emerging elements of "good practice" Public Credit Registry (PCR)

- Rating policy carefully considered
 - ▶ syndicated loans should have uniform rating
 - ▶ small loans don't require monthly rating for PCR
 - ▶ requiring all loans by a borrower to have the same rating can mask differences in loan types, quality
 - ▶ distribution of ratings to financial system can create perverse incentives

25



Elements of a Robust Credit Reporting System

26



Reviewing the Elements of a Robust Credit Reporting System

- Providers and users of credit data
 - Credit reporting institutions (both in the public and private sectors) and credit reporting industry structure
 - Quality of the data, public data availability
 - Legal framework for credit reporting
 - Regulatory framework for credit reports
 - Use of credit information for bank supervision
 - Consumer outreach & education

27



Providers and users of credit data

- Commercial Banks and other regulated financial institutions
- Non-bank financial intermediaries
 - ▶ credit card issuers, insurance firms, automobile finance companies, mortgage lenders/guarantors
- Retailers (appliance retailers, other stores)
- Firms providing business-to-business credit, trade credit
- Microfinance institutions
- Other businesses which provide goods or services on credit (utilities, cell phone providers, agribusiness, etc.)

28

Providers and users of credit data

- What is the financial market structure?
 - ▶ How concentrated is the banking / financial sector?
- What are the main financial sector products?
 - ▶ Are banks lending to a broad spectrum of the population? Do they offer varied products & services?
- What are the most important non-bank sources of finance? How are these changing?
- In the real sectors of the economy, what are the most important sources of financial services and credit? Are there special industry credit services?
- What role does microfinance play?

29

Institutional Arrangements for Private Credit Registries

Institutional Type	Pros	Cons
Private firm w/no bank ownership	All types of data, independence	No automatic access to data
Private firm w/ bank ownership	All types of data, Special access to bank data	Independence may be questioned
Bank association	Access to bank data, integrity	Only bank data, only bank access
Chamber of Commerce	Retail & non-bank data, broad cover, historical record	No bank data, Limited funds for modernization
Commercial & credit insurance firms	In-depth data on commercial sector	Limited coverage, High cost per entry
Industry-specific databases	In-depth data on single sector	Lmtd. Scope – can't cross-check data

30



Quality of the Data Collected

- Open system, not a closed network
 - ▶ Majority ownership by a limited group of lenders will discourage a broader database
- Collect both positive & negative information
- Maintain data for a reasonable time frame – 5 years minimum
 - ▶ do not delete negative data when debt is repaid

31



Quality of the Data Collected

- Data should be inaccessible after a certain amount of time
 - ▶ time limits may vary by size of loan, type of inquiry
- Credit reports should not include highly sensitive information such as political or religious affiliation, etc....
- Other identifying information, such as gender, should be evaluated more carefully

32



Quality of the Data Distributed

- Integrity and transparency are paramount
 - ▶ special standing of any group, including owners or government, will discourage participation
- Open system preferable, reciprocity not necessary
- Access to more detailed information preferable
 - ▶ loans described individually, not aggregates
 - ▶ institutions providing credit identified
- Restrictions to prevent “cherry-picking”
- Distribution reflects privacy considerations

33



Legal framework for credit reporting

- Legal framework should encourage information sharing among lenders
 - ▶ Provide legal clarity regarding acceptable information sharing practices
- Consideration of privacy issues important
 - ▶ broad privacy or data protection laws may unduly limit credit reporting – **balance privacy with economic impact of limiting access to data**
- Competition policy aspects of credit info.

34

Consumer Protection

- Borrowers should have access to their own data
- Notice of adverse actions based on report
- Record who has accessed data as part of report
- Consumer-friendly procedures in place to challenge erroneous information in reasonable time frame
- Clearly established privacy policy

35

Consumer Rights Regarding Personal Data

	Argentina ¹	Brazil ²	Chile	Colombia ³	Mexico	Peru	U.S.	E.U.
Access to Information								
From credit bureaus	X	X	X	X	X	X	X	X
From any public or private data controller	X	X	X	X	--	X	--	X
The cost and time of delivery is regulated (at least for credit bureaus)	X	X	X		X	X	X	X
Correction of Information								
From credit bureaus	X	X	X	X	X	X	X	X
From recipients of information or creditors	X	--	X	--	X	--	X	X
From public or private data controllers	X	X	X	X	X	X	X	X
Recipients of reports listed	X	--	X	X	X	X	X	X
Right to be excluded from marketing lists	X	--	X	--	X	--	X	X
Regulation of consumer rights in cases of adverse actions	X	--	--	--	X	X	X	X

36



Regulatory framework for credit reports

- Regulatory framework usually weaker than legal framework in developing countries
- Regulatory framework with enforcement
 - ▶ **Can, and do, regulators effectively enforce laws and regulations, via:**
 - Audits
 - Lawsuits
 - Fines
 - Reviewing industry codes of conduct
 - ▶ **Do consumers have the ability to bring complaints outside the judicial system?**

37

Regulatory Authorities' Powers & Responsibilities Over Credit Reporting Firms

	Argentina	Brazil ²	Chile	Colombia ³	Mexico	Peru	U.S.	E.U.
Regulatory powers								
Regulatory or advisory body	X	--	--	X	X	X	X	X
Examination or approval of codes or standards	X	--	--	--	--	--	--	X
Supervise regulation & enforcement								
Receive and settle complaints	--	X	--	--	X	X	X	X
Access to data to verify compliance with data protection provisions	X	--	--	--	X	X	X	X
Conduct or cause audits to be conducted to data controllers	X	--	--	--	--	--	--	X
Bringing lawsuits	X	X	--	--	--	X	X	X
Sanctions and remedies	X	X	--	--	X	X	X	X
Dissemination, education	--	--	--	--	--	--	X	X
Bound to submit an activity report	--	--	--	--	--	--	--	X

38



Credit reporting and bank supervision

- Supervisors include financial institutions' use of credit information as part of inspections, both on and off-site
- Use data from PCRs to identify large problem borrowers, to fine-tune regulations and in analytical work to identify risk-categories of borrowers
- Require publicly (government) owned financial institutions to provide data to legitimate credit reporting firms, associations
- Encourage all financial institutions to participate in credit reporting

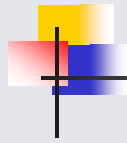
39



Consumer Outreach and Education

- Readily available information on managing credit and on the rights & responsibilities of borrowers regarding credit reporting
 - ▶ Printed materials at appropriate level, language (internet, banks, retailers, government offices can all provide access)
 - ▶ Radio or television public service ads
- Role of industry in providing consumer assistance
- Outreach to lenders on importance of credit information
- Outreach to other interested parties (judges, microfinance institutions, etc.)

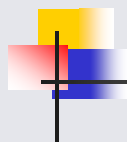
40



Conclusions

- Credit registries are an increasingly important part of modern financial systems and exist in most Latin American countries
- Priorities for strengthening credit reporting in Latin America include:
 - ▶ Enhancing the legal and regulatory framework, including strengthening institutions with regulatory oversight
 - ▶ Optimizing the use of public registry data in banking supervision and regulation
 - ▶ Addressing information access and security issues
 - ▶ Strengthening consumer protections

41



Public Policy for Credit Reporting Systems: Strengthening Public-Private Dialogue and Partnership

Beijing, China
September 28-30, 2004

- Legal & Regulatory Framework
 - Public Credit Registries & Bank Supervision
 - Relationship between Public and Private Registries
 - Credit Information for SMEs and Microfinance
 - Strategies for Public Education & Outreach
- Conference Website: creditreporting2004.com

42