

The value of comprehensive information sharing

Wider access to credit and sustainable economic
growth through credit risk management tools

Oscar Madeddu,
Mexico City – December 14, 2006



Agenda

- A natural symbiosis: access to credit and information sharing **1**
- Credit Reporting international trends and LAC overview **2**
- How can authorities help? **3**

The problem

Access To Finance

"...la única manera de derrotar el odio es crear una sociedad de inclusión, democratizar préstamos, y expandir el crédito a empresas pequeñas y medianas.

Los bancos deben hacer su trabajo y expandir el crédito a las personas."

Alvaro Uribe
(Presidente de Colombia - Sep 2005)

"... el 2005 confirmará a este país como el país de las micro finanzas y como una nación donde las personas pueden acceder al crédito.

Estamos facilitando la inclusión de millones de personas quienes no tenían acceso al sistema bancario."

Luis Ignacio Lula da Silva
(Presidente de Brasil - Enero 2005)

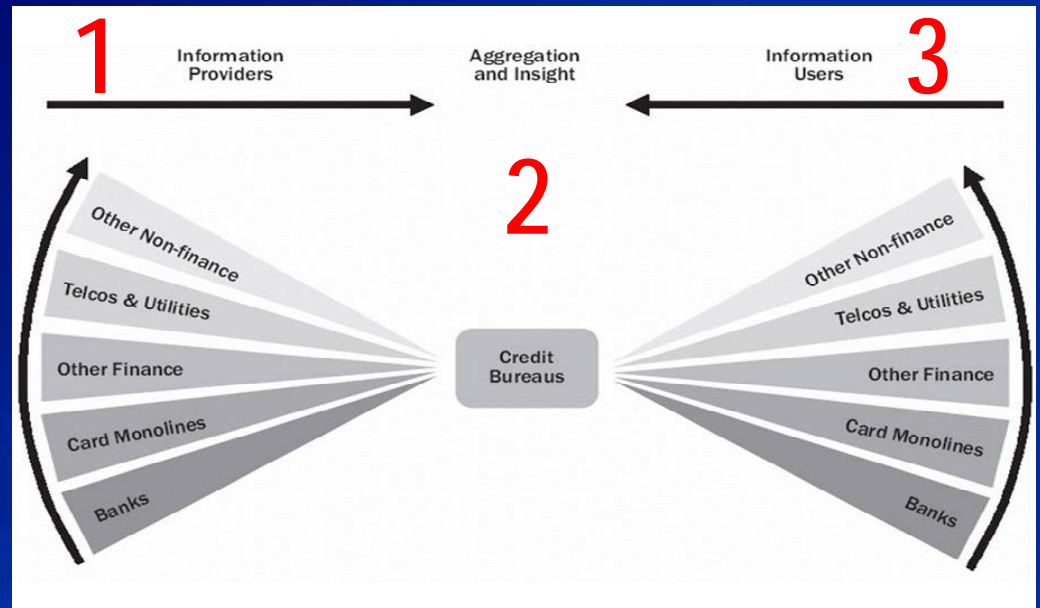
How can Private Credit Bureaus help?

• A Credit bureau is a private, for-profit, commercial entrepreneurship that:

1. collects credit information (positive and negative) on consumer credit, micro, SME loans from all lenders

2. Processes the data, includes other data sources and adds value to the data through technology and experience

3. sells the processed information back to the lenders (users) as credit reports and other services (e.g. bureau scores)

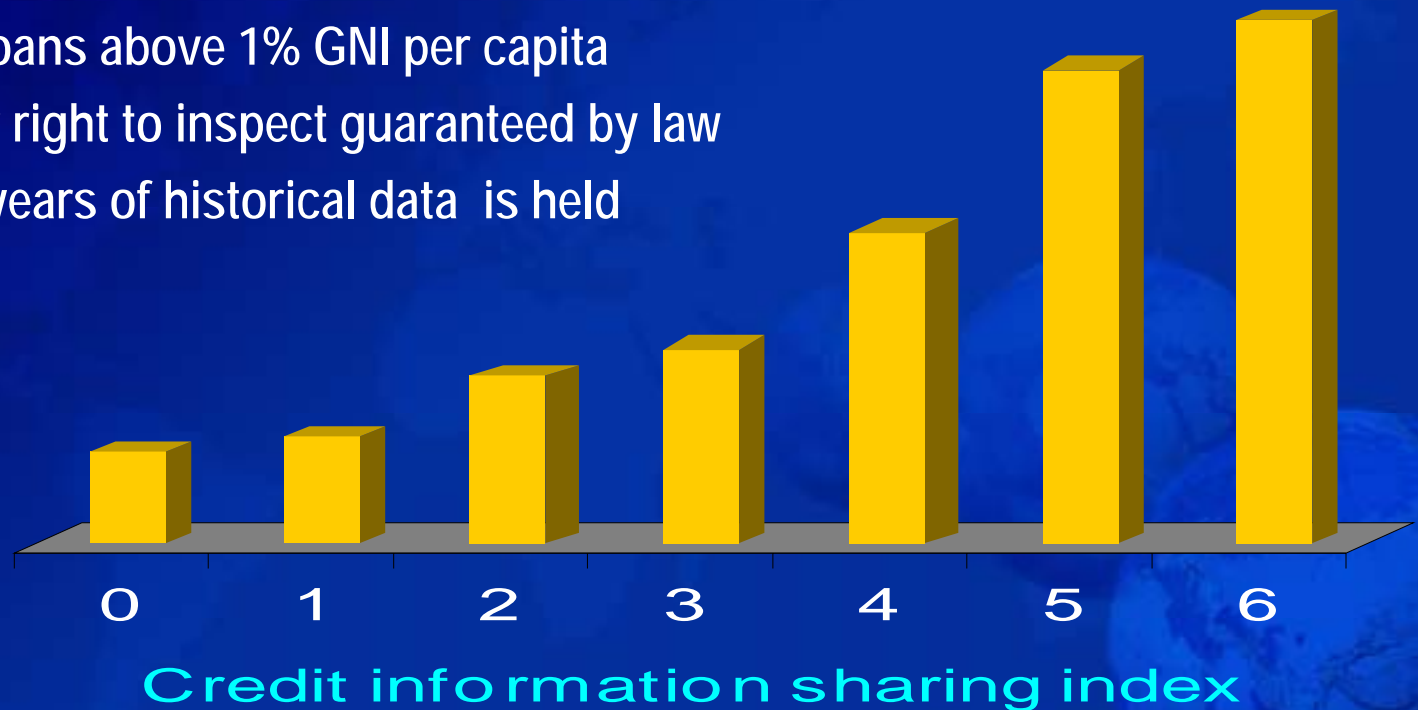


- credit reporting started in an industrial manner during the late 50s in the US
- PCBs are regulated by specific norms that also protect consumers data privacy & rights
- are generally licensed and/or supervised by the central Authorities
- are generally operated by leading international reputed providers, or good local ventures

World Bank's rating of Private Credit Bureaus

Maximum score: 6

- Both firms and individuals are listed
- Both positive and negative information
- Retailers and/or utilities submit data
- Includes loans above 1% GNI per capita
- Consumer right to inspect guaranteed by law
- 5 or more years of historical data is held



Type of information shared

- Data sharing among lenders and PCBs can be voluntary or on compulsory basis

Personal information

- ID
- Name
- Company name
- Address
- Telephone

Account/s information

- Type of Credit
- Bank (*)
- Account number (*)
- Date opened
- Loan amount
- Tenures
- Score

Performance information

- Current loan balance
- Current arrears
- Time in arrears
- Worst arrears
- Payment history (24 m)
- Date closed
- Date of the report
- Previous inquiries (6 m)

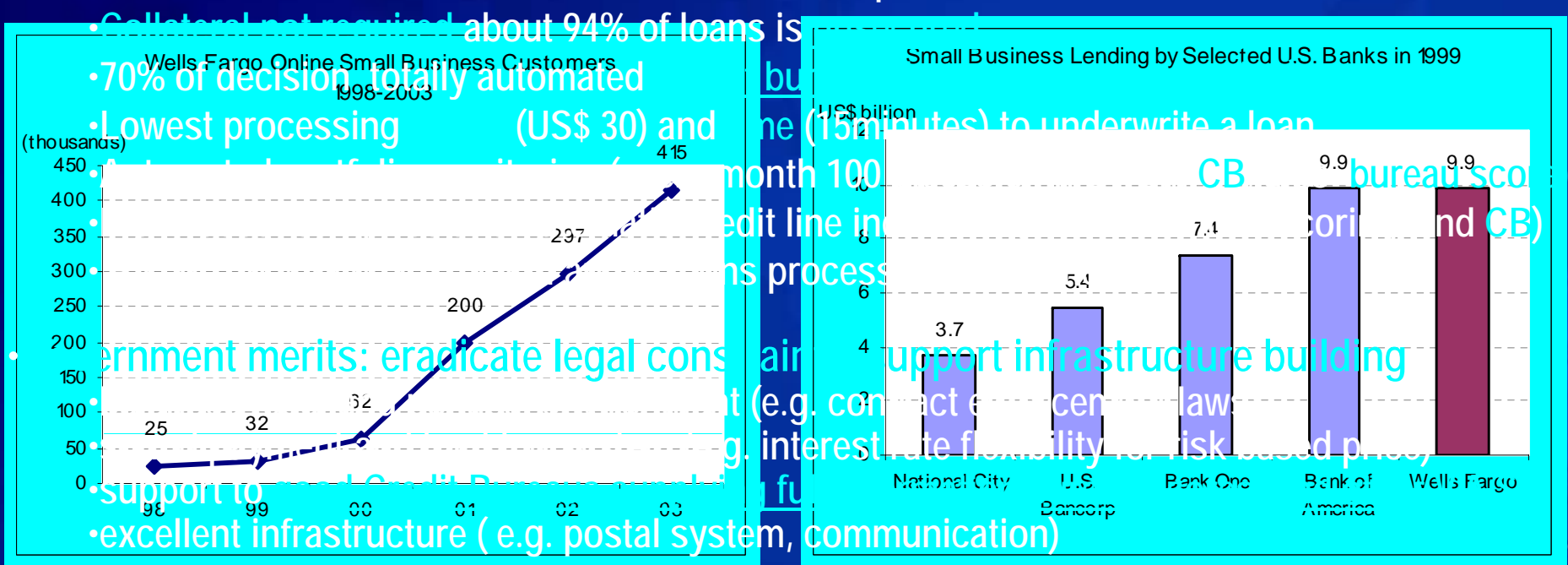
(*) This information is not given to other users

Benefits of credit reporting

- For Borrowers:
 - Improved access to credit for borrowers with good credit histories (*reputational collateral*)
 - Lower credit costs (risk-based pricing) and wider range of products available
 - Impartial, quicker credit assessment without collateral requirement
 - Clear and enforced consumer's rights
- For Lenders
 - Higher lending volumes
 - Lower NPLs (with significant bottom line impact)
 - Lower operating cost
 - Portfolio monitoring: prevention of over-extension, serial borrowing, frauds
 - Support in compliance with Basel II
- For the national economy
 - Better control of credit systemic risk
 - Overall lower cost of credit
 - Increased access to credit for a larger segment of the population (most vulnerable)
 - Reduced over-indebtedness & NPLs
 - Evolution of non-cash payment options (cheques, cards) become more attractive.
 - Encourage investment and stimulate economic growth
 - Technological and informational infrastructure improvement
 - Higher financial international rating

Lending to SME through the CB and without collateral

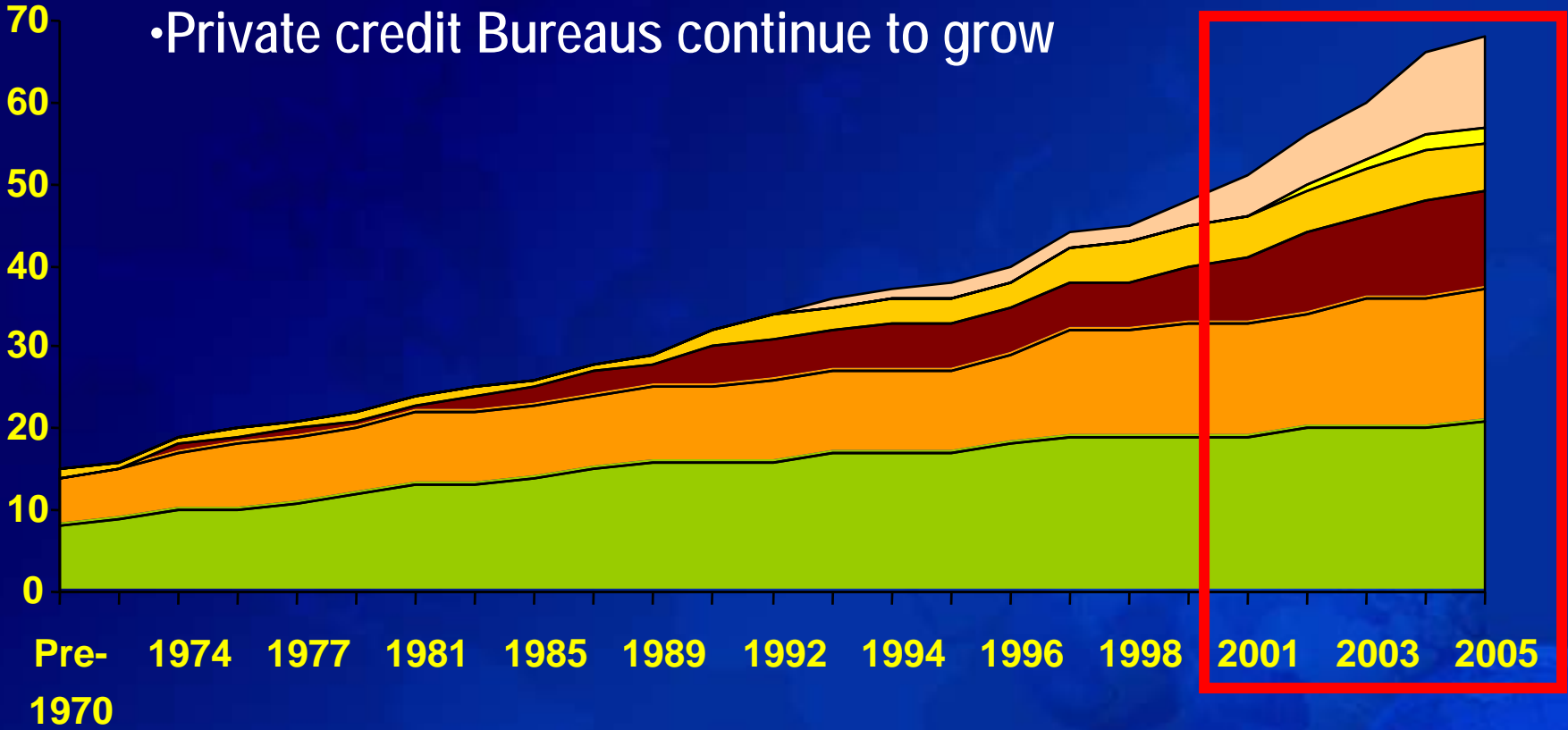
- In 1994 Wells Fargo started Business Direct (new SME division)
 - Average customer profile: sales US\$ 325.000 year; employ > 5 people
 - Maximum loan amount US\$ 100.000 average loan amount US\$15.000
 - Portfolio: by 1999 US\$ 9.9 billion; by 2003 US\$ 15bn
 - In 2002 WF rated number 1 SME lender in the USA
- Success factors?
 - Loan applications accepted by Internet, phone, mail (or branch)
 - No tax return or financial / income statements required;



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Monitoring info-sharing in more than 120 countries: major international trends

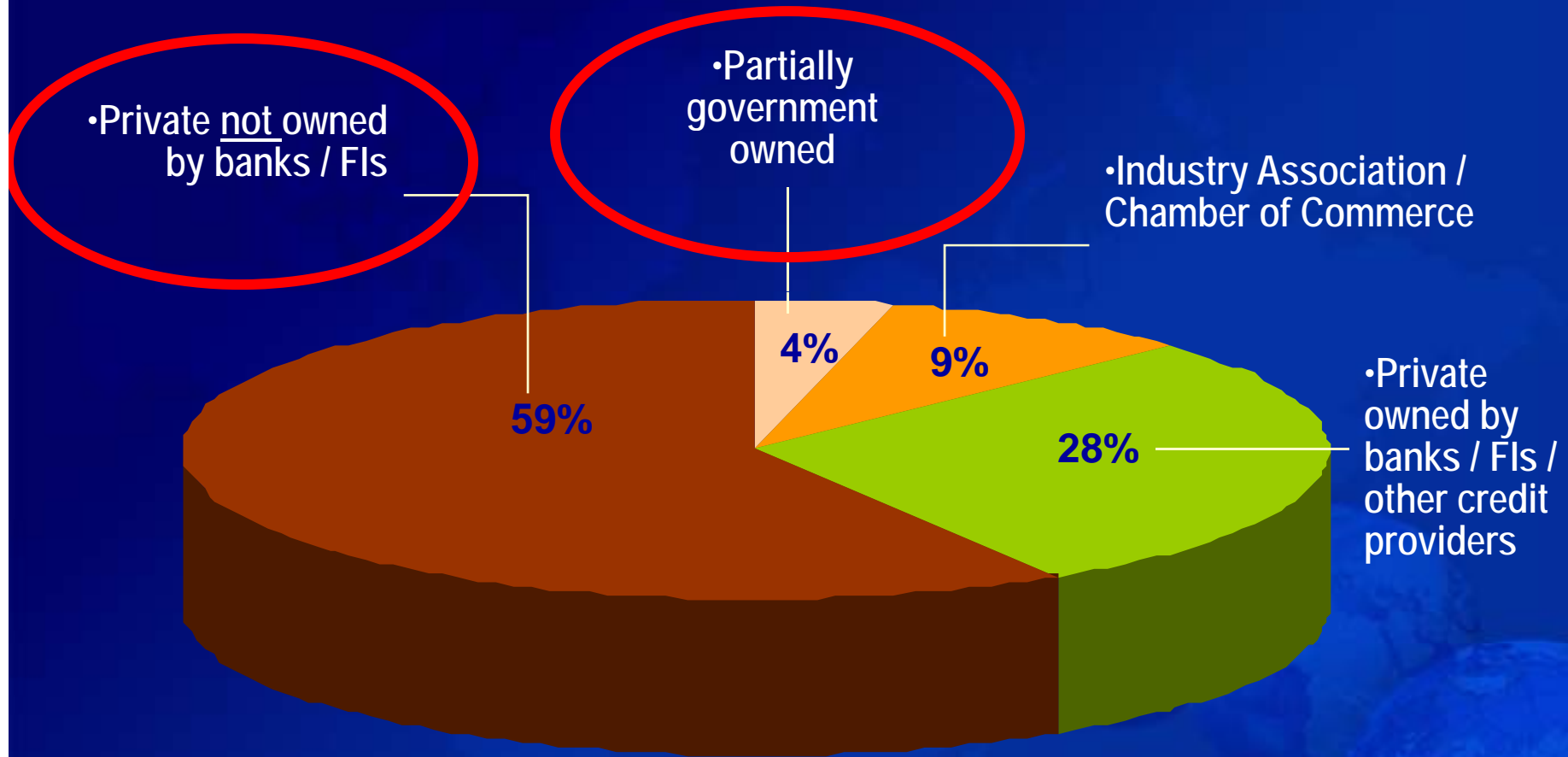


■ OECD ■ Latin America ■ Asia ■ Africa ■ Middle East and North Africa ■ Eastern Europe and Central Asia

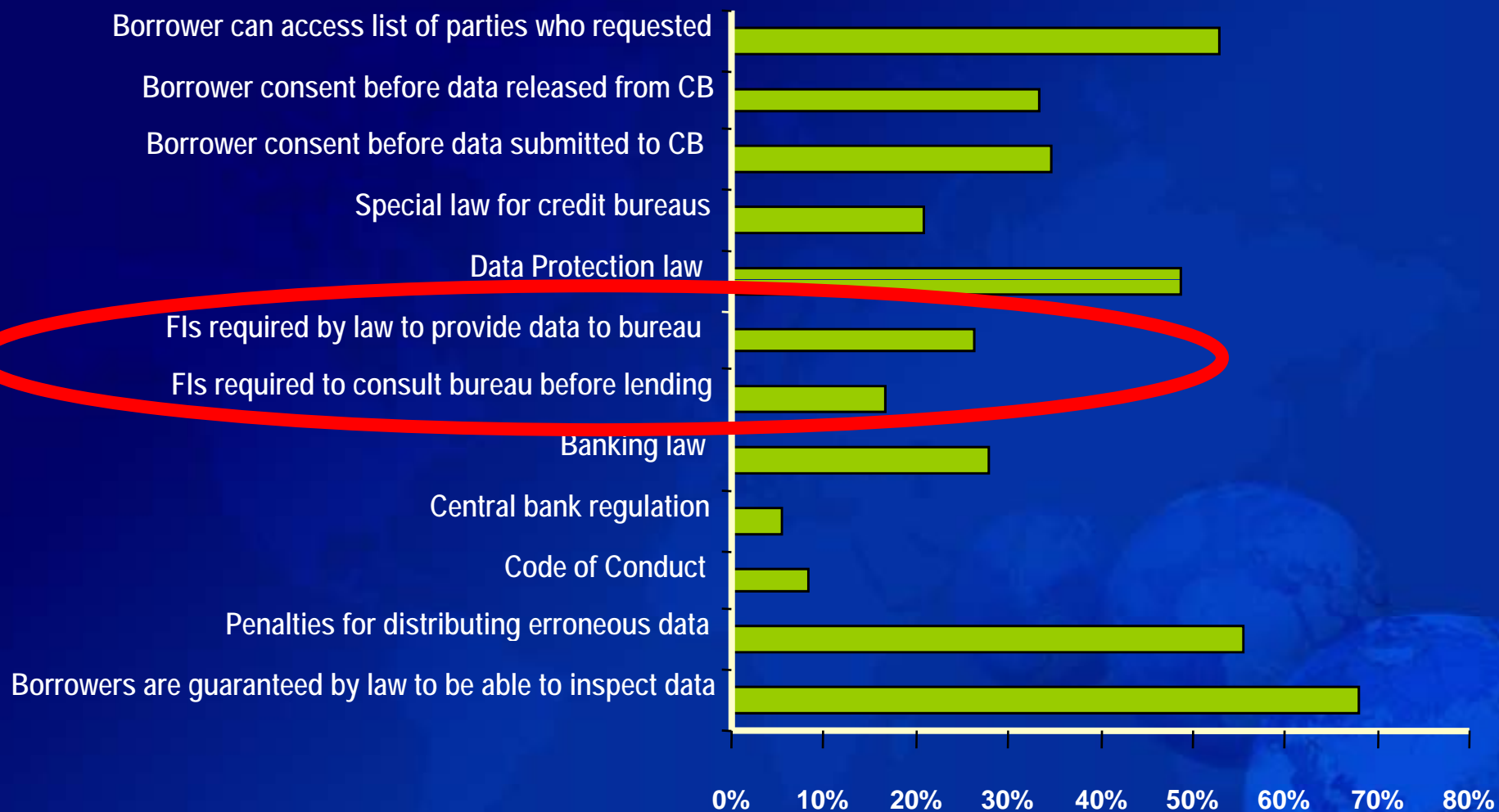


Source: Doing Business 2006

Ownership of private credit bureaus



Laws and regulations relevant to credit bureaus

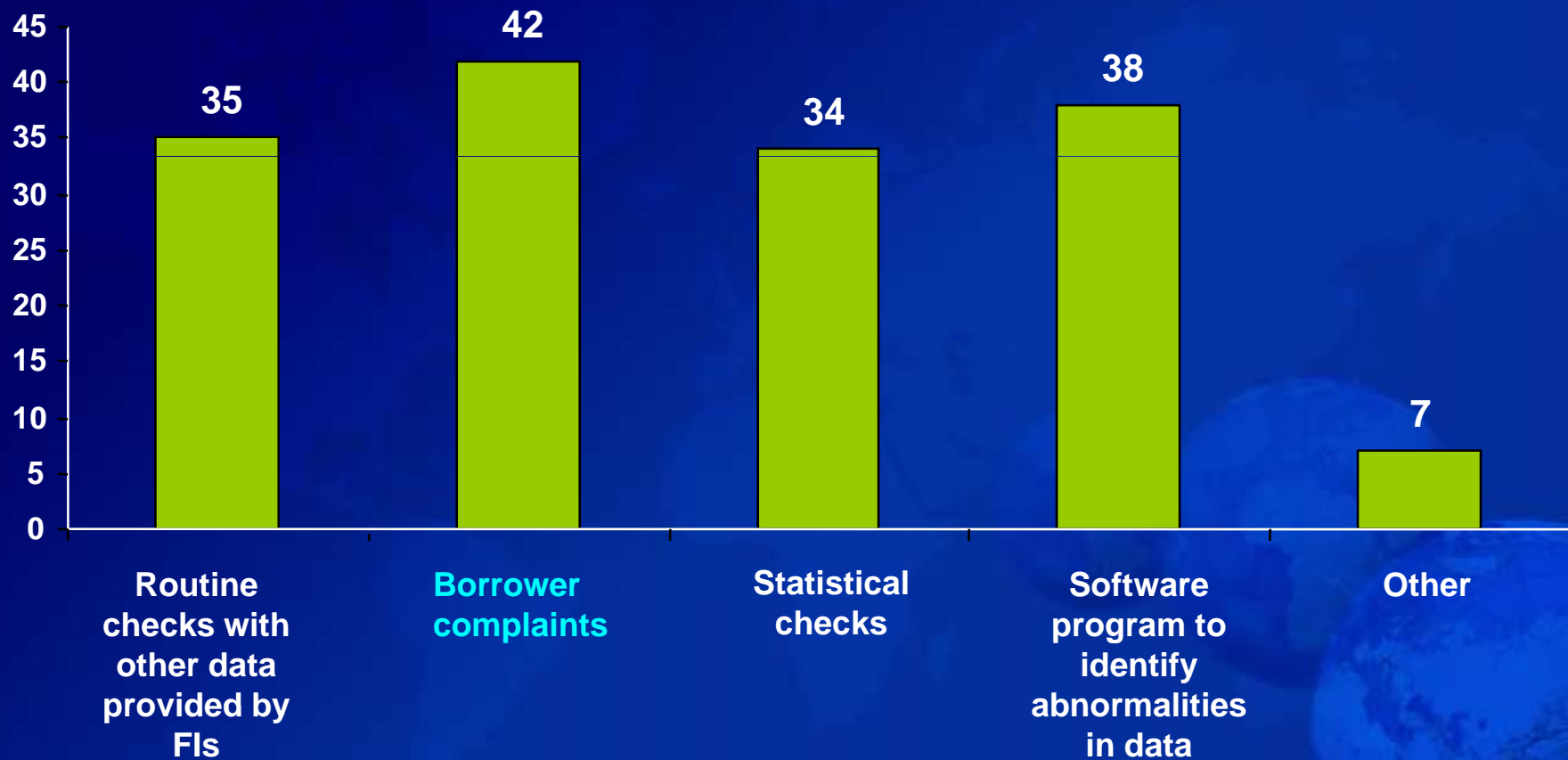


When are records erased from the database by PCBs?

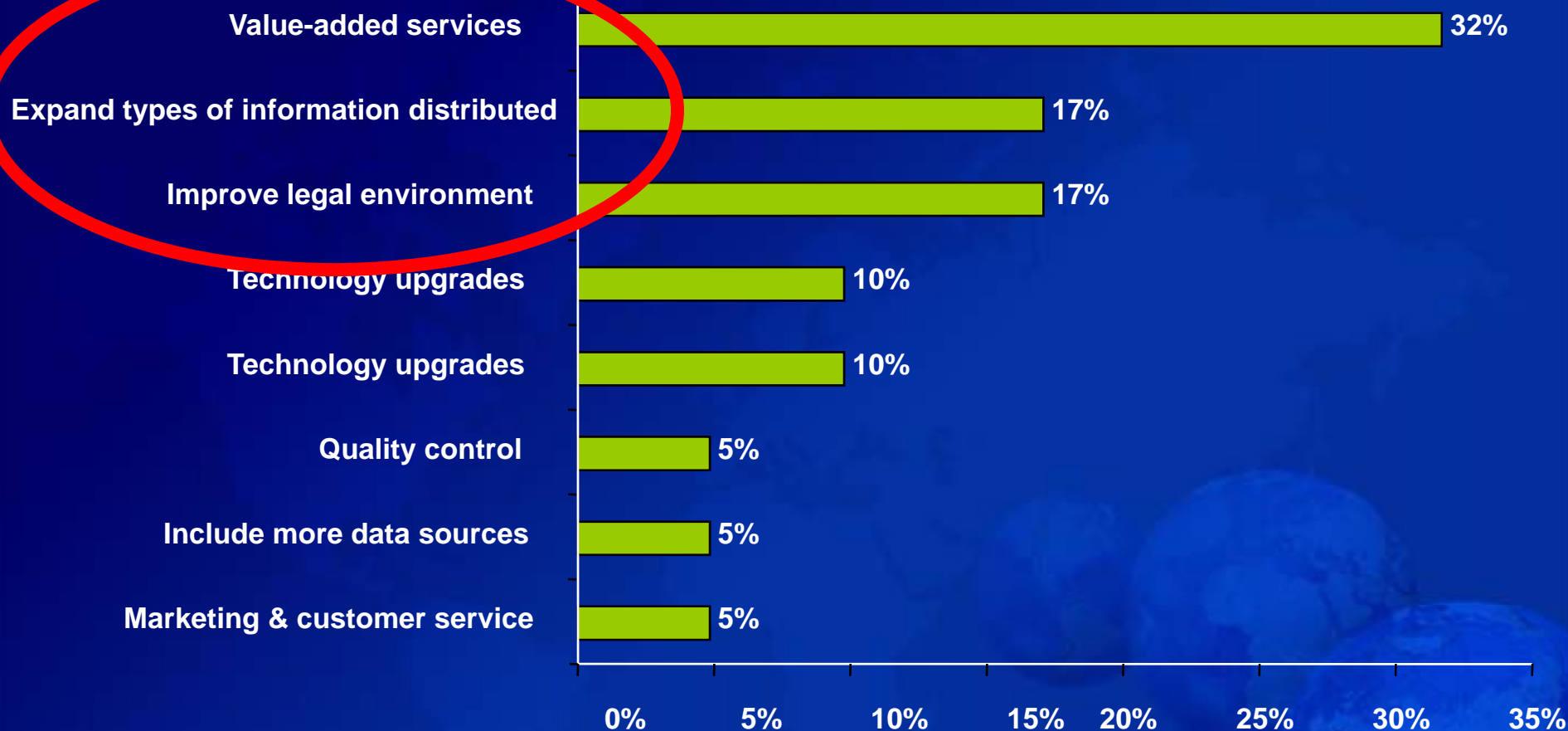


Source: Doing Business 2006

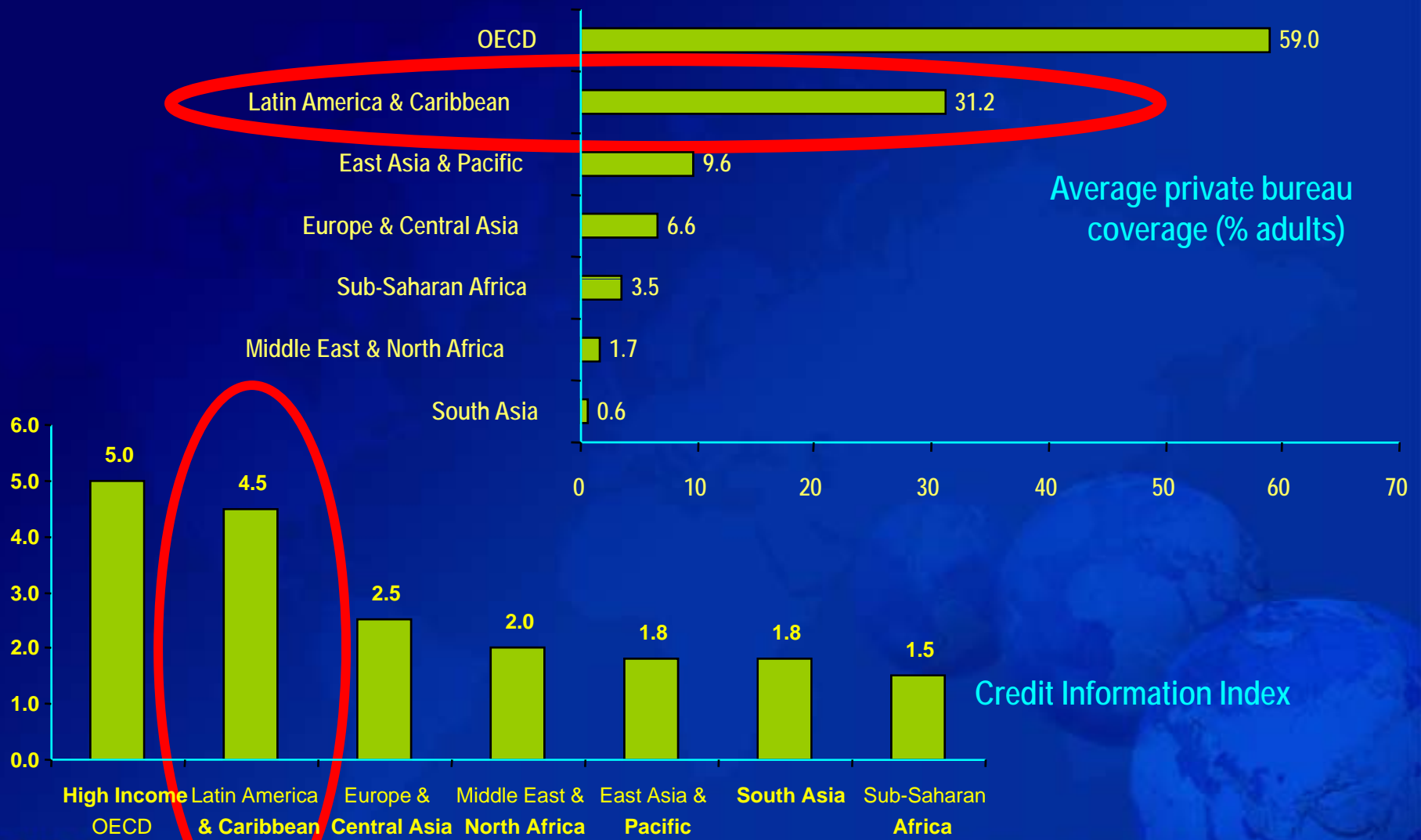
How to ensure accuracy and integrity of data



Main areas of development for private credit bureaus



What about information sharing in LAC? The bright side...



Source: Doing Business 2006

...and the dark side

•Despite info sharing traditions:

- quality of information is still not the finest (positive missing, or fragmented)
- fragmented and uncompleted databases (e.g. no retailers, non-regulated entities)
- legal framework is an “organized anarchy” (weak, missing)
- lack of regional standards in presence of regional demand (e.g. Central America, E.C.)
- lack of competition or patent monopoly in some countries
- consumers’ rights often underrated, not fully granted, not known
- info-sharing culture unevenly spread, (peaks in Panama, Mexico, Ecuador, D.R)
- added value services still in infancy
- risk management tools and automated underwriting largely unknown
- minimal retail credit literacy among consumers, often also among lenders
- value and predictive power of negative data largely overestimated
- negligible use of PCBs in underwriting SME / micro enterprises
- lack of unique identification / tax numbers in many countries
- PCRs’ misinterpretation of objectives / responsibility / function

A typical story...

The "horrid" month end of Jorge S.



Over 40% of LAC population still without positive info

Presence of negative info



Presence of positive & negative (*)



(*) Countries colored in brown only share negative information

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Case study 1 - India

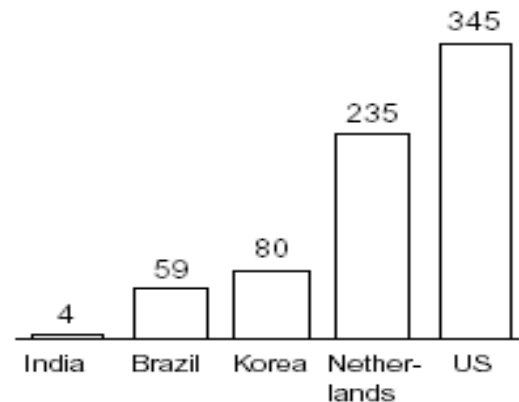


- In 2001 RBI (Central Bank) requested an assessment of retail banking to McKinsey
- Scope: why penetration in all retail products was very low?
- Particularly: why low penetration in retail credit?

RETAIL BANKING OUTPUT – CROSS COUNTRY COMPARISON

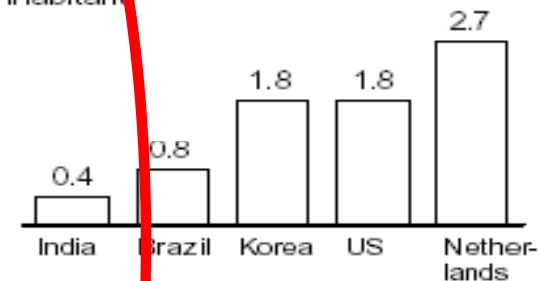
Payment output per capita

Number of payments per year per inhabitant



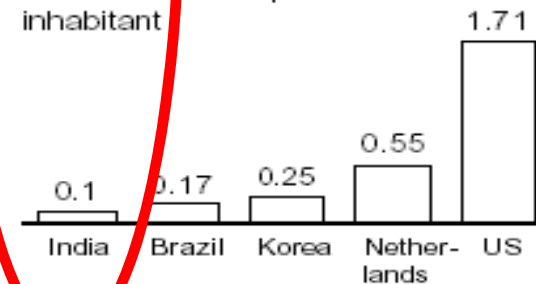
Deposits output per capita

Number of deposits per inhabitant



Loans output per capita

Number of loans per inhabitant



Source: RBI special statistics; McKinsey analysis

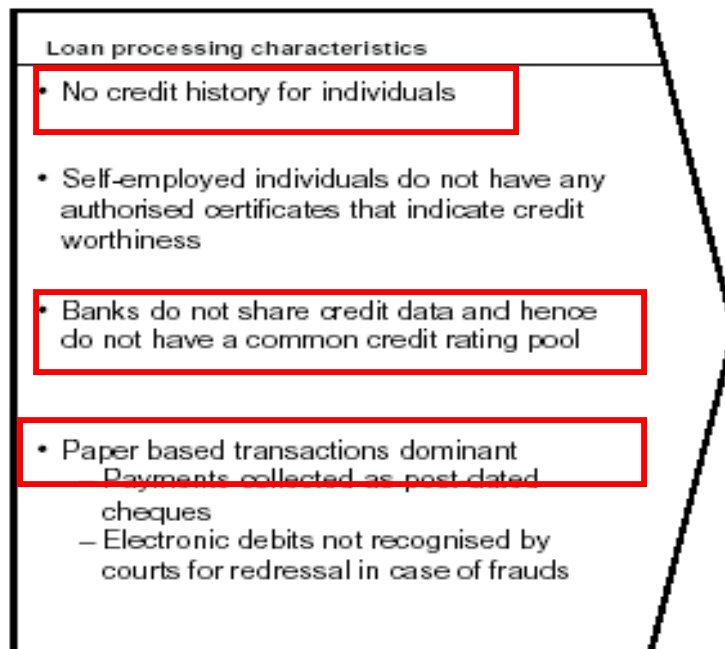
Case study 1 - India



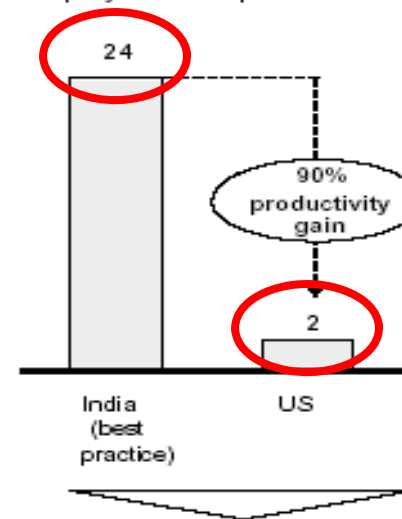
Findings:

- as for credit low lending volumes and lower access to credit basically a result of **lack of information sharing / risk management tools and automation**

CREDIT RATING INFRASTRUCTURE



Average processing time for loans Employee hours per loan



Given that 12% of all jobs are in credit verification, overall productivity can improve by ~10%

Case study 1 - India:



- **Additional issues**
 - Strong recent uncontrolled growth of consumer credit
 - Scarce retail risk management culture, weak infrastructure, immense territory & population
 - RBI serious worries about a LAC type of crisis, led to the creation of a working group
 - Working group recommended:
 - the establishment of a PCB as a fundamental need for the country credit system
 - that should rely on world class experience and best technology
 - to be operated by the private sector and not by the central bank authorities
 - accompanied by a friendly legal framework for CB establishment
- **Solution: Central Bank led the reforms - RBI played a key, determinant role since day one in:**
 - Instilling among lenders the concept/need for a private Credit Bureau and fostering its development
 - Following project from planning to implementation
 - Leading legislation drafting
 - Monitoring progress on consent acquisition: reports to be submitted by banks to RBI
 - Banks boards to closely monitor that sharing of data happened
 - Penalties on banks that did not comply with submission of data to CIBIL
 - Not creating involuntary competition with its Public Registry
- A private Credit Bureau, CIBIL (Credit Bureau of India Ltd.) was finally launched in April 2004
- Shareholders: two major banks plus Trans Union and D&B

Case study 1 - India: legal challenges



- Restrictions on disclosure of credit information without consent from the borrower
- A two step approach taken by RBI:
 - Initially, consumer consent for old and new loans has allowed database creation
 - Secondly a CB ad-hoc legislation has been drafted and discussed by the parliament
- The situation as of November 2006 was the following:



- **Enable Banks / FIs / SFCs / NBFCs to share all data without consent**
- **Establish the regulatory framework for Credit Bureaus in India**
- **Enunciate the rights and responsibilities of Members and Bureaus**



Case study 2 – Nicaragua: the shortcut



- Background:
 - Until 2005 Nicaragua had neither info-sharing nor a specific legal framework
 - Bank law empowers the Superintendence (SIBOIF) to regulate CBs
 - In 2005 the SIBOIF enforced a lean, comprehensive regulation (rather than a law)
 - SIBOIF empowered to license / supervise CBs
 - This solution is quicker, hassle free and has same legal impact of a law
 - Positive and negative information sharing is allowed
 - Regulated and non-regulated entities can share data with private CBs
 - Demanding licensing requirements
 - At least a minimum of 1 year previous experience in the industry,
 - Code Of Conduct,
 - High data security/ integrity and technology level required
 - Standard quality and controls must be externally audited and confirmed
 - Back up and disaster recovery plan part of license application

Case study 2 – Nicaragua: the shortcut



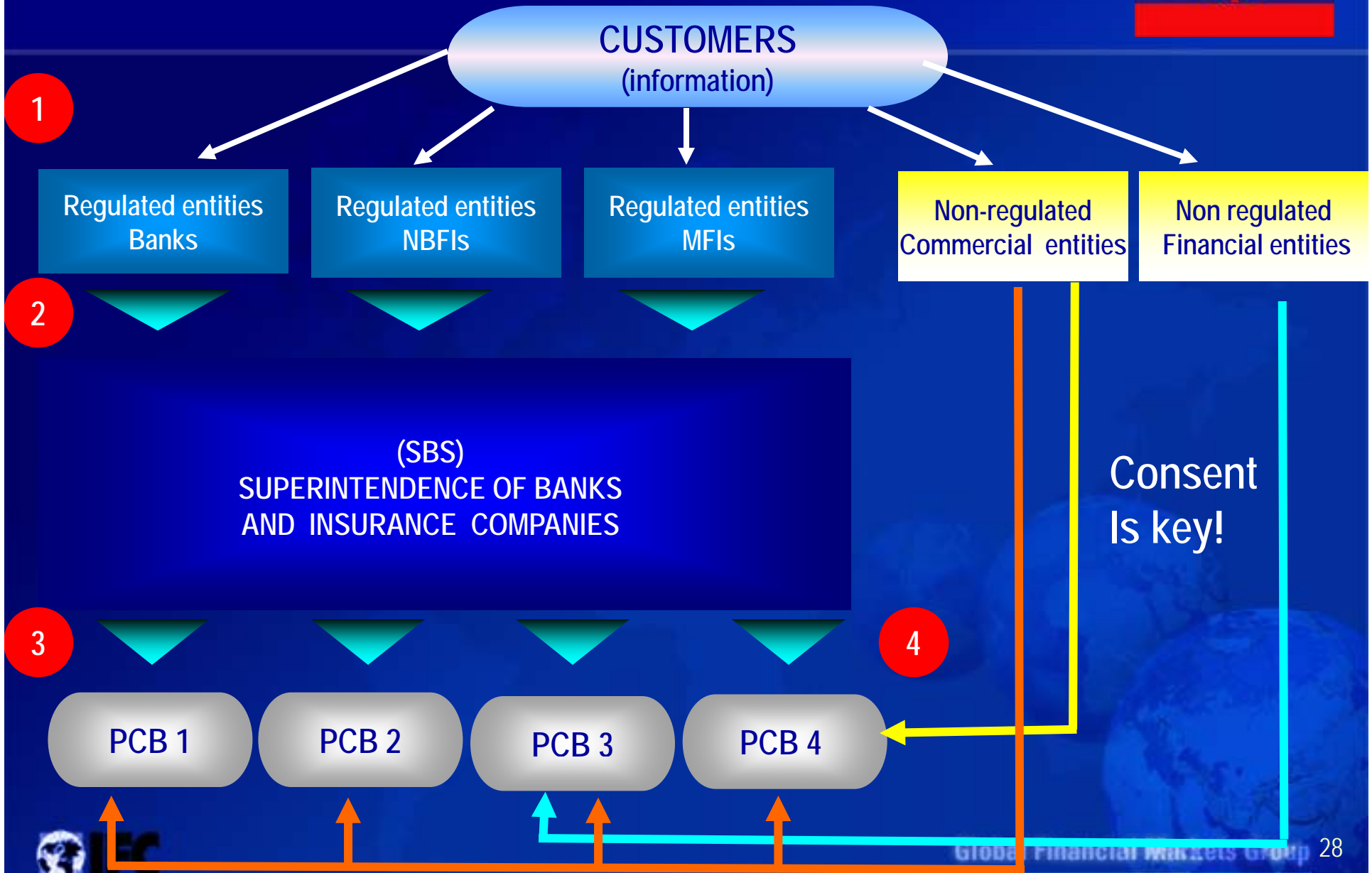
- Regulation highlights:
 - Consumer consent required to inquiry the CBs
 - Consumer's rights to see (free once a year) dispute, correct own information
 - Information must be kept inside the database for 5 years
 - In case of missed deadline for dispute solution CB must withdraw information
 - Annual external audit (within 90 days) on: system, security, norm compliance
 - Penalties: fines, temporary suspension of license, license withdrawal
 - The SIBOIF may request at any moment whatever information from any CBs
 - No mention is made in the regulation about keeping the database in the country

Case study 3 - Ecuador



- Background:
 - Superintendence restless effort to foster positive info and risk management tools
 - Objectives
 - to expand credit access to informal economy without increasing risk levels
 - to consolidate credit databases in the financial and non-financial sectors
 - to minimize credit analysis and evaluation costs, thus reducing interest rates
 - to reduce the moral risk at country level
 - Challenges:
 - No specific law existing to establish, regulate and supervise Credit bureaus
 - Solution envisaged:
 - SBS regulation allowing supervision of CBs, using as basis the Financial Inst. Law
 - As of January 2003, six credit bureaus qualified.
 - Evolution:
 - Important politicians argued that the SBS power to establish regulate CBs
 - The absence of a CB Act was raised at the National Congress level
 - After endless discussions the Credit Information Bureaus Act was approved in 2005
 - The Act is less flexible than the Superintendence regulation however still a good law
 - Gives legal support to CBs, as well as protection to credit holder's rights.

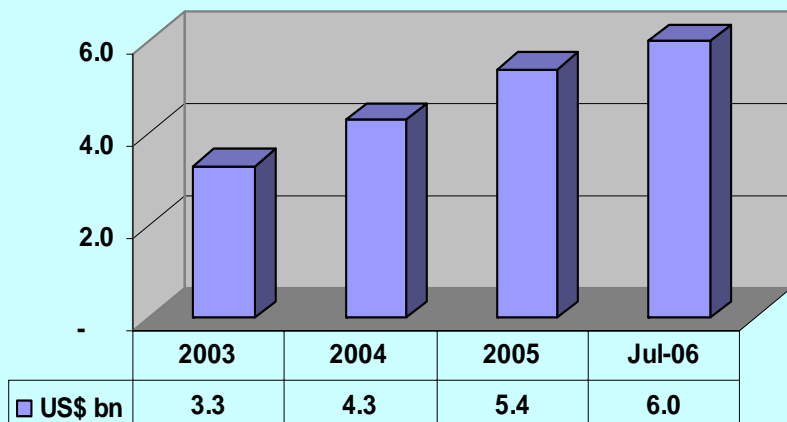
Case study 3 - Ecuador - information flow



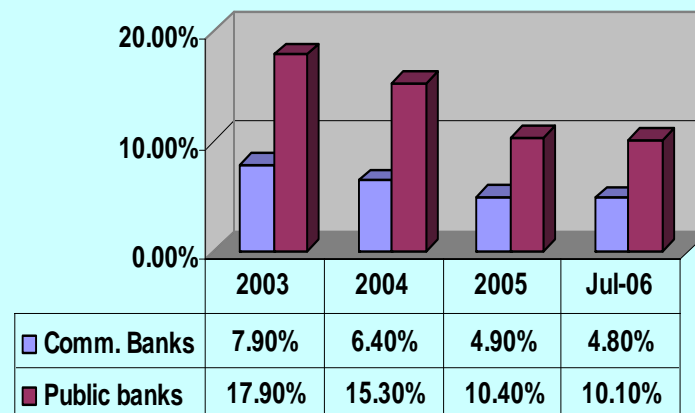
Case study 3 – Ecuador: the result



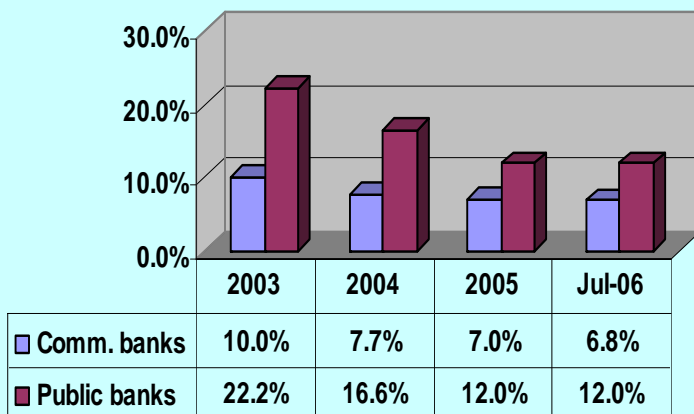
Banks gross portfolio growth



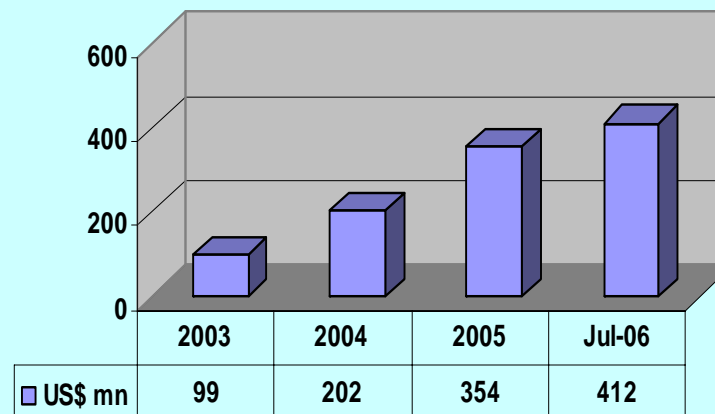
Bad debt decrease year on year



Provisions decrease as a % of gross portfolio

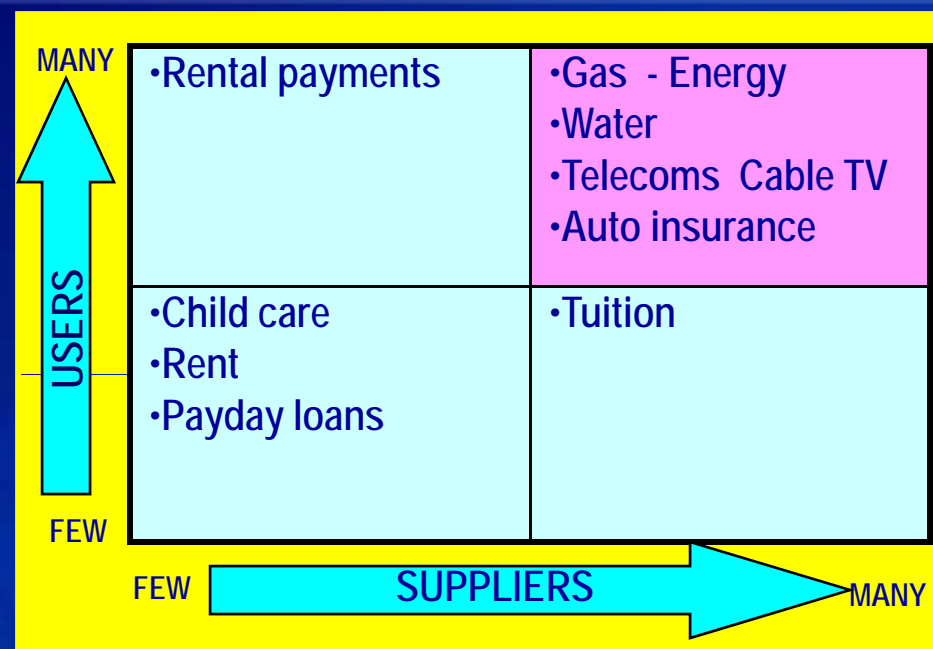


Banks' microcredit portfolio growth



Case studies 5 – Score the “unscorable”

- Poor consumer, informal economy, micro business pay cash and have no credit history
- They have difficulty in accessing credit
- Phenomena known as “thin-file” or “no-files”
- In the US 35-50 million
- In Mexico up to 50% of the population
- The majority are engaged in relationship that can be defined as “credit like” or ‘cash-like”
- These include : utilities, rentals, insurance, cable TV, pay-day loans, childcare



- Regularity on these payments is a strong risk indicator, and a shortcut to build a credit history
- This data is normally referred as “non-traditional” or “alternative” is very predictive
- Utilities (public ones in particular), are the most helpful since universal, concentrated, reliable
 - However rarely reaches the CBs because of regulatory hurdles to share this information
 - Problem not due to restrictive laws but to lack of law that allows sharing this info
 - In **Panama** the new CB law allows sharing of “non-traditional” data (mainly utilities)
 - In **Brazil** the new CB law project (Medida Provisoria) allows the sharing of non traditional data

Credit cards / person

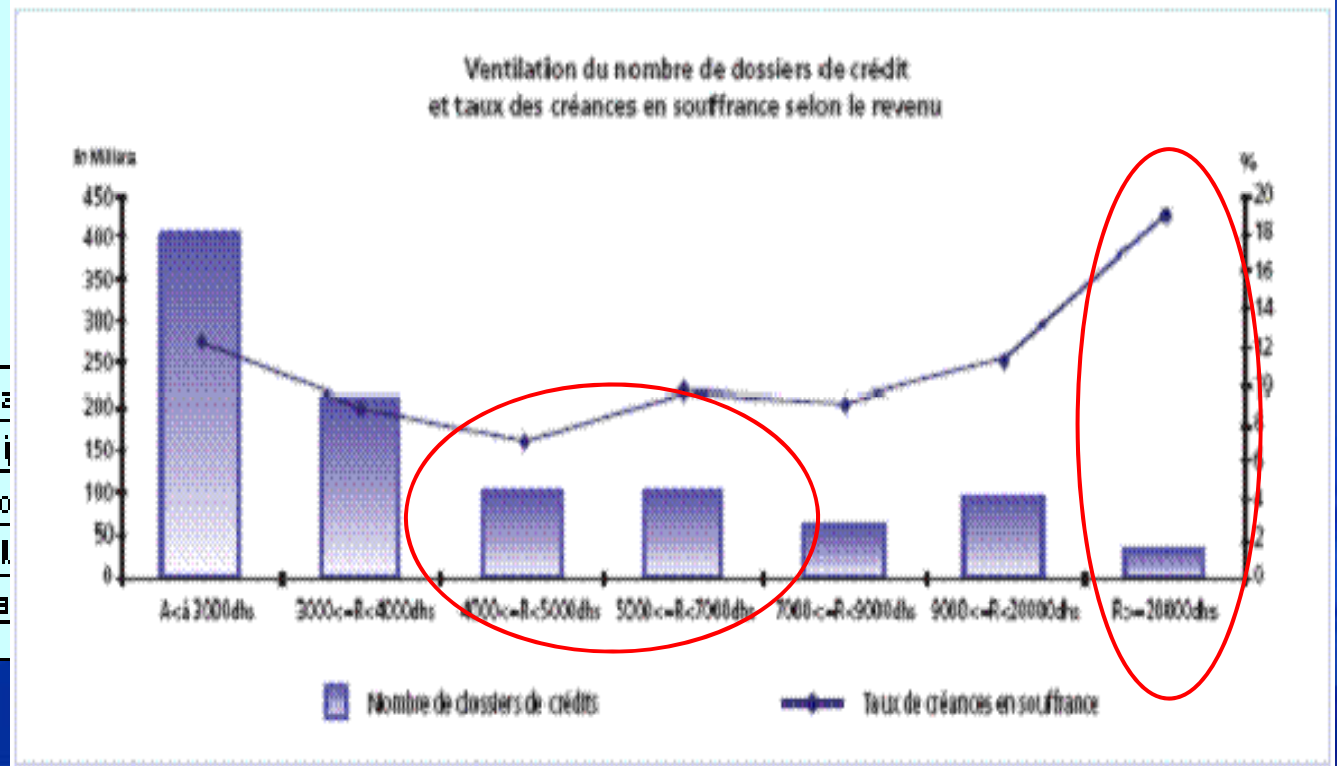
Typical bank portfolio

◆ Indicateurs d'activité et de rentabilité des sociétés de financement

Rejection rates 2004 - 2005 - 2006

Banks / NBFIs' NPL rates (2006 - by loan type)

> Graphique n°17



Thanks for your attention

Q & A?

omadeddu@ifc.org