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POLICY & ECONOMIC RESEARCH COUNCIL

Foundational Implementation Issues in Full-file, Comprehensive Credit Reporting

by

4th Meeting of APEC Business Advisory Council
Singapore – November 9, 2009

Asia-Pacific Credit Coalition

Agenda

Introduction: Basic Virtue of Full File, Comprehensive Reporting

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The Logic of Information Sharing

Solidly established that full-file (positive and negative data), comprehensive (across many sectors) reporting:

- **reduces "asymmetric information" problems, that is, lender can better assess the likelihood of repayments**
- **resulting in…**

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…Greater Credit Access

Table 1: Percentage Point Change in the Acceptance Rate by Shift in Reporting Regime (percentage change shown in parentheses)							
	Negative-only to Full-file					Segmented (Bank-only) to Comprehensive Reporting	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Default Rate	Barron and Staten, U.S. files	Turner et al., U.S. files	Turner and Varghese, Colombia	Majnoni et al., Argentine …	Majnoni et al., Brazilian …	Barron and Staten, U.S. files	Turner, Canadian files
0.5%							16.5 (52.7%)
1%							8.2 (13.1%)
2%		13.4 (47.0%)			15.9 (32.3%)		7 (8.8%)
3%	35 (87.9%)	9.2 (23.0%)	7.4 (290.6%)	10.7 (21.7%)	26.4 (47.3%)	8.0 (10.6%)	9.1 (10.9%)
4%	9.5 (12.9%)	8.4 (17.8%)			6.7 (7.9%)	10.0 (12.4%)	
5%	4.3 (5.1%)	4.9 (8.8%)	36.2 (702.9%)	0.6 (0.1%)	1.9 (2.0%)	2.2 (2.3%)	
6%	2.3 (2.5%)	3.3 (5.5%)					
7%	0.5 (0.5%)	2.3 (3.6%)	45.2 (332.5%)	1.76 (2.1%)			

Greater access: a host of studies indicate that widened credit access follows from greater information sharing, when information is used properly

Evidence from

- **US**
- **Canada**
- **Brazil**
- **Colombia**
- **Argentina**

At 3% default target, Argentine files show increased approval of 10% of borrower pool with full-file data

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…Better Loan Portfolio Performance

Percentage Point Change in the Default Rate in Switch from Full-file to Negative-Only (percentage change shown in parentheses)

Acceptance Rate	Barron and Staten, using U.S. files	Turner et al., using U.S. files	Turner and Varghese, using Colombian files (includes non-financial trade lines)	Majnoni et al., using Argentinean files	Majnoni et al., using Brazilian files
20%			4.94 (140%)		
30%		0.8 (62%)	4.94 (120%)		
40%	**1.84 (170%)**	**0.6 (33%)**	**8.96 (183%)**	**0.92 (60%)**	**1.48 (114%)**
50%		0.3 (10%)	8.54 (146%)		
60%	1.45 (76%)	0.4 (8%)	8.1 (113%)	0.83 (28%)	1.53 (83%)
70%		0 (0%)			
75%	1.03 (34%)				
80%				0.96 (19%)	0.86 (30%)
100%	0 (0%)	0 (0%)		0 (0%)	0 (0%)

Source: John M. Barron and Michael Staten, "The Value of Comprehensive Credit Reports: Lessons from the U.S. Experience," in Margaret M. Miller ed., *Credit Reporting Systems and the International Economy*, 273-310 (Cambridge, MA: MIT Press. 2003). Michael Turner et al., *The Fair Credit Reporting Act: Access, Efficiency, and Opportunity* (Washington, DC: The National Chamber Foundation, June 2003). Michael Turner and Robin Varghese, *The Economic Impacts of Payment Reporting in Latin America* (Chapel Hill, NC: Political and Economic Research Council, May 2007). Giovanni Majnoni, Margaret Miller, Nataliya Mylenko, and Andrew Powell, "Improving Credit Information, Bank Regulation and Supervision." World Bank Policy Research Working Paper Series, No. 3443 (Washington, DC: World Bank, November 2004).

Better loan performance: a host of studies indicate that default rates decline with greater information sharing, when information is used properly

Evidence from
- US
- Brazil
- Colombia (includes non-financials)
- Argentina

At 60% acceptance target Argentine full-file reduces defaults by 0.83% of borrower pool.

…Fairer Distribution of Credit Across Social Segments

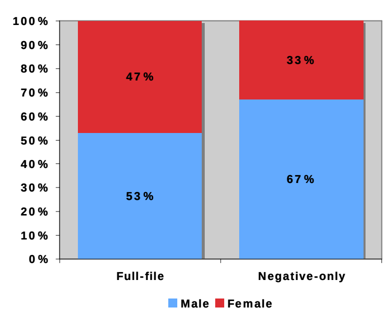
Disproportionate increase in access for the underserved

Effects on Acceptance Rates for a 3 Percent Targeted Default Rate between Full-file Reporting and Negative-only Reporting, by Demographic Characteristics (US Data)

	Negative-only (index = 100)	Full-file (index = 100)
Race-Ethnicity		
Caucasian, Non-Hispanic	100	121.8
African American	100	127.9
Latinos	100	136.8
All Minority	100	135.5
Gender		
Female	100	121.8
Male	100	123.0
Age		
<36	100	147.1
36-45	100	121.8
46-55	100	121.2
56-65	100	119.8
66-75	100	117.9
76+	100	119.9
Household Income (US$)		
< 15,000	100	135.9
15,000-29,000	100	129.7
30,000-49,000	100	124.2
50,000-99,000	100	120.6
>100,000	100	117.8

Source: Michael Turner et al., *The Fair Credit Reporting Act: Access, Efficiency, and Opportunity* (Washington, DC: The National Chamber Foundation, June 2003).

Share of accepted borrowers by gender (for 7% default target) (Colombia)



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However, How to Get There from Here?

Benefits of positive, comprehensive well established.

But foundational issues of implementation must be addressed first:

- how to approach the development of the regulatory framework?
- how to approach establishing financial identity, especially in emerging markets?
- whether and how to incorporate non-financial data?

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Developing The Regulatory Framework

Approaches: well elaborated statutes and regulations vs. contracts and common law vs. mix of both:

- **Data subject rights determined by law (minimum)**
  - Common law and contracts: UK, South Africa prior to National Credit Act (2007), USA prior to Fair Credit Reporting Act (1970)
  - Statutory law and regulations: USA, Mexico, Korea, Kenya (in progress)
- **Determines issues of enforcement. What's best may depend on 2 factors:**
  - Strength of juridical-legal system, strength of regulatory agencies
    - Common law, contracts better where regulatory enforcement capacity poor
    - Transition as capacity is built, e.g., South Africa
  - How developed creditor rights are
    - Can courts be used to recapture loans or
    - Will information sharing substitute or
    - Both, again depends on enforcement power (in rights in bankruptcy, collateral)

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Developing the Regulatory Framework (con't)

The issue of data ownership:

- **Given consumer rights (access, notice, redress, etc.), is data better owned by repository or by data furnishers?**
  - Credit reporting agencies own data in USA, South Africa,
  - Statutory law and regulations: USA, Mexico, Korea, Kenya (in progress)
- **Pros and cons of ownership models:**
  - Data furnishers own data
    - Pros: easier to get data furnishers to contribute data
    - Cons:
      - Slower in developing value-added services
      - Data used strategically against new entrants (scoring)
      - Slower to expand into new non-bank and non-financial sectors
  - CRAs own data
    - Pros:
      - Quick to develop value added services
      - Expands into other sectors faster, greater financial inclusion
      - Levels playing field for new entrants
    - Cons: harder to get bank and financial data furnishers to provide data

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The Problem of Establishing Financial Identity

Establishing financial identity:

- **Perhaps central issue in assisting financial inclusion**
  - In economies with no national ID or stable addresses, how to link accounts for data subject?
  - Biometrics as promise, but issues of privacy and voluntary provision--slow in uptake
- **Matching processes of data firms:**
  - Never single point
    - Data is always matched on multiple levels
      - National ID#, address but also…
      - Employer, birthday, gender, etc.
    - In emerging markets, what else may help?
      - Social grant ID#s, but also
      - Utility payment accounts, cell phone numbers, etc.
      - But regulations need to permit collection and sharing of data for ID matching purposes (limited use)
  - Lessons from region and world would be of use
    - Different approaches in different emerging economies
    - Research and account of best practices for ID matching by economic, legal environment would be of great use for policy makers.
    - Simple issue, but limits the take off of a wide, financially inclusive reporting

Embracing Non-Financial Data in Credit Files

Research and experience indicate non-financial reporting greatly increases financial inclusion:

- **Collecting and sharing information on**
  - Utility payments
  - Remittances
  - Telecom payments (perhaps also prepayment patterns)
  - Rental data
  - Social grants? Income data from unemployment insurance?
- **Issue of modes of gathering:**
  - For private sector data, model largely clear--direct sharing with CRA
    - Data providers have incentives to share (better cash flow, less churn)
    - CRAs bear most of the compliance cost
  - For public data, other options
    - CRAs facilitate data transfer from database to lender
    - With permission of data subject

Gradual v. Rapid
Alternative Data Collection

Gradual v. rapid apply to at least two dimensions of credit report contents:

- **First--<u>breadth and depth of positive information</u> that is collected, e.g.,**
  - Payments,
  - Loan amount,
  - Outstanding balance,
  - Credit limit, and
  - Type of collateral
- **Second-- <u>scope of sectors</u> that report to credit bureau**
  - Data may not be collected from all types of credit providers (segmented into retail, bank, money lenders--e.g. Japan)
  - Data may not be collected for all credit instruments and *for other non-financial* deferred payment obligations

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Steps Forward

These three issues are foundational for the development of an *inclusive* and not narrow credit reporting system and in need of closer examination.

Supporting research for policy makers, develop toolkit by examining:

- Costs and benefits of different approached to regulatory framework
  - By type of economy
  - By regulatory enforcement capacity
- Lessons and best practices in establishing financial identity in emerging markets
- What non-bank and especially non-bank data should be targeted at the beginning and what can be adopted gradually?

Importance of early dialogue between government and CRA to develop framework conducive to both protection of consumer rights and healthy financial system

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POLICY & ECONOMIC RESEARCH COUNCIL

100 Europa Drive, Suite 403
Chapel Hill, NC 27517

www.infopolicy.org

Phone: +1.919.338.2798

Asia-Pacific Credit Coalition