

POLICY & ECONOMIC RESEARCH COUNCIL

Credit Reporting Trends in Asia-Pacific and Globally

by Michael Turner, Ph.D.

*3rd World Credit Congress & Exhibition
Sydney, Australia - May 20, 2011*



Asia-Pacific Credit Coalition

Introduction: APCC Overview

Changes in the Credit Reporting Landscape

Surprises, Choices and Pitfalls: 5 Lessons

Conclusion

About APCC

- **The Asia Pacific Credit Coalition, an affiliate of the non-profit Policy and Economic Research Council (PERC), is committed to:**
 - **Promoting credit reporting standards** within APEC;
 - Establishing value of credit reporting standards as **means of financial inclusion & SMME lending.**
- **In pursuit of goals, APCC conducts:**
 - **Outreach** to policy makers, media, and industry execs;
 - **Research** demonstrating need for standard and associated policies.

Core Principles

The APCC members believe that credit reporting should be based on the following general principles:

1. **Positive and negative payment data** should be reported to private credit bureaus;
2. **Bank, non-bank, and non-financial payment data should be reported**; data should not be segmented by sector
3. **Consumer rights and protections are paramount, as spelt out in OECD Fair Information Principles**;
4. **Private credit bureaus** and public credit registries (PCRs) are complementary; private bureaus focus on making lending efficient, and PCRs on oversight;
5. **Reporting of payment data should be voluntary**; and,
6. **Data use should be limited** to well-defined permissible purposes.

Related Efforts

Similar standards being pursued by:

- 1. World bank/International Finance Corporation**
 - Global level
 - Just completed
 - Highly useful guidelines for development of bureau
- 2. International Standards Organization (to be launched)**
 - Private sector efforts
 - Focus on standards for firms more than on regulatory frameworks
 - Longer time horizon for adoption

Why adopt standards?

Research shows that using full-file data—including income/employment data—for credit granting results in:

Increased, Lower-priced,
Safer, Sounder, Fairer and
Broader Lending

Data blind-spots lead to undue risk and poor lending

In the recent past, many mortgages and other credit instruments were underwritten without verifying income or with little regard to borrower capacity

Consequence =
over-indebtedness

Examples of misused lending products:

- SIVA—Stated Income, Verified Assets
- SINA—Stated Income, No Assets
- SISA—Stated Income, Stated Assets
- NINA: No Income, No Assets loans
- NINJA: No Income, No Job (and) Assets loans



“And so Mike noticed that every month, the guidelines were getting a little looser. Something called a stated income, verified asset loan came out , which meant you didn't have to provide paycheck stubs and W-2 forms, as they had in the past...The next guideline lower is just stated income, stated assets...

Then the next one came along, and it was no income, stated assets. So you don't have to tell the people what you do for a living. You don't have to tell the people what you do for work. All you have to do is state you have a certain amount of money in your bank account...

And then, the next one, is just no income, no asset. **You don't have to state anything.** Just have to have a credit score and a pulse....Actually that pulse thing. Also optional. Like the case in Ohio where 23 dead people were approved for mortgages.”

This American Life
The Giant Pool of Money

Aftermath of Credit Crisis

- Reduced appetite for risk
- Reduction in credit extended
- Stricter lending guidelines and underwriting standards
 - By lenders
 - ✓ Larger down payments
 - ✓ Higher minimum credit scores
 - By regulators
 - ✓ For higher priced loans, lenders must verify income of the borrower via third-party documents



Evidence-based lending proves there is a clear need for better data on credit capacity

Status of Standards

Credit Information Sharing standards are part of two separate APEC initiatives:

1. Financial inclusion:

- Credit reporting as means of broadening financial access
- Credit reporting as means of bringing larger lenders to underserved borrowers

2. SME financing:

- Credit reporting and information sharing as means of funding SMEs for growth, increasing employment
- Credit reporting and information sharing as means of promoting safety and soundness

Policymaker Workshops

In addition to standards, Sept. Tokyo workshop for policymakers from region on implementation:

- **Education on regulatory frameworks**
- **Providing language for legal reform**
- **Presenting best case and applicable models for related challenges such as financial identity**
- **Related aspects of risk decisioning, e.g., SMME collateral registries and sharing data on liens**

Introduction: APCC Overview

Changes in the Credit Reporting Landscape

Surprises, Choices and Pitfalls: 5 Lessons

Conclusion

To Full-File 2007-2010 (N=15)



- Albania
- Brazil
- Croatia
- Georgia
- Ghana
- Kenya
- Latvia
- Morocco
- Russian Federation
- Tunisia
- Uganda
- Ukraine
- United Arab Emirates
- Uzbekistan
- Zambia

Source: World Bank *Doing Business* 2010

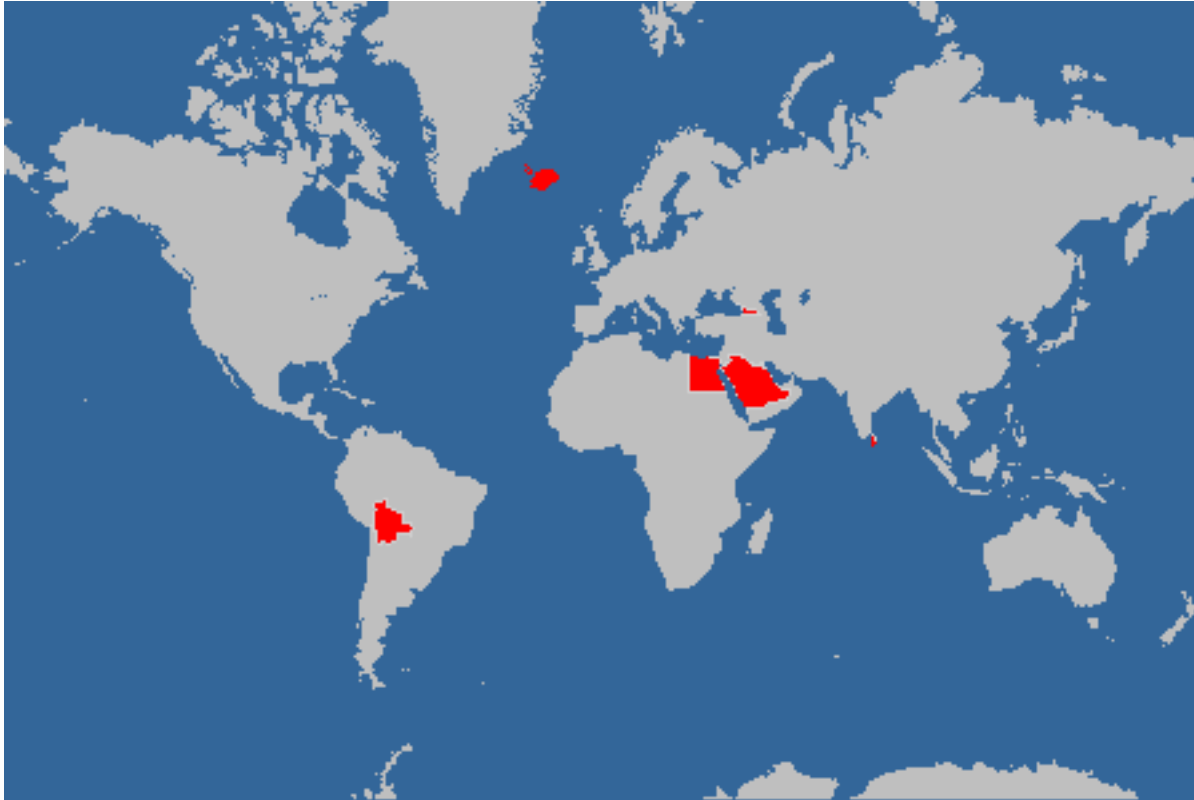
To Full File 2004-2010 (N=30)



- Albania
- Bahrain
- Belarus
- Brazil
- China
- Costa Rica
- Croatia
- Czech Republic
- Egypt
- Georgia
- Ghana
- India
- Kenya
- Kosovo
- Latvia
- Morocco
- Nigeria
- Panama
- Pakistan
- Qatar
- Russia
- Rwanda
- Saudi Arabia
- Slovak Republic
- Sri Lanka
- Tunisia
- Uganda
- United Arab Emirates
- Uzbekistan
- Zambia

Source: World Bank *Doing Business* 2010

Changed to Legally Include Retailers/Utilities 2007-2010 (N=9)



- Bolivia
- Egypt, Arab Rep.
- Georgia
- Iceland
- Kuwait
- Papua New Guinea
- Saudi Arabia
- Sri Lanka
- Trinidad and Tobago

Source: World Bank *Doing Business* 2010

1% per capita GDP or lower Loan Floor, 2007-2010 (N=25)



- Albania
- Armenia
- Azerbaijan
- Belarus
- Bulgaria
- Croatia
- Egypt, Arab Rep.
- Ghana
- Indonesia
- Kenya
- Mauritius
- Montenegro
- Morocco
- Mozambique
- Oman
- Papua New Guinea
- Russian Federation
- Rwanda
- Sri Lanka
- Syrian Arab Republic
- Tunisia
- Uganda
- Ukraine
- United Arab Emirates
- Uzbekistan
- West Bank and Gaza
- Zambia

Source: World Bank *Doing Business* 2010

**Also largely accounted for by expansion
of credit reporting into microlending**

Expansion of Consumer Rights of Access 2007-2010 (N=27)



Source: World Bank *Doing Business* 2010

- Albania
- Belarus
- Colombia
- Croatia
- Egypt, Arab Rep.
- Georgia
- Guatemala
- Honduras
- Indonesia
- Iran
- Kenya
- Kyrgyz Republic
- Macedonia
- Mauritius
- Morocco
- Russian Federation
- Rwanda
- Serbia
- South Africa
- Sri Lanka
- Tunisia
- Uganda
- Ukraine
- United Arab Emirates
- Vietnam
- Yemen
- Zambia

Some like Egypt as part of comprehensive CR development, others like Indonesia as registries become oriented towards risk assessment

Including Firms as Well as Individuals 2007-2010 (N=10)



- Ghana
- Greece
- India
- Montenegro
- Papua New Guinea
- Russian Federation
- Syrian Arab Republic
- Uganda
- Uzbekistan
- Zambia

Source: World Bank *Doing Business* 2010

Changes & Proposed Changes in APEC Region (N=9)



A blue left bracket and a gold right bracket are positioned at the top of the slide. A thin gold horizontal line spans the width of the slide, with a thicker black horizontal line below it.

Agenda

Introduction: APCC Overview

Changes in the Credit Reporting Landscape

Surprises, Choices and Pitfalls: 5 Lessons

Conclusions



Lesson 1:

**Changed lending patterns, yes,
but first the
“valley of transition”.**

Expected Changes in Lending Patterns

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, Colombian files	Majnoni et al., Argentinean files	Majnoni et al., Brazilian Files	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

Expected Changes: Distributional Fairness

Table 2: Change in the Acceptance Rate with Reporting Regime Change

	US Full-File (Neg.-Only = 1.00)	Colombia Full-File (Neg.-Only = 1.00)
Ethnicity		
Black	1.28	
Hispanic	1.37	
White	1.22	
Age		
18-25	1.47	18.31 (a)
26-35		
36-45	1.22	6.48 (b)
46-55	1.21	4.54 (c)
56-65	1.20	3.85 (d)
>65	1.19	
HH Income (000)		
<20	1.36 (a)	
20-29	1.3 (b)	
30-49	1.24	
50-99	1.21	
>99	1.18	
Gender		
Female		12.39
Male		5.91
(a) Actual Range is 18-32; (b) Actual Range is 32-42, (c) Actual Range is 42-50; (d) Actual Range is > 57.		

Fairer access: these studies also indicate that credit access widens to under privileged groups (ethnic minorities, low-income segments, women)

Evidence from

- **US**
- **Colombia**

Expected Changes as Monitoring Devices

Wider access & fair distribution are indicators of a better functioning lending system, resulting from information sharing...

...in the long run

Short run may involve potential surprises

The Valley of Transition

Sometimes information sharing is followed by a contraction of credit access , i.e., it “gets worse before it gets better,” Logic:

- When only negative information is shared, overextensions are hard to observe when borrowers utilize multiple lenders to service debt.
- Only negatives reported here means overindebtedness is NOT observed

**Information sharing shows overextended customers.
Potential consequences:**

- Banks reduce lending because of an uncertainty about the risk associated borrower
- Banks reduce lending because of the need to cover defaults results from withdrawal of credit

The Valley of Transition: Hong Kong and Others

Hong Kong: information sharing a response to rising credit card bankruptcies

- Info sharing reveals large numbers servicing debt with debt
- Bankruptcy filings increased from 893 in 1998 to 4,606 in 2000 to 25,328 in 2002.
- Bankruptcies spiked as lenders became increasingly aware of borrowers using loans to service other loans
- Two-year recovery time

**Potential similar pattern in Argentina with SMME loans
BUT not seen in Russia**



Lesson 2:
**Gradually change most of the
time, but not on all dimensions**

Gradual v. Rapid Implementation


Rapid v. gradual expansion (practice):

- Data furnisher comfort levels (e.g., skills infrastructure, competition)
- Consumer protection, practices must emerge in tandem

Gradual v. Rapid Implementation

Rapid v. gradual expansion of laws/regulations:

- Concerns for societal norms of privacy
- Concerns about “fit” of other regulations
 - Bankruptcy and collateral
 - Creditor rights
- Concerns for development of lending markets (structure of secondary markets, e.g.)



Lesson 3:
**More data reduces identity
based crime**

Data Security Issues

All else being equal, the fact of more data being “out there,” that is, in more databases, increases the chances of data in unauthorized hands.

BUT all else is NOT equal: more data also available to fight identity theft.

- Payment patterns available to them to identify fraudulent activity.
- Truth databases to verify identity and simply to identify fraud.

Data Security Issues: The Role of Disclosures

Reporting of new account information to a centralized third party **allows a data subject to review what new accounts** have been opened in her/his name.

Free disclosures serve as **instruments to reduce ID theft**. Key is to engage the data subject.

Declining number of ID theft cases and **declines in total losses** in recent years in US following FACT Act (mandated free disclosures).

A decorative horizontal line consisting of a thin black top line and a thicker, light olive-green bottom line. A blue left square bracket is positioned on the left side, and a gold right square bracket is on the right side.

Lesson 4:

More and better data

Data Quality Issues: More and Better Data

Positive data can improve data quality:

1. Positive systems are more likely to be automated, i.e., **less human error**
2. Positive data—like account balances, credit limit data, etc.—allow for **internal tests of consistency**

Data Quality Issues: More and Better Data

Positive data can improve data quality:

New PERC study found:

- 0.5% of credit reports had dispute outcomes resulting in material change (upward movement of +1 risk tiers);
- 0.98% of credit reports had dispute outcomes resulting in 25 point or more increase.
- 95% of study participants who disputed information satisfied with dispute resolution.

99.5% of all tradelines reviewed (81,238) either confirmed accurate or not disputed.

A blue left bracket is on the left side. A gold right bracket is on the right side. A thin black horizontal line and a thicker gold horizontal line are positioned below the brackets.

Agenda

Introduction: APCC Overview

Changes in the Credit Reporting Landscape

Surprises: Choices and Pitfalls

Conclusions

Pipe-in vs. Pipe Out

Do not view reform merely as compliance issue (pipe out)

New data creates new business opportunities (pipe in)

If lawyers are driving process, your firm will lose

Participate in meaningful pre-transition testing

Trends are clear—must reform to remain competitive

Critical Moment for Australia *Part I*

Role of credit data sharing in lending/economy under-appreciated in Australia.

Issue is BIGGER than banking—it is about asset building/wealth creation, social equity or fairness, sustainable economic growth.

Issue is BIGGER than privacy—must weigh actual privacy risks (if any) against actual social and economic benefits of increased credit information sharing.

Critical Moment for Australia *Part II*

Ownership structure matters—bank ownership of private credit bureaus distorts competition.

- Creates conflicts of interests (Mexico, Russia, Singapore)
- Negatively affects retail credit market (Japan)

MUST NOT LET WINDOW FOR REFORM CLOSE:

- **Coalition build**—ARCA needs more diversity
- **Reframe issue**—policymaker education needed

POLICY & ECONOMIC RESEARCH COUNCIL

302 E. Pettigrew St., Suite 130
Durham, NC 27701

www.perc.net

Phone: +1.919.338.2798

