



APFF

Asia-Pacific Financial Forum



Key Messages

Credit Information Systems

2015

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BACKGROUND

Most micro-, small and medium enterprises (MSMEs), lack sustainable access to finance, preventing them from effectively participating in economic activities, joining global value chains, and benefiting from the growth of trade and investment. Entrepreneurs and business owners at the micro- and small end of the spectrum often lack fixed or moveable assets that can be used as collateral. Many economies furthermore do not have systems that make effective use of moveable assets. Reputational collateral if available could be used by lenders to bridge the gap, as it is used in many developed economies.

MSMEs and consumer are often excluded from the credit system as a result of asymmetric information, which stems from the fact that a lender's knowledge of a borrower's likelihood to repay (their "risk profile") is imprecise and must be inferred based upon available information. The assessment of risk is crucial as loans involve an agreement to pay in the future. One common result of information asymmetries is the misallocation of credit, as risk profiles are incorrectly assessed in both directions—with high-risk borrowers confused for low-risk ones and vice versa.

Credit information sharing systems help overcome the problem of asymmetric information. Credit information, can bridge the financing by gap by giving lenders greater capacity to identify good risks and bad risks correctly. A properly structured credit information sharing system, as a core element of financial infrastructure, can help close the financing gap for consumers and MSMEs. Where credit information systems provide only negative information, information available to lenders is inadequate and only those inside the system continue to benefit. Where positive data is included but only credit information from financial institutions is provided, individuals who wish to start businesses but have no previous credit history are excluded. Credit information systems that are full-file (collecting both negative and positive data) and comprehensive (collecting data from many sectors, including from non-financial provides such as utilities payments) create a more inclusive financial system. Additionally, private credit bureaus, which are typically focused on providing information, specifically tailored to lenders' needs, are associated with higher lending to consumers and MSMEs. Effective credit information systems can be based in a robust legal and policy frameworks that balances the objectives of consumer and privacy protection with that of access to data, and supported by financial education to promote capacity of lenders and borrowers to effectively use them.

Numerous studies have validated these findings. Barron and Staten found, for a 3% default target, an 87.9% increase in acceptance rates when switching from negative-only information to full-file using U.S. data.¹ Similarly, World Bank research reports, for a 3% default target, a 21.7% increases in lending in Argentina and a 47.3% increase in lending in Brazil for the same switch.² PERC research found similarly that including non-financial data significantly increases access to credit. For a 3% default target, the inclusion of utility payment data enables lenders to extend credit to an addition 5.5% of the total applicant pool and inclusion of telecom data extends credit to 4.1% in the United States.³ Given that the share of the population that are financially excluded in emerging markets are larger than seen in the US, this figure can be much larger with the right data sources.

¹ John M. Barron and Michael Staten, "The Value of Comprehensive Credit Reports: Lessons from the U.S. Experience," in *Credit Reporting Systems and the International Economy*, Margaret M. Miller ed., 273-310 (Cambridge, MA: MIT Press, 2003).

² 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, November 2004).

³ Michael Turner et al., *Give Credit Where Credit Is Due* (Washington, DC: Brookings Institution, December 2006).

RECENT PROGRESS IN APEC ECONOMIES

APEC member economies have been developing credit bureaus and expanding the credit information sharing system to collect data from retailers, non-financial service providers, and microfinance institutions. Member economies have also been working to promote a robust private sector engagement in the market for credit information products and services.

DEVELOPMENT OF THE PRIVATE SECTOR: In Indonesia and the PRC, new reforms are paving the way for the emergence of private sector bureaus.

CREATION OF GREATER COMPETITION: In Mexico, the competition commission has been working to improve the functioning of credit information systems by promoting greater competition and thereby greater financial inclusion.

EXPANSION OF ACCESS TO DATA: The new Philippine credit registry resulting from reform will greatly increase the data available to credit bureaus and thereby to lenders for underwriting, making it more efficient and inclusive.

FINANCIAL INFRASTRUCTURE DEVELOPMENT NETWORK & PATHFINDER INITIATIVE

The development of credit information sharing systems will be a core element of APFF's proposed new initiative, the Financial Infrastructure Development Network (FIDN), which brings together private and public sector actors, multilateral institutions and industry associations to undertake workshops, dialogues and studies to promote the following:

- Legal frameworks for credit information systems based on the World Bank's General Principles of Credit Reporting;
- Model language for regulations governing the sharing of public data with credit information systems among participating economies;
- Working with the private sector to improve the capacity of lenders in the use of credit information products and value added services;
- Benefits of and pathways to a common data format/dictionary for credit information systems in APEC economies;
- Examining the benefits and challenges of linking the credit information databases of APEC members, forming a regional credit information network, and the use of credit information to support cross-border trade and services; and
- Online resources aimed at policy makers as well as a series of workshops focused on building capacity for developing regulatory frameworks, establishing and operating private credit bureaus and enhancing lenders' ability to use credit information.

APFF is looking to launch a pathfinder initiative that will address how to create a policy driven environment that enables many more of the MSMEs in the region to access finance. Credit information systems when properly structured are a core part of the financial infrastructure.

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For further information please contact: Robin Varghese, Vice President of International Operations, PERC, at varghese@perc.net