



Credit Bureaus
Enabling Economic
Growth & Prosperity





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The development of a country's financial sector is directly related to its development as a whole: a strong financial infrastructure provides the essential capital needed to allow entrepreneurship to flourish.

Credit Bureaus

Enabling Economic Growth & Prosperity

Information is the lifeblood of the modern economy. Still, in many countries, information about a business's or individual's credit track record is simply unavailable. The result: borrowing money is difficult and interest rates are high to offset the higher risk. Visa recognizes the importance of bridging this gap and is supporting the work of IFC to set up or improve credit bureaus in developing countries.

Today, less than 25 percent of the people living in developing countries have access to formal financial services, including banks, as compared to up to 90 percent in developed markets. But while such access is essential, it does not tell the whole story: in many developing countries, banks and other lending institutions often focus on large commercial clients and top retail clients, which, due to both existing reserves and substantial collateral, pose low lending risk. Loans to underserved populations, which have neither and therefore pose potentially high lending risk, are either priced too high or are simply unavailable.

Credit bureaus can help correct this imbalance by allowing banks and other lending institutions to collect and share data on millions of potential borrowers, thus allowing lenders to gather information on the creditworthiness of each. By facilitating information exchanges among lenders, credit bureaus help them sort good borrowers from bad, price loans appropriately, decrease processing time and reduce screening and other transaction costs.

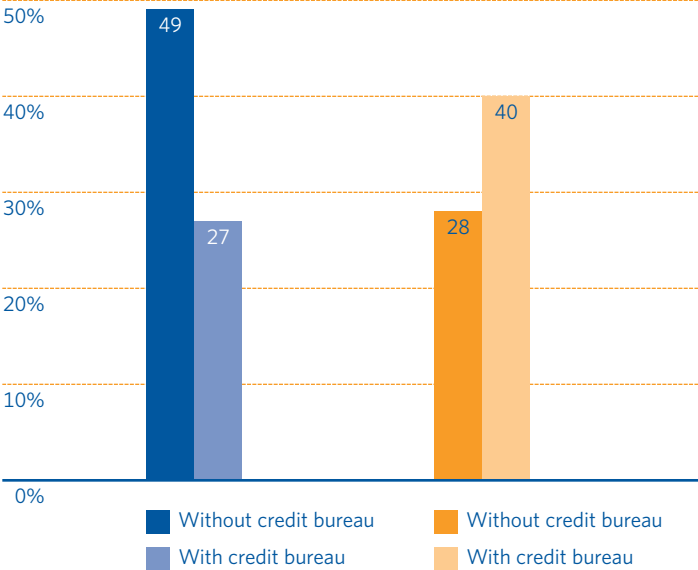
By the same token, credit bureaus also help banks and other financial institutions recover loans: when borrowers know that their credit information will be shared, they have an additional incentive to pay. Good borrowers also benefit from lower interest rates, as lenders compete for their business.

Strong credit bureaus are therefore essential not only to individual prosperity, but also to a country's overall economic growth.

Credit Bureaus Increase Access to Loans for Small Businesses

Percent of small firms reporting high financing constraints

Probability of a small firm obtaining a bank loan



Estimates based on data on 5000 firms in 51 countries

Source: Love & Mylenko, 2003

Private v Public Bureaus

There are two types of credit bureaus: public and private. Both can exist in the same country. Private bureaus can be found in approximately 60 countries and in nearly every developed country. Public credit bureaus, usually set up by central banks and found mostly in developing countries, exist in approximately 70 countries.

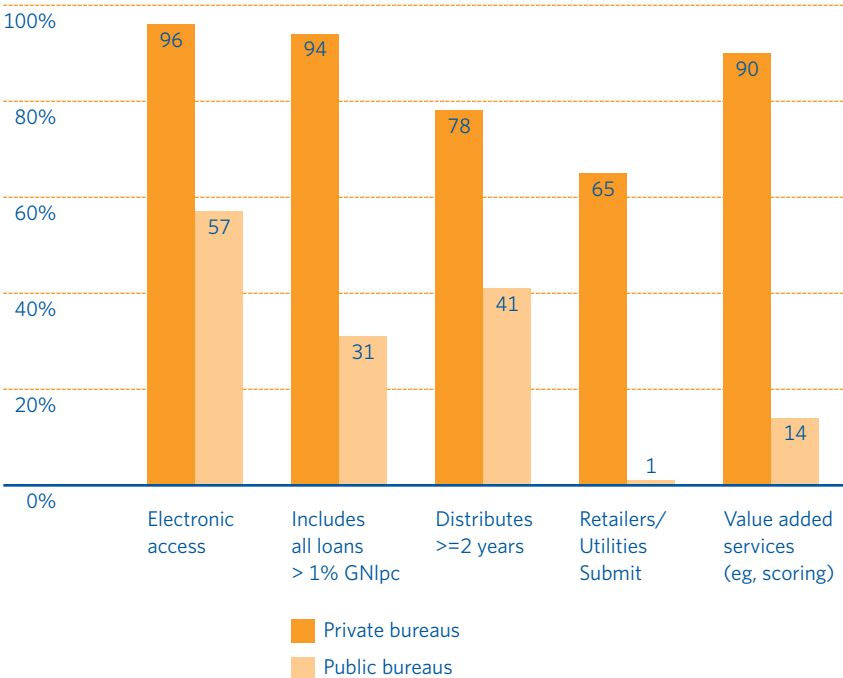


Public registries are managed by the government, usually the central bank or bank supervision agency. Because public registries are set up to support bank supervision and monitor systemic risk, rather than to facilitate credit transactions, they usually only include loans above a certain amount. They may also have restrictions on who may submit data—for example, banks v retailers. The time period from which such data is available also varies—from as little as two years to as much as 10. Finally, public registries typically restrict who has access to the credit information collected, when this information can be made available (eg, within 24 hours), how it can be made available (eg, electronically) and how much it will cost. As a result, they do not always provide lending institutions with the information they need to develop accurate risk analyses.

Private bureaus, formed in response to market needs, are better designed for facilitating credit transactions: they collect information from a wider range of sources—trade creditors, retailers, courts and utility companies—and over a longer time period. They also have fewer restrictions on access to this data.

In developing and transitioning countries, where fewer people have access to formal banking services, such non-traditional sources can be a valuable predictor of credit risk. A World Bank study found that in the United States, including information from non-bank businesses allows lenders with a target approval rate of 60 percent to reduce default rates by 38 percent.

Private Bureaus Are Better Oriented to Serve Lenders



Source: World Bank "Credit Reporting Systems Project", 2002

Positive v Negative Information Sharing

An important distinction is whether credit bureaus gather and distribute “positive” or “negative” information—or both.

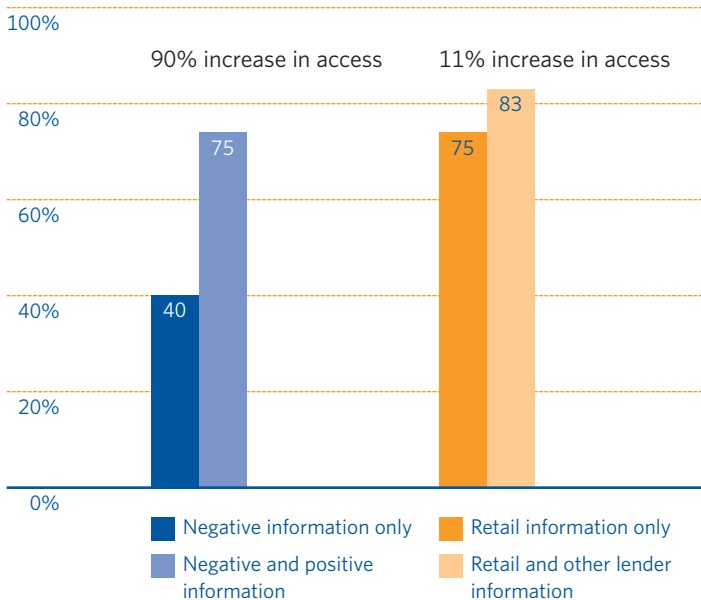


Negative information includes history only on past defaults. Information pertaining to debt is deleted from credit history if and when the debt is repaid.

Positive (“full-file”) information includes a more comprehensive credit portrait. It includes records on all open and closed credit accounts, including the amount approved, defaults and other repayment details.

More Information Increases Access to Finance

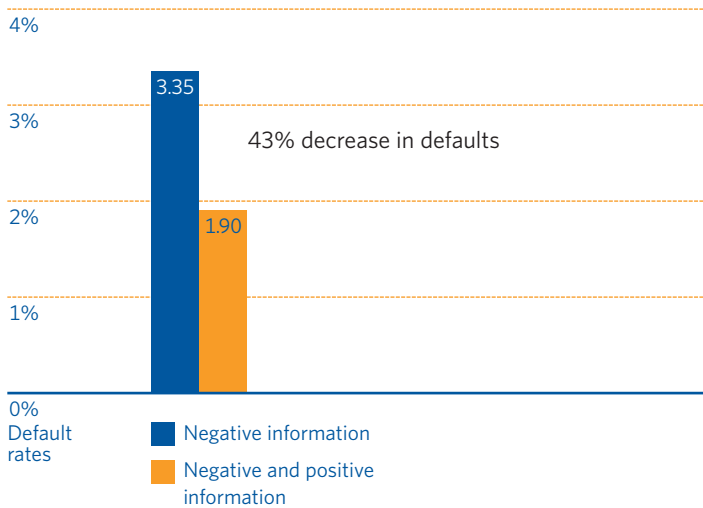
Percent of applicants who obtain a loan



Source: Barron & Staton, 2000

Default Rates Decrease with Positive Information

Effect on default rates of including positive information (simulation using U.S. data)



Source: IFC "Credit Bureau Knowledge Guide", 2006

A report that includes positive information allows the lender to assess credit risk more accurately. A report that only lists negative information (ie, defaults) would exclude high-risk lenders who have amassed a significant amount of debt but who have not yet defaulted.

A World Bank study, based on information from Argentina, found that even large lending institutions can experience a significant drop in defaults (and a corresponding increase in lending volume) if positive information is included in credit reports.

Legal & Regulatory Framework

A strong legal and regulatory framework is critical to the success of the credit reporting process. Strong laws that include the following characteristics can help the development of robust credit reporting and thus contribute to economic growth:



Open system. A system that allows financial institutions as well as non-bank entities—retailers, telecom and utility companies—access to credit history.

Permissible purpose. Legislation that protects the rights of individuals and firms, which permits information sharing while ensuring that data is not misused. Access to information is often only allowed for certain purposes, such as credit approval, portfolio monitoring, debt collection and employment.

Authorized access to information. Laws that allow only authorized parties to access credit information and permit that information to be used only for permissible purposes.

Consent. Explicit or implicit individual borrower consent should be required to both provide data to the bureau and to access a credit report. This allows individuals to control how, when and where their credit history is shared.

Length of information retention. Legislation which allows credit information to be stored for only a specified length of time. According to a World Bank survey, out of 78 private credit bureaus, 57 preserved historical information for more than five years, and 34 credit bureaus preserved data between five and seven years.

Positive and negative information sharing. Because lenders may be hesitant to share positive information (for fear their competitors might poach their best customers), laws should allow for information sharing while restricting the ability of banks to poach other banks' customers. For example, the legislation may specify that a lender can only access a bureau's information if an individual or a firm has applied to the lender for credit.

Consumer protection. Regulations that allow individuals to check their own credit history as well as the ability to correct erroneous information.

Licensing and registration. Licensing requirements that require credit bureaus to meet certain financial, security and governance standards. In the absence of licensing or registration procedures, any errors or disputes will need to be resolved through the courts. This approach works well in countries that have well-developed and efficient judicial systems, and where consumers can file a class-action lawsuit in case of systemic violations. Most developing countries opt for a strong regulatory agency instead.

Access to public information. Public information should be available at low or no cost.

Enforcement of such laws and regulations is also essential to the smooth functioning of credit bureaus. Generally, one of two approaches is taken:

Supervisory authority. A strong supervisory authority with the power to license, register and control credit bureaus. The authority's functions usually include issuing industry regulations, granting licenses, conducting or requesting audits, receiving and analyzing complaints, and imposing penalties.

Industry self-regulation. The enforcement authority's role is limited to issuing clarifying statements, collecting complaints, and in some cases bringing class-action suits in case of systematic violations—all within a legal framework.



Visa & the International Finance Corporation

Helping to Support the Development of Credit Bureaus in Developing Economies

As one of the world's leading payment companies, Visa is committed to extending access to finance to the unbanked community. Credible and reliable credit information is critical to businesses and individuals, and effective credit bureaus are essential to the development of a country's economy.



Since 2005, Visa has been working with the International Finance Corporation (IFC), the private sector arm of the World Bank Group, on its Global Credit Bureau Program. Since the launch of the programme, IFC has supported the development of credit bureaus in over 40 countries through technical assistance and investment, including support to the regional credit bureau in Central America and the first private credit bureau in Egypt, work on the legal and regulatory framework in Kenya and Panama, and ongoing assistance towards the development of a private bureau in Vietnam.

Visa provides global programme support for the IFC Global Credit Bureau programme, and is pleased to collaborate in other areas of shared interest including microfinance.

For more detailed information on credit bureaus, please refer to the "Credit Bureau Knowledge Guide" published by IFC.



International Finance Corporation

Headquarters
2121 Pennsylvania Avenue, NW
Washington, DC 20433-0008
United States of America

Visit us as www.ifc.org

Visa International Service Association

Corporate Headquarters
P.O. Box 8999
San Francisco, California 94128-8999
United States of America

Visit us at www.corporate.visa.com

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