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# SmartLessons

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## Establishing a Sound Credit Reporting System: Perspective from *Doing Business*

*Credit registries and bureaus—essential elements of the financial infrastructure—enhance access to financial services. By sharing credit information, they help reduce information asymmetries, increase access to credit for small firms, improve borrower discipline, and support bank supervision and credit risk monitoring. This SmartLesson focuses on the Doing Business Getting Credit – Credit Information index, which measures rules and practices affecting the coverage, scope, and accessibility of credit information available through a credit registry or bureau.*

**Background**

The importance of credit reporting is highlighted by its inclusion in the World Bank-IFC *Doing Business* project—an annual report documenting the regulations that enhance and constrain business activity (see Box 1). However, 35 of the 189 economies measured by *Doing Business* do not have an agency that compiles and distributes credit and personal information to lenders. Recognizing this gap in information sharing, we offer some lessons learned and good practices observed worldwide in establishing well-functioning credit reporting systems.

**Lesson 1: Establish a sound legal and regulatory framework.**

The launch of a credit registry or bureau is often preceded by legislation that establishes the environment, rules, and rights of the public and private stakeholders involved. The legal and regulatory framework for credit reporting should be clear, fair, and supportive of consumer rights. In 2012/13, respondents reported that credit bureau laws exist in 76 of the 189 economies measured, central bank regulations in 103, banking laws in 100, data protection laws in 94, and consumer protection laws in 56.

While the legal framework differs from

**Box 1: About *Doing Business***

The *Doing Business* project, launched in 2002, looks at domestic small and medium companies in 189 economies and measures regulations that apply to them through their life cycle. The annual report provides quantitative measures of regulations for starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts, and resolving insolvency. *Doing Business* also measures regulations on employing workers.

The Getting Credit indicator is composed of two parts: 1) the legal rights of borrowers and lenders on secured transactions, and 2) the sharing of credit information. For the latter, *Doing Business* acquires data in two stages: First, it surveys banking supervision authorities and public information sources to confirm the presence of a credit registry or bureau. Second, when applicable it administers to the registry or bureau a detailed questionnaire on its structure, laws, and associated rules. *Doing Business* verifies questionnaire responses through several rounds of follow-up communication with respondents as well as by contacting third parties and consulting public sources, and it confirms questionnaire data through teleconferences or onsite visits.

economy to economy, it should establish the rights and obligations of the credit reporting agency, data providers, users, and data subjects. It should also provide clear guidelines on permissible and prohibited data, data security obligations, data retention periods, other compliance matters, and actions in the event of noncompliance.

In 2012/13, 11 economies enhanced access to credit information by adopting laws or regulations improving frameworks for sharing credit information. For example, in June 2012, Bhutan adopted the Regulations for Licensing and Functioning of the Credit Information Bureau, which provides details of data to be supplied to the credit bureau, reporting modalities, time limits, and the terms and conditions of using the data and information by authorized users. In December 2012, the Bank of Tanzania published the Credit Reference Bureau Regulations, stipulating the licensing and governance of the credit bureau, the obligations of the credit bureau and data providers, the protection of data subjects, and the power of the banks.

A sound legal and regulatory framework should also establish consumer rights and provide a framework for consumer concerns with credit reporting data that may result from fraud, data entry mistakes, and improper merging of information by the credit reporting agencies. For example, in January 2013, China adopted the new Credit Information Industry Regulations, which cover the collection, collation, preservation, and processing of personal credit information, as well as the distribution of information to the user of the credit registry. Specifically, Clause 17 of the Regulations guarantees borrowers' right to access their data in the credit registry twice a year free of charge.

### Lesson 2: Set up a credit reporting agency.

Establishing a new credit bureau or registry is an important move to improve access to credit in an economy (Box 2). Over the past 10 years, more individuals and firms have been listed in a credit bureau's or registry's database (Figure 1). A study in China finds that borrowers' access to credit increases when banks obtain additional information through a credit registry.<sup>1</sup> Borrowers with information from

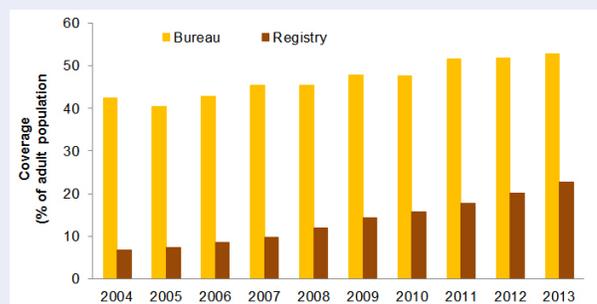
<sup>1</sup> X. Cheng and H. Degryse, "Information sharing and credit rationing: Evidence from the introduction of a public credit registry," European Banking Center Discussion Paper, 2010

#### Box 2: Credit Bureau versus Credit Registry

**Credit bureau**—a private firm or nonprofit organization that maintains a database on the creditworthiness of borrowers in the financial system and facilitates the exchange of credit information among banks and other regulated financial institutions.

**Credit registry**—a database managed by the public sector (usually by the central bank or the superintendent of banks) that serves primarily to supervise financial activities in economies while providing similar credit reporting functions as a credit bureau.

Figure 1. Increasing credit reporting system coverage, 2004-2013



Note: Coverage indicator reports the number of individuals and firms listed in the credit bureau's or registry's database as of January 1, with information on their borrowing history from the last five years. The number is expressed as a percentage of the adult population aged 15 and above, according to the World Development Indicators.

Source: World Bank Group, Doing Business database, 2013 edition.

a second bank in the credit registry receive higher credit limits than other borrowers.

Sharing credit information can also benefit lenders. Research in Albania concludes that information from a credit registry improves loan performance; loans given after the launch of the credit registry in Albania are 3 percentage points less likely to turn problematic.<sup>2</sup>

As of January 2013, over 1.3 billion individuals and firms worldwide are covered by a credit bureau and 600 million by a credit registry. The number of credit bureaus recorded by *Doing Business* grew from 48 out of 145 economies in 2004 to 99 out of 189 economies in 2013 (Figure 2). The number of credit registries increased from 61 out of 145 economies in 2004 to 93 out of 189 economies in 2013 (Figure 3).

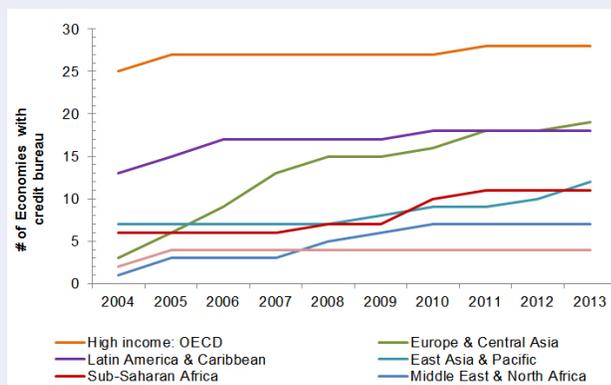
Establishing a credit bureau or registry requires significant investment and coordinated efforts across the public and private sectors. For example, the first Credit Bureau of Moldova was founded in 2011—with the joint effort of 14 commercial banks and a total investment of \$1 million—to sustain information sharing between financial institutions. Its coverage grew by over 50 percent in two years, from about 76,000 firms and individuals in January 2011 to over 115,000 in January 2013. By February 2013, with Tajikistan's credit bureau starting operations, nearly all economies in Europe and Central Asia had established a functioning credit reporting system.

### Lesson 3: Consider nonfinancial institutions as data providers.

For a comprehensive picture of a borrower's payment behavior, credit reporting agencies should consider data not only from financial institutions but also from nonfinancial

<sup>2</sup> P. Behr and S. Sonnekalb, "The effect of information sharing between lenders on access to credit, cost of credit, and loan performance—Evidence from a credit registry introduction," *Journal of Banking and Finance*, 2012.

Figure 2. Europe and Central Asia established the most credit bureaus (private), 2004-2013



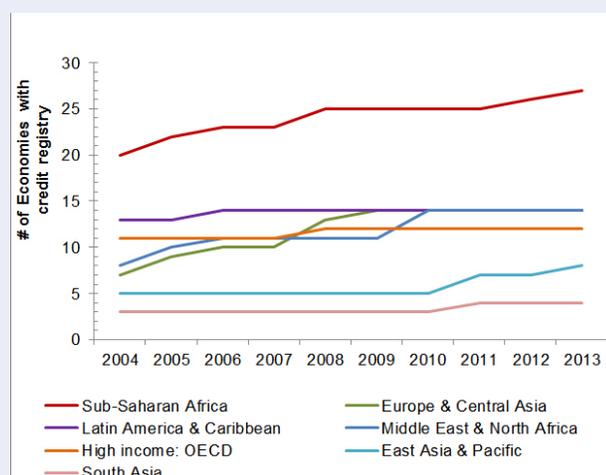
Source: World Bank Group, *Doing Business* database, 2013 edition.

entities such as trade creditors, retailers, and utility companies. Since credit registries have a different mandate than bureaus, it is usually the credit bureaus that collect and distribute data from the nonfinancial institutions.

Including credit information from nonfinancial institutions is one effective way to expand the range of information distributed by credit bureaus. Providing information on payment of consumer loans or electricity bills can help establish a good credit history for those without previous bank loans or credit cards. This represents an important opportunity for expanding access to finance for people without traditional banking relationships.

According to the *Doing Business* survey, 32 of 99 credit bureaus around the world distribute credit information from trade creditors, 41 from retailers, and 30 from utility companies. In April 2011, for example, two mobile phone companies and an electricity and gas company in Rwanda started providing credit information to the credit bureau, leading to an immediate 2 percent increase in the number

Figure 3. Sub-Saharan Africa established the most credit registries (public), 2004-2013



Source: World Bank Group, *Doing Business* database, 2013 edition.

of firms and individuals registered in its database. In November 2012, two Bahraini car dealers started sharing payment history with a credit bureau, because they had suffered from high-risk customers and delinquency and came to understand the advantages of participating in credit reporting with the bureau.

In addition, 21 credit bureaus and registries worldwide share information with other credit reporting agencies, 15 distribute information from courts, and 3 from statistical agencies. Also, 64 credit bureaus and 30 credit registries provide data from microfinance institutions. For example, Kazakhstan enacted legislation in November 2012 that enabled microfinance institutions to share data with credit reporting agencies, increasing the coverage of the credit bureau by almost 7 percent. In January 2013, Kenya passed its Finance Act, requiring all institutions, including microfinance institutions, to share credit information with the credit bureau.

**Lesson 4: Report the good as well as the bad.**

Credit information can be negative (covering defaults and late payments) or positive (such as on-time loan repayments and the original and outstanding amounts of loans). A credit reporting system that distributes only negative information penalizes borrowers who default on payments but fails to reward borrowers who pay on time. Sharing information on reliable repayment allows customers to establish a positive credit history and improves lenders' ability to distinguish good borrowers from bad ones. It also ensures that a credit reporting system will include high-risk borrowers that have accumulated significant debt exposure without yet defaulting on any loans.

Sharing full information makes a difference for both borrowers and lenders. A study in Brazil finds that 56 percent of the sample population would get credit if only negative information is used, but more than 82 percent would get credit if both positive and negative information is available.<sup>3</sup> Access to positive information also would reduce the default rate from 3.37 percent to 1.84 percent of loans issued—equivalent to about a 45 percent reduction in portfolio losses for Brazilian banks. In June 2011, Brazil adopted the Positive Registry Law, allowing credit bureaus to collect and share positive information.<sup>4</sup>

According to *Doing Business*, 11 of the 154 economies with a credit reporting system still share only negative information, indicating a move toward full information sharing. For example, in December 2010, the central bank of Oman launched the Bank Credit and Statistical Bureau System, which collects positive and negative information

<sup>3</sup> A. Powell, N. Mylenko, M. Miller, and G. Majnoni, "Improving credit information, bank regulation and supervision: On the role and design of public credit registries," Policy Research Working Paper 3443, World Bank, Washington, D.C., 2004.

<sup>4</sup> Reduction in default rate from 3.37 percent to 1.84 percent is based on the assumption that banks extend credit to 60 percent of the population. If banks extend credit to 40 percent of the population, the default rate would decrease from 2.78 percent to 1.30 percent of loans issued.

on borrowers, including information on any type of credit facility and on both performing and nonperforming loans. In March 2013, the Philippines' BAP Credit Bureau replaced the old Loandex system with a new Positive Data Sharing System, which covers consumer and microfinance loans.

### **Lesson 5: Distribute historical data within an optimal timeframe.**

After credit reporting agencies collect the information, for how long should they distribute the data to users? Credit bureaus and registries should strike a balance between lenders' need to have sufficient information for risk assessment and borrowers' right to improve their credit history over time.

About one-half of credit bureaus and one-third of credit registries measured by *Doing Business* distribute three to five years of historical information to users. The next most common timeframe, for more than one-fourth of credit bureaus and one-fifth of credit registries, is six to ten years.

Both extremes—sharing no historical information and distributing it indefinitely—may hurt lenders and borrowers. For lenders, when credit reporting agencies do not preserve historical information or erase negative data upon repayment, assessing credit risks becomes more challenging. For borrowers, when credit reporting agencies distribute repayment shortfalls indefinitely, it weakens incentives to improve repayment habits and impress future lenders. According to *Doing Business*, only 1 of 99 credit bureaus and 2 of 93 registries do not distribute any historical information, while 5 bureaus and 10 registries erase negative information immediately upon repayment. Only six credit bureaus and five registries distribute all available historical data indefinitely.

Today, 82 credit bureaus and 37 credit registries distribute more than two years of historical data. The historical purpose of a credit registry (to supervise and monitor systemic risk in the financial sector) helps explain why it is less likely to distribute historical data than a credit bureau (which aims to facilitate the exchange of information for credit-granting purposes). When credit reporting agencies do distribute historical data, they should distribute at least two years of information.

### **Lesson 6: If beneficial, enable cross-border credit reporting.**

In the course of globalization and financial liberalization, borrowers have become more mobile and so may require access to credit abroad. For financial institutions to assess the creditworthiness of borrowers outside of their domestic market, credit information needs to become available across borders.

For example, nine central banks in Europe—Austria, Belgium, the Czech Republic, France, Germany, Italy, Portugal, Romania, and Spain—signed a memorandum of understanding that encourages credit registries to exchange credit information on a regular basis and allows institutions to inquire about the indebtedness of a borrower in participating countries.<sup>5</sup> Some European credit bureaus have signed similar bilateral agreements to exchange information on the basis of reciprocity, such as between SCHUFA in Germany and several credit bureaus in Europe, including Austria (KSV1870), Greece (TIRESIAS), Ireland (ICB), Italy (CRIF), Lithuania (Creditinfo), Netherlands (BKR), Poland (BIK), Slovenia (SISBON), Spain (Equifax) or Sweden (UC).

However, cross-border data transfer involves many challenges. Different legal frameworks, especially those concerning data privacy protection, may apply and be in conflict with the credit reporting agency's domestic obligations. In addition, different market practices, data content, and terminology may impede sharing of credit information in foreign markets. A framework for cooperation between relevant institutions and regulators can help mitigate potential risks.

### **Conclusion**

A sound credit reporting system can be an effective tool for fostering access to credit in an economy, especially for individuals and small firms. The practices outlined in the lessons above help lenders assess borrowers' creditworthiness using objective criteria—and benefit deserving borrowers by increasing their chances to get credit. And enhancing access to credit improves stability and opportunities for families, businesses, and the economy as a whole.

<sup>5</sup> Signatory countries that face national legal obstacles are not committed to the exchange of information under this MoU; instead, they agree to strive to remove the legal obstacles prohibiting the exchange of such information (listed in an annex for each of the relevant countries).



#### **DISCLAIMER**

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