Operations of credit bureaus

The Financial Express, December 18, 2005

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Credit, in simple terms, signifies lending with corresponding borrowing and a process of repayment, usually at an agreed rate of interest. A credit bureau is an agency that researches and collects individual credit information and sells it for a fee to creditors/members so they can make a decision on granting loans. It not only collects but also processes and stores credit information - both positive and negative - both on the existing borrowers and the potential.

Typical clients of a credit bureau include banks, mortgage lenders, credit card companies and other financing companies. They are also commonly referred to as consumer reporting agency or credit reporting agency.

Functions

The primary function of a credit bureau is to act as a repository of credit information - both current and historical data on existing and potential borrowers. These bureaus provide a platform for sustainable growth of BFSI by helping in fraud and loss prevention and enabling the member institutions to achieve higher accuracy in risk prediction. It also facilitates faster decision making in regard to sanction of credit and identify good borrowers, thus reducing the incidence of adverse selection. It solves the problem of asymmetric information between borrowers and lenders especially when the cost of collecting and collating the information is exorbitantly high and time consuming as well.

Benefits

The benefits emanating from setting up of credit bureau can be classified for each stakeholder as under:

Banks

- Measure and price the underlying risk of an account objectively thereby minimizing lending risks
- Gain better understanding of the credit history of customers
- Effective management of cross-institution exposures
- Improved credit portfolio
- Help institutions increase segment specialisation and market products better
- Standardisation of credit allocation
- Easier, faster and cheaper processing of credit applications
- Enhance credit risk management practices in line with global best practices

Customers

- Pricing that accurately reflects individual circumstances
- Access to easy credit for good customers
- Greater understanding by customers of the need to manage their credit

Regulators

• Gain access to accurate and timely data about the state of the consumer finance market
• Promote sound development of the national credit system
• Face a reduced likelihood of significant industry delinquencies and the need to 'bail-out' or recapitalise domestic lenders

Sources of information

There are three major sources of credit information for a bureau:

• Public domain data (court judgments, records of the registrar, published information on firms, corporate, etc)

• Negative listing (where credit granters list defaulting payers)

• Closed user groups where subscribing credit institutions provide full details of their clients

The information so collected by the bureau can be either negative or positive. Negative financial data includes adverse information on the borrower such as delinquencies, defaults, penalties, frauds or bankruptcies.

Adverse public record data would find its way to the negative credit file. Positive financial data includes historical record of facilities availed and good and satisfactory performance of loan repayment. Positive data would also include favorable information in the public domain or external data.

Information for credit report

There are usually four types of information:

Identifying information

Your full name, any known aliases, current and previous addresses, unique identification number, year of birth, current and past employers, and, if applicable, similar information about your spouse.

Credit information

The accounts you have with banks, retailers, credit-card issuers, utility companies, and other lenders (accounts are listed by type of loan, such as mortgage, student loan, revolving credit, or installment loan; the date you opened the account; your credit limit or the loan amount; any co-signers of the loan; and your payment pattern over the past two years).

Public record information

Court records on bankruptcy, tax liens, or monetary judgments (some consumer reporting agencies list non-monetary judgments as well).

Recent inquiries

The names of those who have obtained copies of your credit report within the past year (two years for employment purposes).

Key requirements

In order to establish and effectively operate credit bureaus the following key requirements should be met:

Legal framework

Although credit bureaus can help to accelerate the development of financial markets and the private sector, it is important to create the right framework for credit information sharing guidelines, for example, to prevent the misuse of collected information.

A clear legal and regulatory framework allows credit reporting to function successfully. Governments can promote a supportive environment for credit bureaus by enacting and enforcing laws that ease the sharing of credit information; the relevant laws include bank secrecy regulations, data protection laws, and consumer protection provisions.

Ownership structure

The advantage enjoyed by public credit bureaus is their ability to set up operations quite rapidly because they rely on established central bank regulation rather than waiting for new laws to be enacted.

But private registries are able to collect information from a large number of sources, from financial institutions to firms selling goods on credit. They may also provide a wider range of services including investigative reports as well as value-added services, such as credit scores and ownership links.

Technology and infrastructure

Some basic questions include: Do banks have the IT ability to submit electronic data to a registry? Are the required information fields electronically collected by banks? (ie Are all banks automated ?) Can information be accessed in real-time via the Internet or a portal? Should a public bureau be operated in-house or should data storage and maintenance be outsourced to an IT firm or private bureau? Another technological challenge is how to identify borrowers in countries without unique IDs like India.

In order to maintain the integrity of the bureau, an accurate ID system must be developed. The timely collection and distribution of data depends on how each country answers these important questions. Technology and infrastructural capabilities form the backbone of an efficient credit bureau establishment and operations.

In addition to these requirements the availability of quality credit information available, manpower and other resource availability and most importantly the receptiveness to change are key factors in the establishment of credit bureaus.

The inherent distrust of both customers and lending institutions to sharing information needs to be overcome.

Global experience

Credit information bureaus have been established not only in countries with developed financial systems like USA, UK, Australia, New Zealand, France, Germany, etc, but also in countries with less developed financial markets like Sri Lanka, Mexico, Bangladesh and the Philippines. The bureaus established in these countries collect information on both the individual borrowers (retail segment) and the corporate sector.

Countries differ in terms of the type of customer information shared. For instance, countries like India, Korea, Hong Kong, Singapore, Thailand and Saudi Arabia have credit bureaus sharing both negative and positive information. While countries like Australia, New Zealand, Malaysia, Indonesia and Fiji share only negative information.

Interesting fact

In the US, once negative information appears on your credit report, there is little you can do to clear it up if the information is truthful and accurate. Generally, such information remains for about seven years, while bankruptcy filings typically stay on the credit report for about 10 years.

Conclusion

Major players (banks & non-banks) & government (regulatory authority) participation is crucial to get credit bureau concept off the ground.

It is also vital to educate consumers and lenders about the role of the bureaus & purpose of using credit reports in order to overcome the inherent reluctance to share information. In order to make the financial system more stable, the key issues need to be addressed urgently.

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