THE WORLD BANK

Facilitating SME financing through improved Credit Reporting

Report of the International Committee on Credit Reporting, chaired by the World Bank

(Draft Version for Public Comments)

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Contents

Abbreviations

BIIA	Business Information Industry Association
CRS(s)	Credit Reporting System(s)
CRSP(s)	Credit Reporting Service Provider(s)
EBA	European Banking Authority
ECB	European Central Bank
ESCB	European System of Central Banks
ESFS	European System of Financial Supervision
EU	European Union
FEBIS	Federation of European Business Information Service
FSB	Financial Stability Board
GPs	General Principles for Credit Reporting
ICCR	International Committee on Credit Reporting
IFC	International Finance Corporation
IFRS	International Financial Reporting Standards
KYC	Know Your Customer
LEI	Legal Entity Identifier
LOU	Local Operating Unit
NCA	National Competent Authorities
NCB(s)	National Central Banks
OECD	Organization for Economic Co-operation and Development
ROC	Regulatory Oversight Committee
SME(s)	Small and Medium Enterprise(s)
SSM	Single Supervisory Mechanism

Foreword

In September 2011, the General Principles for Credit Reporting were issued by the World Bank and produced under its guidance by an international task force composed by central banks, other economic authorities, multilateral organizations, consumer/data protection authorities and credit reporting industry associations. In March 2013, the Task Force agreed to continue working on the policy implications related to the implementation of the General Principles for Credit Reporting and was transformed into a permanent committee, the International Committee for Credit Reporting (ICCR). This committee is currently comprised by the Arab Monetary Fund, the Asociación Latinoamericana de Burós de Credito, Association of Consumer Credit Information Suppliers, Banco Central do Brasil, Banco de España, Banque de France, Banca d'Italia, Banco de México, Bank for International Settlements, Business Information Industry Association, Center for Latin American Monetary Studies (CEMLA), Central Bank of the Republic of Turkey, Consumer Data Industry Association, Deutsche Bundesbank, European Bank for Reconstruction and Development, Inter-American Development Bank, International Finance Corporation, People's Bank of China, Reserve Bank of India, South Africa's National Credit Regulator, U.S. Consumer Financial Protection Bureau and the World Bank.

At its meeting in Rome in March 2013, the ICCR identified credit reporting on small and medium enterprises (SMEs) as a key area requiring further development to effectively reduce information asymmetries between lenders and borrowers, and by this means contribute in improving SMEs' access to adequate external financing.

In this context, the ICCR has produced this report, which analyzes the status of credit reporting with regard to SMEs and identifies 10 possible actions that could be undertaken by authorities and other relevant policy makers to address the identified failures.

I. Introduction

1. The *General Principles for Credit Reporting* were issued by the World Bank in September 2011.[1] Since then, the World Bank and the International Committee on Credit Reporting (ICCR) have been leading efforts towards the implementation of the General Principles worldwide. Among those efforts, the World Bank and the ICCR are developing more detailed guidance for specific credit reporting areas and activities.

2. This report is one of the concrete outputs of the work following the General Principles. It addresses one of the most significant problems that limit the ability of most Small and Medium Enterprises (SMEs) around the world to obtain adequate external financing to underpin their productive activities: information asymmetries. Creditors assess the creditworthiness of credit/loan applicants based on two basic criteria: their financial capacity or ability to repay a loan, and their willingness to repay the loan. Due to information asymmetries, however, not all necessary information to assess creditworthiness of applicants is available to creditors.[2] In addition, gathering information that is not readily or easily available is overly costly. These problems are normally exacerbated in the case of SMEs, and are often a cause of the denial of loans and other forms of external financing to them.

3. A credit reporting system's (CRS) basic objective is to address information asymmetries, which is crucial for determining repayment capacity and repayment willingness.[3] Credit reporting can therefore be extremely valuable to creditors for enhanced, fact-based credit risk assessments, and in this sense can also be seen as a tool to facilitate access to financing, including by SMEs. However, while credit data and other relevant information on large corporations and on individuals is generally broadly available in one or more

[1] The World Bank (2011), "*General Principles for Credit Reporting*", Washington DC, USA. This report identifies 5 key topics for analyzing credit reporting systems: i) data; ii) data processing; iii) governance arrangements and risk management; iv) legal and regulatory environment; and, v) cross-border data flows.
[2] Asymmetric information is also associated to adverse selection and moral hazard problems, among others.
[3] For example, evidence of on-time payments, late payments/ arrears, defaults, bankruptcies on previous contractual financial obligations, etc.

credit reporting service providers (CRSPs) in a country, this is usually not the case for information related to SMEs.

4. In this context, enabling and/or improving the flow of such credit-related data and other relevant financial information on SMEs can contribute in alleviating their financing constraints. In other words, ensuring creditors have easy access to accurate, meaningful and sufficient information on SMEs in a systematic and timely manner would enhance their ability to assess SME creditworthiness, and hence could improve SME access to financing.[4] Indeed, studies like those of Beck et al (2008a),[5] which surveyed banks to identify the primary reasons the SME segment is not better served, confirm the importance of having adequate access to credit history data on SMEs: 70 percent of developing country banks and 44 percent of developed country banks in this survey stated that the existence of a credit bureau in their country facilitated SME lending.[6]

5. The main objective of this report is therefore to identify actions that could be undertaken by authorities and other relevant policy makers to improve the flow of data and other relevant credit information on SMEs to creditors through credit reporting systems. For this purpose, the report first analyses the overall status of credit reporting activities in connection with SMEs. The key topics or areas identified in the World Bank General Principles report delimit the scope of this analysis.

Structure of the Report

6. Chapter 2 provides an overview of SME access to financing, including a description of the main sources of financing, modalities of credit and the key players in this market.

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[4] Moreover, in competitive markets other benefits of credit reporting activities may be passed on to borrowers, for example in the form of a lower cost of capital. For additional information see Marco Pagano and Tullio Jappelli, "*Information Sharing in Credit Markets,*" The Journal of Finance, 43 (1993): 1693–1718; A. Jorge Padilla and Marco Pagano, "*Endogenous Communication Among Lenders and Entrepreneurial Incentives*," The Review of Financial Studies, 10 (Spring 1997): 205–236; and Tullio Jappelli and Marco Pagano, "*Information Sharing in Credit Markets: The European Experience*," Centre for Studies in Economics and Finance, Working Paper No. 35 (March 2000).

[5] Beck, Demirgüç-Kunt, and Martinez Peria (2008a).

[6] Moreover, the disparity between developed and developing country banks likely reflects greater SME informality and lack of reliable financial information on them in developing countries, thus making banks in such countries even more reliant on credit history information.

Chapter 3 discusses credit reporting in connection with SMEs and provides an overall evaluation of the current status of these activities. Chapter 4 provides some general conclusions and outlines some potential actions to address the identified shortfalls.

II. SME Access to Financing

7. SMEs play a valuable role in job creation and make significant contributions to economic growth in developed and developing economies alike.[7] As a result, establishing a dynamic SME sector features prominently on the economic development agendas of practically all countries around the world.

8. The criteria commonly used to differentiate between small, medium-sized, and large enterprises include number of employees, total assets or sales/turnover, among others.[8] For example, a large number of academic sources and many policymakers define an SME as a firm with fewer than 250 employees.[9] In the banking sector, most banks define small and medium-sized firms as those with sales of less than US $2.5 and $10 million, respectively.[10] In other cases, banks use the intended loan size as a proxy to determine whether the firm is small, medium or large.

9. To delimit its scope, this report does not propose a definition for SMEs along the lines described in the previous paragraph. Rather, the approach in this report is to center the analysis on credit reporting for those cases in which an economic entity seeks financing *as an enterprise* (i.e. commercially), thereby shifting the focus of the report away from the pure consumer lending/consumer reporting space.[11] On the other hand, the report does not consider the case of larger SMEs that may have a greater variety of external financing options at their disposal, like access to capital markets to issue equity or debt instruments, syndicated loans, and even cross-border lending, among other possibilities.

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[7] In Europe, for example, SMEs account for 99 percent of all businesses, provide two out of three private sector jobs and generate more than half of the total value-added produced by businesses in the EU. For additional details see European Commission http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/index_en.htm

[8] In many countries microenterprises are included as part of the general SME concept.

[9] For example, in the World Bank Enterprise Surveys, 46 economies define MSMEs as those enterprises having up to 250 employees. In the European Union, SMEs are defined in EU recommendation 2003/361 by two main factors: number of employees (10-250) and either turnover ≥ € 2 mm and ≤ € 50 mm, or balance sheet total ≥ € 2 mm and ≤ € 43 mm. The US Small Business Administration defines a small business as having fewer than 500 employees.

[10] Beck et al (2008a).

[11] Based solely or mainly on the personal creditworthiness of individuals, including business owners.

II.1 Financing Needs of SMEs and Forms of Financing

10. Like any type of business, SMEs need financing for two basic purposes: i) financing the production cycle once it has been stabilized (i.e. working capital financing); and, ii) financing capital expenditures to expand the current business, to create new ones, or simply for maintenance purposes (e.g. plant and equipment maintenance or updates).

11. The two basic forms of financing for businesses are internal financing and external financing. The basic internal financing sources are the retained or undistributed profits from the business obtained in previous years and fresh capital injections by the owner(s) of the SME. In turn, external financing can be provided by financial institutions, suppliers and other types of creditors, as will be described in further detail below.[12]

12. Financing working capital needs or financing capital expenditures needs involves quite different scenarios in terms of the amount of funds required, the repayment period and the nature of the specific risks involved, among other elements. To finance working capital, most SMEs rely on internal financing, and/or short-term credit from suppliers, and/or some specialized financial products like factoring. Only rarely SMEs recur to a direct loan from banks or other financial institutions to finance their working capital needs.[13] In the case of capital expenditures, which normally represent larger amounts than do working capital needs, SMEs sometimes rely on internal financing, often involving fresh capital injections from shareholders, although in many cases SMEs tend to recur to long-term financing from financial institutions, mainly in the form of outright loans from banks and some hire purchase and leasing products.

13. From another perspective, financing needs, and the way these are addressed through internal or external financing or a combination thereof, differ depending on whether an SME is a start-up or already an established business. Starting-up a business from scratch

[12] A recent trend is peer-to-peer lending, which in essence consists of lending money to unrelated parties without going through a traditional financial intermediary, but mainly online through peer-to-peer lending companies' websites. These loans are typically unsecured, and are made to individuals rather than to businesses. Nonetheless, by this means an existing shareholder of an SME could obtain funding for fresh capital injections to the business.
[13] Current account overdrafts are often used in some countries, however.

with external financing is rarely a real possibility for an SME, especially if the entrepreneurs/owners do not already have a track record as successful business people.[14] Hence, the vast majority of business start-ups rely on internal financing.[15]

14. Research shows that business start-ups that build a deposit relationship with a bank (e.g. checking account or savings account) also tend develop a credit relationship faster with that bank.[16] Once SMEs become larger and have established a trading and financial record, more sophisticated forms of external financing are likely to become available to them, possibly even including financing through capital markets.

II.2 External Financers of SME and their Product Offering

15. As briefly introduced in the previous section, the main external financers of SMEs can be broadly classified into financial institutions and non-financial creditors. In many countries, governments also act as direct creditors of SMEs, for example through programs to support financially enterprises in the start-up phase or programs that focus on financing enterprises owned by women.

16. Within the financial institutions category, studies have shown that banks are the main source of external financing for SMEs across countries.[17] Domestic banks specialized in SME lending (e.g. some cooperative banks) have traditionally been important players. Nevertheless, for a number of years universal banks have also entered the SME space and are now as relevant as specialized or niche banks in many countries.

17. The traditional financing products offered by banks, and in some cases also other types of financial institutions, include medium-term and long-term outright loans, usually on a collateralized basis; a variety of leasing products; other products involving some form of cash advance like factoring, reverse factoring and invoice discounting; and, products like

[14] Even specialized external financers like venture capital mutual funds would very rarely invest in new business ventures with too many unknown variables.

[15] In some cases start-ups may be provided with consumer lending products such as credit cards. These are granted on the basis of the personal creditworthiness of the owner(s) of the business.

[16] See, among others, the World Bank Enterprise Surveys, Finance Section.

[17] Beck et al (2008a).

corporate credit cards to finance smaller purchases/expenses. Bank guarantees are also offered to support financing provided by other parties, for example as part of a credit guarantee scheme for SMEs, or in connection with international trade activities of SMEs.

18. Among the non-financial institutions that are important financers for SMEs, first and foremost are their business suppliers through the provision of trade credit, i.e. supplying the merchandise/services in advance to requiring the associated payment. It consists typically of an open line of credit and is normally unsecured. The repayment period varies widely depending on the type and size of the firms involved, although rarely does it extend to more than a few (2-3) months. Larger firms normally have access to a longer repayment period than do smaller, newer companies. In practice, trade credit is a major source of short term funding for most businesses.

19. The customers of SMEs (and of other types of firms) can also provide external financing by paying in advance to receiving the goods and/or services produced by the SME.[18]

20. Other institutions involved in the external financing of SMEs include trade credit insurers, credit rating agencies and credit reporting service providers (CRSPs). Such entities do not provide the financing themselves, but the services they provide (e.g. information, guarantees) serve as an input for those parties that do provide financing. In some countries, certain government agencies and/or development banks also provide such supporting or auxiliary services, in lieu of or complementing direct financing.

21. In essence, trade credit insurance protects trade creditors against the risk that their buyer does not pay or pays very late, and is therefore a risk management tool that trade creditors use when deciding whether to grant credit or not to a buyer, like an SME, and on the terms and conditions of such credit.[19] [20]

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[18] One example are some real estate projects in which buyers pay for the property during or before construction, thereby providing financing to the construction company, normally in exchange for a discount on property's price.

[19] On the other hand, banks would typically be willing to lend larger amounts and in better financing terms to the trade creditor itself if its account receivables are insured.

[20] In other cases, the seller requires the buyer a letter of credit from a bank that the payment will be received on time and for the correct amount. Letters of credit are more common in international trade transactions.

22. Ratings by independent credit rating agencies are another piece of information for creditors, some of which may have established formal policies requiring a minimum rating by the applicant in order for it to be able to obtain a loan or other form of financing. It should be noted however that independent ratings have traditionally been prepared and used in connection with financing operations involving transactions in capital markets. In the case of SMEs, which rarely have access to capital markets for financing purposes, independent credit ratings like these are not yet very common.[21]

Table 1: Entities Involved in SME Financing and Main Features of Their Product Offering

	Direct providers of financing facilities to SMEs		**Other institutions providing services that support financing to SMEs**
	Financial Institutions	**Non-financial Institutions**[22]	
MAIN PLAYERS	Banks, Leasing Companies	Business suppliers, some Governments	Credit Insurers, Credit Rating Agencies, Banks and some Governments acting as Guarantors, CRSPs
MAIN PRODUCTS	Outright loans, cash advance-type products, leasing, credit cards for small expense financing	Trade Credit in the case of business suppliers. Outright loans in the case of governments.[23]	Credit insurance, Credit Ratings, Credit Guarantees, Credit Reports
TYPICAL LENGHT OF FINANCING	Short-term, except for some loans or leases for capital expenditures	Short-term (usually less than 90 days) for trade credit. Variable in the case of government loans.	Not applicable.

Source: Own elaboration.

[21] From another angle, some credit rating agencies sell methodologies and other tools that are used by lenders, mainly financial institutions, to make their own estimates of certain variables, like probability of default estimates.
[22] As earlier noted, customers can also be a financing source for SMEs. They are not included in this table to avoid potential confusion.
[23] Some governments also provide non-reimbursable grants, although this is more common for microenterprises.

II.3 Constraints to SME financing

23. SMEs typically face more severe constraints to growth than do large companies. Though the constraints are many, limited access to finance and the cost of credit are typically identified in SME surveys among the most important ones.[24] For example, Stein et al estimate that the total unmet need for credit by formal SMEs today is in the range of US$1.3-$1.6 trillion, or US$700-$850 billion if SMEs in high-income OECD countries are excluded.[25] Further, it is estimated that between 55 to 68 percent of formal SMEs in emerging markets are either unserved or underserved in terms of their financing needs. Beck et al (2006) conclude that, as a result of these constraints, SMEs finance a smaller share of their investment with formal sources of external finance than do large firms and instead, rely more heavily on informal sources of finance, such as borrowing from family and friends or from unregulated moneylenders.[26]

24. One important element behind the SME "credit gap" is the information asymmetries between external creditors and SMEs. Information asymmetries are the focus area of this report, as stated in the introductory chapter. However, it needs to be noted and recognized that there are several other micro and macro factors that also inhibit adequate external financing for SMEs, as illustrated in Figure 1. The most relevant of these other factors are described briefly below.

25. Some of the obstacles to SME financing are associated precisely to their own nature as smaller companies. This includes factors such as lack of critical economic size, and the somewhat informal and generally less sophisticated management of SMEs. In the first case, relatively small average loan volumes may not warrant the costs of targeted credit

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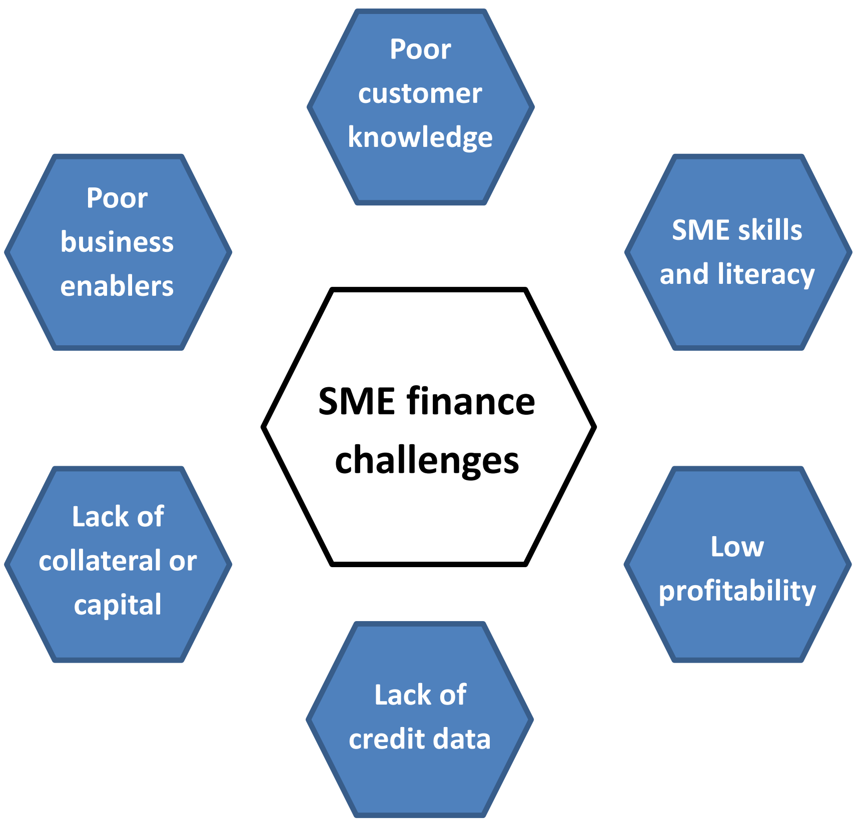
[24] See for example Beck and Demirgüc-Kunt (2006). Further, this study shows obstacles related to finance, crime, and policy instability directly affect firm growth, finance being the most relevant one. Also relevant are the World Bank Enterprise Surveys present data on 130,000 firms in 135 countries. The 15 major obstacles identified in these are access to finance; access to land; business licensing and permits; corruption; courts; crime, theft and disorder; customs and trade regulations; electricity; inadequately educated workforce; labor regulations; political instability; practices of competitors in the informal sector; tax administration; tax rates and transport. Survey data may be accessed at http://www.enterprisesurveys.org/Data/ExploreTopics/finance.

[25] Stein, P., Goland, T. & Schiff, R. (2010)

[26] See also Beck et al. (2004b).

risk analyses that are required in the absence of more standardized and comprehensive credit data.[27] As for the second factor, from the perspective of lenders most SMEs lack the understanding of developing a coherent and acceptable business plan to underpin their credit/loan application, and if a loan is granted they often fail to provide robust updates or progress reports on the unfolding of the business plan.

Figure 1: Main challenges faced by Creditors in connection with SMEs



Source: Adapted from SME Finance Forum of the International Finance Corporation.

26. Some macro factors that act as poor business enablers include lack of adequate legal and enforcement protections for creditors, like bankruptcy laws that favor debtors' rights in a non-equitable manner *vis-à-vis* creditor rights, weak definition of property rights that hinder pledging property as collateral, and in general weak contract

[27] From another perspective, these costs would be reflected in high fees and interest charged on the loan, which may make the loan inaccessible to the SME.

enforcement. Problems like these tend to be more acute in developing countries, and affect not only SME financing but also lending to large firms and consumers.[28] One relevant study in this specific area is that of Beck et al (2008a), which finds that there are significant differences in the extent, type and pricing of bank loans to SMEs across developed and developing countries, and that these are driven by differences in the institutional and legal environment.[29] In particular, banks in developing countries provide a lower share of loans for capital expenditures (i.e. prefer shorter term engagements with SMEs) and charge higher fees and interest rates to SMEs than banks in developed countries.

27. Other macro factors that recently are believed to have affected the ability and/or willingness of creditors, in particular from banks, to engage with SMEs include the restructuring of many national banking sectors after the financial crises that emerged in 2008, and the bank solvency regulations in the Basel II and more recently the Basel III Capital Accords. On the latter, several studies have found that the Basel III risk weighting approach to calculate capital requirements, which is basically the same as that of Basel II, encourages portfolio concentrations in assets like government bonds, mortgages and lending between banks.[30] It also favors lending to companies with an external credit rating of A or above, practically all of which are large companies.[31] When these methodologies to calculate capital requirements were introduced in the early 2000s with the Basel II Capital Accord, many banks started withdrawing from SME lending and reduced overdrafts, thus driving SMEs to alternative financing like factoring, securitized receivables, leasing and trade credit.

[28] In addition, leasing, factoring and other products that can be more appropriate for SMEs in certain situations tend to be less developed in developing countries. For further details see IFC (2010 and 2013).
[29] The institutional and legal elements the authors consider are: i) cost of enforcing contracts; ii) cost of registering property; iii) the availability of credit history information; and, iv) the degree of protection of property rights.
[30] See for example Blundell-Wignall and Atkinson, 2010.
[31] SMEs that are unrated have a risk weighting of 100%, or 75% if the loan is considered part of the retail portfolio (i.e. less than 1 million Euro. Other conditions also apply). From this it follows that under Basel III a bank needs to hold core Tier 1 capital for 7% of the loan for SMEs with 100% risk weighting, as opposed to 1.4% (7% × 20%) for a company with an AAA rating.

III. Current status of Credit Reporting Activities in relation to SMEs

28. From a policy perspective, perhaps the main and most important role of credit reporting systems consists in addressing information asymmetries between creditors and borrowers or potential borrowers in order to facilitate an effective, yet quick and less costly, credit risk assessment.

29. This chapter aims at assessing in general terms the adequacy of credit reporting activities in relation to SMEs, in order to evaluate the degree to which credit reporting is contributing or may further contribute to improved SME external financing. In this regard, to better contextualize the role of credit reporting a brief section on the main technologies used by creditors to assess SME creditworthiness is presented below.

III.1 Credit evaluation technologies – specificities of SME financing

30. In essence, creditors assess potential debtors, including SMEs, on the basis of two broad criteria sets: i) the financial capacity or ability of the debtor to repay the credit facility or loan; and, ii) the willingness of the debtor to repay the credit/loan. More specifically, *repayment capacity* refers to whether the SME (or any other debtor) will be able to repay according to the terms and conditions of the credit/loan contract. Repayment capacity is typically determined taking into account the prospects of the SME's business, and often also the prospects for the broader market segment or niche in which the SME is participating. *Repayment willingness*, on the other hand, is inferred based on the SME's historical repayment patterns with regard to previous contractual financial obligations, including trade credit, loans and other forms of financing. Payment performance with regard to some non-financial obligations (e.g. payment of taxes, utilities) may also be included.

31. To determine *repayment capacity*, creditors will normally require the debtor's financial statements reflecting its most recent financial position as well as the 2-3 previous years. For loans or other products financing capital expenditures, creditors will also require medium-term and long-term financial projections that reflect the expected

materialization of the business plan that underpins or justifies the need for the loan or other financing facility.

32. With regard to determining *repayment willingnes*s, creditors will seek for all available credit histories (i.e. covering as many financial and non-financial obligations of the applicant as possible), focusing on specific items such as on-time payments and any late payments by the applicant, payments in arrears, defaults, and any bankruptcy filings, among other elements.[32] In addition, due to the vast majority of SMEs being closely held companies with single or very few shareholders, most creditors will also wish to assess the credit behavior of the SME owners to determine whether this can contaminate the creditworthiness of the SME as well as to determine whether to ask for the SME owner's personal guaranty.[33]

33. Creditors have used alternative approaches to assess SME creditworthiness when the information elements described above are not readily available to them, are incomplete or are not reliable, as it is often the case when it comes to SMEs.[34] Relationship lending is one of the most relevant alternative techniques. Relationship lending relies primarily on so-called "soft" information (i.e. information different from formal financial statements or other commonly required quantitative and qualitative standard information) like information on the personal characteristics of the owner(s) of a firm. Such information is gathered by the loan officer through continuous, personalized, direct contacts with the SME owners and managers, and the local community in which they operate. Under this model, approval of the credit facility and subsequent credit risk management by the creditor are normally done at a decentralized level.

34. Until recently, the conventional wisdom regarding SME finance was that domestic specialized banks were more likely to finance SMEs because they tend to engage more

[32] The data elements generally required in a standard credit report for businesses are discussed in further detail in the following section.
[33] Many owners of smaller SMEs commingle personal and company accounts. For this and other reasons, it is not uncommon that for microenterprises creditors often evaluate the credit application as a consumer lending transaction, based solely or mostly on the credit behavior and overall financial performance of the owner(s).
[34] The reasons for this will be discussed in detail in the remaining sections of this chapter.

in relationship lending. However, some recent studies (e.g. Berger and Udell 2006; Berger et al 2007; de la Torre et al 2008) have begun to dispute this conventional wisdom, arguing that other types of banks, including large and foreign-owned, can be as effective in SME lending through the use of specific lending products such as factoring, leasing and asset-based lending.[35] Through the use of these products, creditors can still serve the financing needs of many SMEs, while ensuring, by requiring collateral, that the impact of any payment defaults will be minimized.[36]

III.2 The role of Credit Reporting in SME lending

35. One conclusion that stems from the discussion in the preceding section is that more and better data and other relevant information on SMEs is crucial to improving their overall access to financing, as well as for being able to obtain more favorable interest rates and in general better terms and conditions. Credit reporting systems can play a key role in making such enhancements in data and information availability and quality possible.

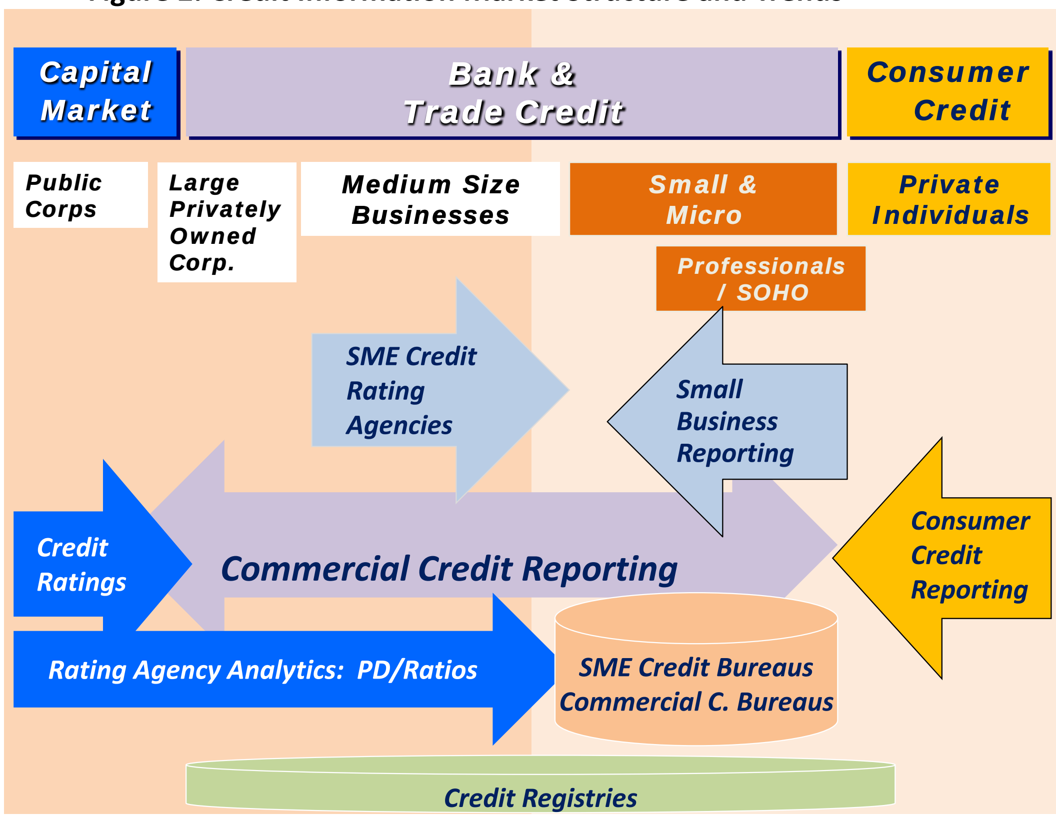
36. Commercial credit reporting companies are specialized entities that operate in the SME credit reporting space. They are a type of credit reporting service provider (CRSP) that specialize in the collection, processing of credit-related information and data, and subsequent distribution or provisioning of credit reports and other analytical tools that support decision-making when it comes to providing credit to businesses.[37]

37. Other relevant CRSPs include credit registries, which compile credit-related information and data on both firms and individuals from banks and other regulated lenders mainly for banking supervision purposes,[38] and some consumer credit bureaus that increasingly are collecting this same information and data on firms, mainly micro and small

[35] Moreover, Beck et. al. (2010) find that the organizational structures and lending technologies applied to SME finance show limited correlations with the extent, type, or pricing of loans to SMEs. These results do not provide support for the notion that relationship lending consistently results in more and cheaper financing for SMEs.
[36] Collateral does not only serve as loss absorber for creditors. Especially in the case of fixed assets pledged as collateral, it becomes yet another incentive for a firm to repay, thereby further aligning the interests of the creditor and debtor.
[37] In contrast, consumer credit bureaus specialize in credit data related to individuals.
[38] In some cases (e.g. France) data on firms is kept under a separate database than data on individuals.

businesses. Figure 2 illustrates the overall structure of the credit information market and how CRSPs are positioned in this market, in particular with regard to SMEs.

Figure 2: Credit Information Market Structure and Trends[39]



Source: Adapted from BIIA.

38. The main users of commercial credit reporting services are commercial banks, other financial sector lenders, credit insurers and trade creditors.[40] In addition, large companies from very diverse sectors of the economy also tend to be active users, although not necessarily for credit-related purposes.[41] In the case of credit registries, in

[39] With regard to credit registries, these often set a threshold above which all loans are to be reported, including consumer loans. On the other hand, credit registries do not gather trade credit information. Also, information available in credit registries is normally made available only to reporting entities, often at no cost.
[40] Comparing with the users of consumer credit reporting, retail merchants and utility companies are major users of this service, while trade creditors and credit insurers would be infrequent users. The latter two often do not even have access to the services of consumer credit bureaus due to, for example, lack of a permissible purpose.
[41] For example, these companies use commercial credit reporting to perform sectorial and economic analysis, study and classify potential new clients, gain knowledge about competitors and other similar purposes to enrich their decision-making processes.

almost all cases usage is restricted to banks and to other regulated financial institutions that report data to the registry.

39. When commercial credit reporting works properly, creditors can rely less on relationship lending and soft information, as discussed earlier, and more on facts and fact-based analyses found in credit reports and other credit reporting products. These arms-length lending technologies open the possibility to all types of non-niche creditors to also engage in SME lending. This, in turn, does not only expand the menu of options for SMEs in terms of the number of creditors willing, in principle, to lend to them, but may also entail new possibilities in terms of a greater diversity of financing products, repayment schedules and other relevant elements.

40. Creditors incorporate credit reporting products in their credit assessment methodologies in various ways. Figure 3 reflects the typical use that real sector companies that provide trade credit make of credit reporting products. Use varies depending on the size of the company itself and also on the number of business customers it has and to which it may need to grant trade credit - many of which are likely to be SMEs.

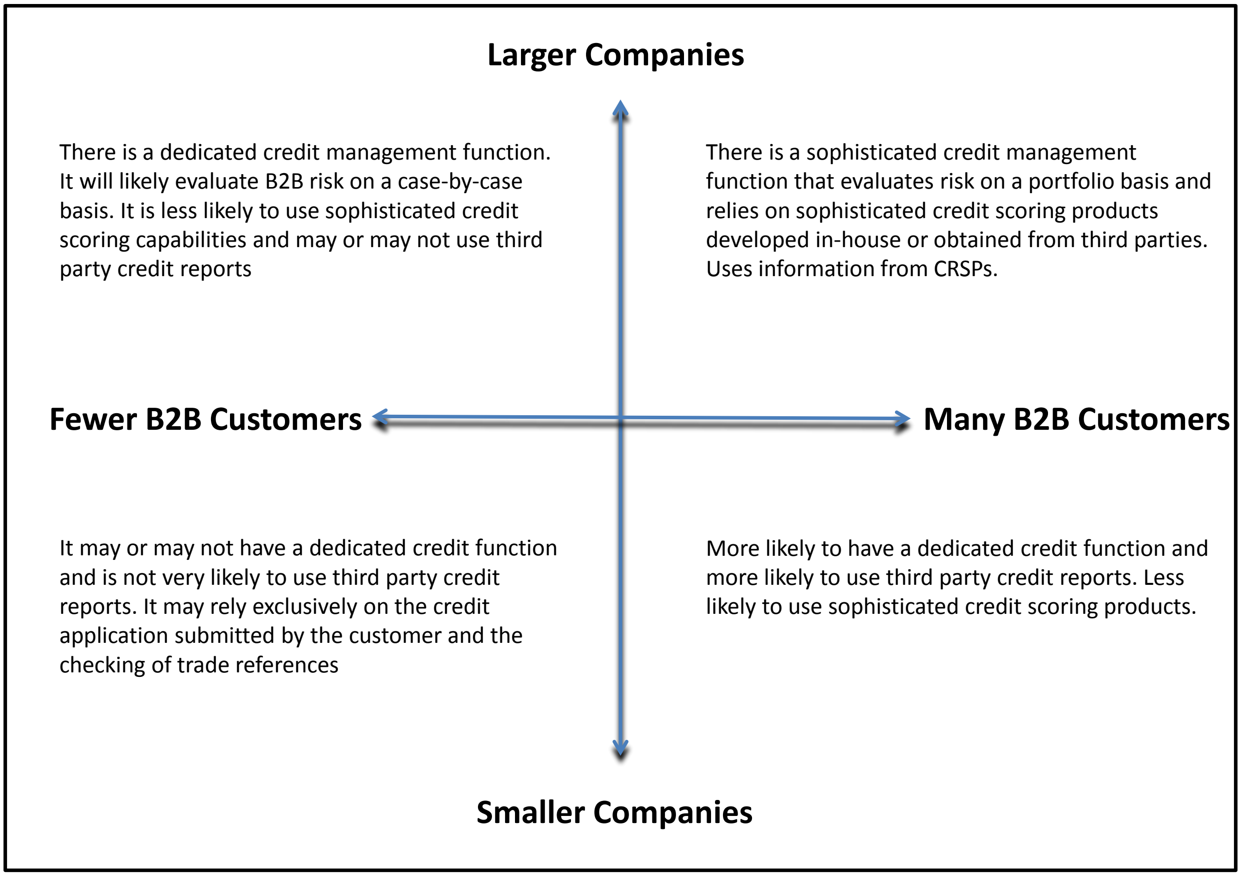
41. A survey by Beck et al (2008) illustrates, on the other hand, the use that banks in developed and in developing countries make of credit reporting for SME financing.[42] Although not necessarily based on a fully representative sample,[43] the results show that 45 percent of banks in developed countries use existing credit reporting services as an input to their credit assessments, while this is only the case for 16 percent of banks in developing countries. Also, for banks in developed countries a good credit history obtained from CRSPs is one of the top-three criteria for authorizing the loan. In general, however, reliance on credit reporting is still low. These results are consistent with the

[42] Beck T., Demirgüc-Kunt, A. and S. Martinez Peria (2008).

[43] This study collected data from 91 banks in a total of 45 countries. On average, the banks that responded account for 32 percent of banking system loans. The loan market share exceeds 30 percent for 24 countries. For 25 countries, a response from the largest bank in the system was obtained.

more general premise that availability of financial information and credit history data for SMEs is inadequate in most countries, apparently even more so in developing ones.

Figure 3: Typical Use of Credit Reporting products by Companies that provide Trade Credit



Source: Adapted from Informa (Spain).

III.3 Enhancing Credit Reporting for SMEs

42. This section aims at identifying the overall current status of commercial credit reporting for SMEs and the impediments that may be hindering it from serving SME creditors more effectively. More specifically, this exercise intends to determine the extent to which existing CRSPs collect, process and make available high-quality, comprehensive credit data and other relevant information on SMEs to creditors, and to identify the associated constraints.

43. At the outset, it should be mentioned that information on the status of commercial credit reporting at a global level is limited, even more so for what relates specifically to

SMEs. Industry organizations have launched several surveys that are useful to understand some of the relevant features of the commercial credit reporting industry.[44] However, there is no comprehensive set of data, like for example a global survey carried out periodically, that gathers detailed and systematic information such as the specific data items that are collected by CRSPs, their sources and the constraints they face.

44. In this context, the analysis in the following section uses the limited available data and builds on the information availability problems most often cited by creditors, as well as on the hands-on experience of practitioners that are members of the ICCR. Credit reporting diagnostic assessments conducted by the World Bank in several countries from 2004-2013 have also served to inform the analysis, in particular with regard to information and data held by public sector entities that is relevant for CRSs.[45]

45. The World Bank *General Principles for Credit Reporting* issued in 2011 targeted primarily consumer credit reporting, and to a lesser extent commercial credit reporting. Nevertheless, the five key analytical areas or topics that were identified in the *General Principles* (i.e. data, data processing, governance arrangements and risk management, legal and regulatory environment, and, cross-border data flows) are deemed relevant to delimit the scope of the analysis of the current status commercial credit reporting.

46. On the other hand, for some of the general principles/areas, consumer and commercial credit reporting basically face the same issues or problems. This is the case of the areas of data processing, and governance arrangements and risk management. Since the issues and problems related to those two general principles/areas have already been covered in the *General Principles*, there is no need to discuss them again in this report.

47. Hence, the analysis of commercial credit reporting in connection with SMEs that is presented in the following section will focus on key aspects relating to the following

[44] For example ACCIS and BIIA.

[45] The basis includes information from 15 countries in Latin America and the Caribbean, 4 countries in Sub-Saharan Africa, 3 countries in Middle East and North Africa, and 2 countries in Europe and Central Asia. Studies in Latin America and the Caribbean were performed in partnership with the Center for Latin American Monetary Studies through the WHCRI project (for details see www.whcri.org).

three general principles/areas: data, relevant elements of the legal and regulatory framework, and issues that affect cross-border data flows.

III.4 Current Status of Commercial Credit Reporting

III.4.1 Data

General Principle 1

> *Credit reporting systems should have relevant, accurate, timely and sufficient data—including positive—collected on a systematic basis from all reliable, appropriate and available sources*

48. This sub-section focuses on two crucial aspects of data: i) sufficiency and overall quality of data collected and distributed within CRSs in connection with SMEs; and, ii) the sources of that information.

Sufficiency and overall quality of data

49. A robust credit reporting system must be able to collect and provide sufficient information and data to enable financiers to make a comprehensive and thorough assessment of SME creditworthiness. This includes not only data and any other information to assess repayment willingness (i.e. credit histories) which traditionally had been the focus of credit reporting, but also specific financial data and other relevant information to help evaluate and determine repayment capacity.

50. To serve as a reference for the discussions in the next paragraphs, Box 1 shows an example of a comprehensive commercial credit report.[46] Box 1 makes it clear that the key broad elements of a comprehensive report are: i) Identification data, to make an unequivocal identification of the data subject, its owners and key executives; ii)

[46] Some of the elements shown in this example (e.g. some of the specific items under History, Legal Structure and Executive) might not be fully applicable to some SMEs.

Financial data; iii) Positive credit reporting data covering facts of contractually compliant behavior; and, iv) Negative credit reporting data, like defaults/arrears and bankruptcies.

Box 1: Data Elements in a Comprehensive Commercial Credit Report[47]

1. **IDENTIFICATION OF THE FIRM**
Company identification data, e.g. tax number

2. TRADE REFERENCES
Information from third parties that in the recent past have extended credit to the applicant, or from public sources that report the credit performance of the applicant.

3. PUBLIC RECORD FILINGS
Court actions; Collections; Suits; Liens and registered charges; Bankruptcies

4. **FINANCE SECTION**
Balance sheet and profit and loss data; Age of financial statements; Comparatives with sector data; Company versus consolidated financial statements (if applicable); Corporations Law Classifications

5. **CURRENT INVESTIGATION**
Significant items that have impacted the company performance (e.g. its risk and/or delinquency scores); Media research; Results of general interview with the firm and any comments in relation to the financial statements; Where Interview has been declined, the reason for same is provided.

6. BANKING AND OTHER FINANCING FACILITIES
Lender name and address; Type of lender; Details of the loan, overdraft, corporate credit card or other facility

7. HISTORY
Incorporation/registration details and a chronology of the applicant's history. Useful data elements include: Corporate structure; If a branch of a foreign company; Company name changes; Limited by guarantee; Shareholding; Directors antecedents; If applicable, parent, ultimate parent and affiliates.

8. LEGAL STRUCTURE
Details regarding the corporate structure of the firm. These are normally obtained directly from an authority, e.g. the Companies Office in the UK or the Australian Securities and Investment Commission.

9. EXECUTIVES
The Chief Executive Officer; Common Directorship/s; Antecedents (where relevant); Other personnel or key managers; Representation on other Boards; Adverse information on Directors; Any changes or when the names of the Directors differ from that shown at the appropriate legal authority.

Source: Adapted from BIIA (2012), *"Standards Governing Commercial Credit Reporting Companies"*.

51. Credit registries generally focus on gathering data on firms, regardless of their size. Likewise, surveys carried out by industry organizations indicate that commercial credit

[47] Credit scores and other predictive tools are sometimes included in the standard report, while in other cases they are provided as an additional service. Two common types of scores are the Delinquency Score, which predicts the likelihood that a firm will become 'severely' delinquent in paying its bills (usually within the next 90 days); and, the Failure or Default Score, that predicts the likelihood that a firm will declare insolvent (obtain legal relief from creditors) or cease operations with loss to creditors (usually within 12 months). On the other hand, predictive analytics are offered now by many software houses, enabling more sophisticated users to build their own scores or comparable tools on the basis of raw information obtained from CRSPs or other sources.

reporting companies collect information on firms ranging from large corporations to microenterprises, including sole proprietors. However, issues and problems specific to SMEs, in particular the smaller ones, place a reasonable doubt on the sufficiency, as well as the overall quality and reliability of the data and other information collected (and distributed) on them. Some of the most relevant problems are discussed below.

52. One of the major challenges for CRSPs is to collect reliable identity information about the SME, so as to unambiguously link it to any positive or negative credit reporting data that may be received on it. Some of the most common types of identity data for SMEs (and other types of firms) are taxpayer ID numbers (e.g. VAT numbers), corporate registration and/or incorporation numbers, the physical address and in some cases the name of the SME owner or owners.[48]

53. One of the major difficulties to ensure that the identity information about the firm is adequate and reliable is that CRSPs are not always able to verify or validate this information. Identity numbers are often obtained directly from the SME or from other public sources and only rarely are CRSPs allowed to verify those numbers directly against the records in the databases administered by the public sector agencies that assign such numbers, like tax authorities.

54. In addition, in many countries there is no single ID number, which increases the possibility of ambiguity in firm identification.[49] There are also high levels of SME informality. In this last regard, for example, even if an SME was assigned a taxpayer ID number or a registration number in the past, it is likely that these ID keys will not be reliable after a few years if they are not used in practice, and, hence, are not kept up to date by the agencies that assign them.

55. More generally, firm identification numbers are subject to the dynamics of business activity, and are therefore affected by events like mergers and acquisitions, or strategies

[48] In some cases, other mechanisms like Dun & Bradstreet's D-U-N-S numbering system are also relevant.
[49] For example, in some countries firms might be identified by the tax ID number, the social security number through which they pay their contributions to the administration, or both.

whereby a firm shutdowns and is later re-incorporated under a different name and possibly with a different tax ID number. Annex 1 shows the example of a global initiative prompted by this type of problems: the creation of the Global Legal Entity Identifier (LEI) to uniquely identify entities that engage in financial transactions.[50]

56. With regard to data and other information to assess a firm's repayment capacity, financial statements and projections or even some barely equivalent financial information are not always available in the case of SMEs, and/or may not be reliable. Many SMEs lack strong financial reporting mechanisms and systems, in part because they may not be required to prepare financial statements and submit them to certain public sector authorities or for public disclosure.[51] Moreover, even if some SMEs do prepare financial statements only rarely are these verified by external auditors. Yet in other cases, the information contained in financial statements that are submitted to financiers is already relatively old. As a result, even when available, the financial information provided by SMEs may not accurately reflect their current financial position and overall business performance.

57. Similarly, the types of credit behavior-related data needed to integrate comprehensive and reliable credit histories are not easily available to CRSPs in many cases. To a large extent this is the result of a vicious circle whereby SMEs are not able to obtain external financing because they do not have a credit history in CRSPs, and they cannot build a credit history until they get such external financing.

58. It is very unlikely that SMEs that have not had a loan or other credit facility with a regulated financial institution will have a credit history in CRSPs. This is because even if a SME has been able to obtain other forms of external financing, namely trade credit, the trade creditor(s) will only rarely report the SME's performance on this financial

[50] The LEI is intended primarily to uniquely identify parties to financial transactions. Eventually the LEI (or a similar initiative) could become relevant for credit reporting. For example, since any entity that is registered, including SMEs, can get a LEI, CRSPs could be able to identify firms universally.

[51] In some countries SMEs do have a legal obligation to prepare and submit financial statements on a regular basis, but the reporting requirements are less stringent than for larger firms. Therefore, the scope, frequency, and quality of the reported information vary substantially. See paragraph 79 on the discussion of IFRS.

obligation to CRSPs. Situations like this are common when reporting to CRSPs or to some relevant public sector agency is not required by a law or regulation,[52] or simply when credit reporting is in general underdeveloped and reporting is not a common practice in the marketplace.

59. Apart from the unwillingness of creditors to report to CRSPs, putting together reasonably complete credit histories of SMEs and other firms may be more difficult if CRSPs are not able to obtain and systematize data from some other crucial data sources, notably public records agencies. The next sub-section deals precisely with the difficulties of CRSPs in accessing all relevant data sources.

Data sources

60. The most common sources of data in the case of commercial credit reporting companies are banks and other financial institutions, some real sector companies (i.e. suppliers that provide trade credit information or trade references) and public sector agencies including public records (e.g. tax authorities, national ID authorities, courts, entities responsible for public notifications, companies' registers, collateral registers). This information is normally complemented with information obtained from investigative processes like site visits and interviews with companies, other information provided by the companies themselves, information from some registries operated by industry associations or representative bodies (e.g. chamber of commerce),[53] information from B2B e-commerce platforms (e.g. Alibaba.com) and information obtained from official gazettes, the press and the Internet.

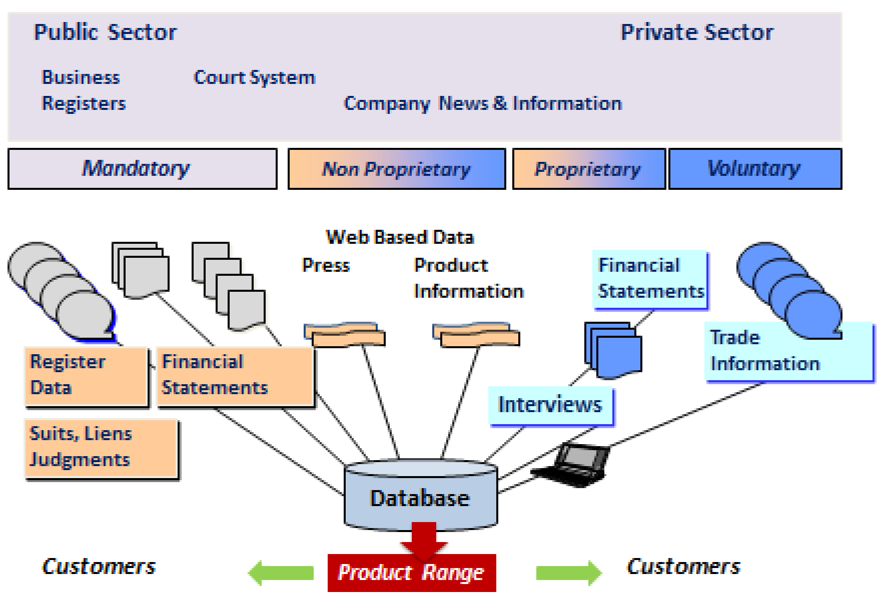
61. Financial institutions, especially banks, are the main providers of data and information on the status of financial obligations of SMEs. In the case of credit registries, in almost all cases banks and certain other regulated financial institutions are the only information

[52] Where credit registries exist, banks and other regulated financial institutions are obliged to report to it.
[53] Some of these registries hold information on letters of credit, promissory notes and other forms of commercial paper, for example. Examples of this kind of registries include the BIC file in Chile, and the RAI file in Spain.

sources, and are required by law or regulation to provide the data required by the operator of the registry, which is normally the central bank of the financial supervisor.[54]

62. In contrast, mandatory reporting to other CRSPs is not widespread. In the case of commercial credit bureaus, while some banks do provide their information voluntarily, many others hold their information as confidential often hiding behind bank secrecy considerations. Others may provide information and data on a limited basis only, for example not allowing the credit bureau operator to disclose the name of the bank/creditor and other important terms and conditions of the loan or credit facility. Alternatively, banks may provide only negative data, or provide data only to commercial credit bureaus that operate on a strict basis of reciprocity, thereby limiting access to this data to other potential users.[55]

Figure 4: Data Sources for Commercial Credit Reporting



Source: BIIA.

[54] As a result, some credit registries, mainly in Europe, do have extensive credit-related information on SMEs.
[55] Reciprocity is however not very common in commercial credit reporting.

63. Beyond banks, leasing companies, factoring companies and other non-bank financial institutions are relevant financers of SMEs, and as such can also be important data providers to CRSPs. In practice, however, the majority of these entities do not share their data with commercial credit bureaus.

64. As previously discussed, trade credit is a major source of short-term financing for SMEs. Hence, reporting by trade creditors on the performance of SMEs on their financial obligations is essential in order for CRSPs to develop reliable credit histories and more accurate analytical tools. Moreover, for those SMEs that have not been able to obtain financing from banks or other formal financial institutions, information on their performance on trade credit obligations can be the only evidence of a positive credit behavior or adequate willingness to repay.

65. Despite their importance, so far trade creditors have not been among the major data providers to CRSPs. Even in countries with a long-standing tradition in credit information sharing in the private sector like the United States, it is estimated that less than 50 percent of B2B suppliers share trade credit information with commercial credit information companies.[56] On the other hand, credit registries do not collect data from trade creditors, and neither can trade creditors use the information and data in the registry, which is normally restricted to regulated financial institutions.

66. Credit insurers could, in theory, fill part of the gap created by the lack of trade credit information in credit reporting systems. Credit insurance typically covers short-term accounts receivables, and as such credit insurers are major repositories of trade credit information. The primary sources of information for insurance underwriting are their customers (i.e. B2B suppliers). Credit insurers also use information from commercial credit information companies, from public sector agencies, and often carry out other investigations.

[56] National Association of Credit Management (NACM), Monthly Report, June 2012.

67. However, to a certain extent credit insurance acts as a substitute of commercial credit reporting, in that some trade creditors may prefer to take on insurance to manage their credit risks instead of developing and paying for a sophisticated credit authorization function. Hence, credit insurers do not have an incentive to share their data with CRSPs.

68. Data from public sector agencies is also crucial for commercial credit reporting, ranging from official identification data for SMEs to data that may assist in determining overall credit behavior (e.g. bankruptcy information from the courts system), to company accounts and other financial information, or to data on the real availability of movable collateral to secure a loan, found at collateral registries.

69. A major problem in this area is that some of the data elements collected and held by public sector agencies might be considered confidential and therefore are not made publicly available, even less so shared directly with CRSPs. In other cases, public sector agencies do not share data simply because there is no legal mandate for them to do so.

70. Public records, on the other hand, by definition ought to be available to the general public, including to CRSPs. However, many public records agencies around the world have very scarce funding and limited staff, which often results in data being outdated or incorrect (e.g. validation techniques applied are very basic, or are not applied at all). The *General Principles* report also notes with regard to public records that *"Services associated with public records agencies are often quite basic, like consultations of physical records or consultation of basic computerized data that cannot be enriched with further data exploitation techniques (e.g. under a data warehouse environment)"*. This situation continues to be widespread, leading to inefficient, costly and imperfect collection of data and other useful information from these sources.

71. In addition to the public sector sources and databases already mentioned, some central banks have developed specialized databases with balance sheet and income statement

information of non-financial institutions (i.e. real sector firms).[57] Databases like these exist in many countries in Europe.[58] Clearly, the type of data held by these databases can be extremely useful for CRSs to assist creditors in their assessment of repayment capacity. However, non-financial institutions report information to these databases mostly on a voluntary basis, and many SMEs do not contribute to this effort. Moreover, financial data at the level of individual firms is considered confidential and only consolidated information by sector is publicly available for economic and sectorial analysis.

III.4.2 Legal and Regulatory Framework

General Principle 4

The overall legal and regulatory framework for credit reporting should be clear, predictable, non-discriminatory, proportionate and supportive of data subject/consumer rights. The legal and regulatory framework should include effective judicial or extrajudicial dispute resolution mechanisms.

72. A specific legal framework to regulate the collection, processing and distribution of commercial credit information has not been developed in most countries. In contrast, consumer credit reporting activities are already regulated specifically or are being targeted for regulation by public sector regulators. A reason behind this difference is that some of the most relevant concerns and problems in connection with consumer credit reporting are not equally relevant when it comes to commercial credit reporting. A clear example is that of ensuring an adequate protection of data subjects' privacy and other consumer rights. Concerns like this are much less relevant in the case of

[57] In some countries these types of financial information on real sector firms are collected by government agencies or industry organizations. In certain cases filing of this information (e.g. year-end balance sheet) is mandatory.

[58] Since 2012 information from all European balance sheet databases is available through the ECB portal. The system (BACH-ESD) allows consultation of each Central Balance Sheet Office.

commercial credit reporting, and hence the underlying regulations are generally not applicable to the latter activities.[59]

73. Nonetheless, there are certain legal and regulatory aspects that can have an important impact on the depth, breadth, quality and overall usefulness of commercial credit reporting for creditors of SMEs and other firms. This section focuses on those legal and regulatory elements that enable or facilitate information flows across the credit reporting system, and elements that promote the effective operation of the credit reporting system in general. Specific issues for discussion include: i) the need for increased transparency of business activities and business outcomes, including clarity on the reporting obligations of data subjects; ii) the role of other public and private data sources; iii) access to and re-use of SME credit data by individuals and firms other than the data subject; iv) non-discrimination of users of credit reporting information; and, v) the role of public sector agencies as overseers of credit reporting systems.

74. At a general level, requirements to SMEs to submit data to public sector agencies or other entities (e.g. due to public policy considerations) are not standard across countries. Often, as earlier discussed, such requirements do not even exist or are far from sufficient to enable a robust assessment of a firm's creditworthiness. Moreover, authorities in some countries are reducing reporting requirements for certain firms, especially SMEs, in an attempt to reduce the administrative burden on them. Initiatives like this are in clear conflict with other important policy objectives like ensuring broader availability of credit data and other information and improving the effectiveness of credit reporting.

75. Where SMEs are not required to publish financial statements, their creditors may in turn be reluctant to share detailed credit performance information about them as the

[59] In the case of sole firm proprietors, for example, when little or no information is available on the firm as such (e.g. financial statements, invoicing and other records), financiers will tend to rely on the behavior of the sole proprietor when meeting his/her personal financial obligations. The collection, processing and distribution of the latter type of information are however covered by privacy laws in many countries. Hence, handling the various data types in credit reports (and/or other products) can be especially challenging for CRSPs.

underlying or embedded financial information may be considered sensitive, especially in the absence of legal or regulatory provisions providing guidance on this other matter. At the same time, many SMEs and other firms guard against disclosing financial and other type of data arguing that the information is vital and essential to their ability to compete successfully and that it is the kind of information that competitors desperately desire.[60] Hence, a clear legal framework on trade secrets might be helpful to specify and standardize the type of business information and data that can be considered confidential and hence not subject to disclosure/reporting.[61] [62] Any restrictions should not, however, be so broad so as to give SMEs (or other firms) the ability to prevent the collection, analysis or distribution of credit-related data by creditors with which SMEs have been engaged in commercial transactions.

76. Very often due to the inadequateness of the data and other information obtained from data subjects and from data providers like banks or trade creditors, CRSPs in the commercial space need to rely heavily on public sector sources. As discussed in the previous section of this report, accessing this information can be difficult and costly or even not feasible for a variety reasons. In some countries, policies pushing for greater transparency with regard to information held by public sector agencies have resulted in the enactment of laws and/or regulations to facilitate access to such information. However, while it is generally accepted that data subjects should be granted access to their own information,[63] laws and regulations are generally silent on whether other

[60] Some firms might be willing to provide this information for statistical purposes, where references to the firm as well as potential means to identify the firm are removed. See for example the case of the specialized databases with balance sheet and income statement information discussed in the previous section.

[61] At the international level the Agreement on Trade-Related Intellectual Property Rights (TRIPS) addresses at a general level the protection of trade secrets. The TRIPS Agreement is one of the constituent agreements that make up the World Trade Organization or WTO. See: http://www.wto.org/english/tratop_e/trips_e/trips_e.html

[62] Some jurisdictions have chosen to protect trade secrets under the intellectual property framework, while others choose to do so through unfair competition and/or antitrust legislation.

[63] Access to own information is also an important tool to improve its quality if data subjects are allowed to request corrections of erroneous or otherwise inaccurate data.

individuals or entities should also be able to access this same information and, for example, re-use it for commercial purposes (e.g. for credit reporting).[64]

77. Central banks, bank supervisors and/or other public sector authorities are often charged with enforcing laws and regulations related to credit, lending and credit reporting.[65] As indicated in the *General Principles* report, however, there is growing recognition that authorities can play other key roles, like leading the development of a vision for the credit reporting system, enhancing coordination with and among all stakeholders and other authorities, and/or in carrying out reform plans, among others, to promote the successful development of the credit reporting system as a whole.

78. Such roles tend to be undertaken by an authority that is designated as system overseer. To accomplish its objectives, the overseer will have at its disposal a variety of tools ranging from monitoring, to regular dialogue through bilateral or multilateral consultations, acting as a catalyst for change, and if necessary relying on regulation.[66] For many aspects, so-called "soft regulation" approaches by overseers, possibly coupled with industry standards (e.g. codes of conduct) developed by the commercial credit reporting industry participants in certain jurisdictions, may suffice. [67] However, for other aspects stronger regulatory measures might be needed. One example emphasized in the *General Principles* report is that of ensuring fair access of all interested parties to credit reporting services (e.g. all current and potential financers of SMEs), which under certain circumstances might only be dealt with through regulation.[68]

[64] In the EU context, the new General Data Protection Regulations includes a first attempt to regulate the use of data stored in public sector agencies for commercial purposes. The regulation has not been enacted yet and it does not cover all potential situations arising from using data from public sources.
[65] In some countries other relevant enforcing agencies can be the data protection authorities, consumer protection authorities and competition and antitrust authorities.
[66] See the Recommendations for Effective Credit Reporting Oversight in Section 4 of the General Principles report.
[67] Two examples are the Business Information Industry Association (BIIA) Code of Conduct and the Federation of European Business Information Service (FEBIS) Code of Conduct.
[68] For example, if the ownership structure of CRSPs does not provide incentives for the CRSP to develop an access policy that encourages broad access to its services. For additional information see the guidelines on effective governance arrangements ensuring that all users have fair access to information under General Principle 3, and the guidelines on non-discrimination under General Principle 4 of the General Principles report.

79. There are also certain other more general legal and regulatory aspects that affect not only credit reporting but that are highly relevant also for many other financial and economic activities.[69] One of these aspects is that of financial accounting, reporting and disclosure standards. Even if internationally recognized standards exist like the International Financial Reporting Standards (IFRS) framework, these have not been adopted in some jurisdictions or have been adopted only partially. In the absence of such standards, or if the same are applied ineffectively in practice, no reliable comparisons of an SME (or other firm) can be made with its peers domestically, let alone cross border, or even comparing the performance of the same SME over time.[70]

III.4.3 Cross-Border Data Flows

General Principle 5

Cross-border credit data transfers should be facilitated, where appropriate, provided that adequate requirements are in place.

80. It is estimated that cross-border sharing of credit data and other information on firms is much larger than cross- border data sharing on individuals. For example, some major players in the commercial credit reporting arena report that an average 20 percent of queries to their database involve some type of international search.

81. In the specific case of SMEs, even if only very rarely they will have established subsidiaries, branches or other types of affiliates in other countries, many SMEs are active exporters and/or importers of goods and services. Hence, SMEs are still likely to require credit and other financial services from creditors based in foreign jurisdictions.

[69] Due to their cross-cutting nature of these aspects, they are not discussed in detail in this report.

[70] It should be noted that this type of inconsistency might originate not only from the financial information that firms might report to CRSP, but also from non-standardized reporting by lenders. A bank, for example, may report under the same credit risk category two loans that were originated with exactly the same terms and conditions, but that are being repaid quite differently in practice (e.g. one could be subject to frequent renewals due to non-repayment of principal). This is clearly misleading for other lenders that use this information from the CRSP.

For example, an exporter in jurisdiction A may require an importer SME in another jurisdiction to obtain a letter of credit from a bank based also in jurisdiction A. The latter bank will then need to make an assessment of the SME's creditworthiness, similar to any other transaction involving a credit risk to it.

82. Credit reporting might be especially useful in assessing creditworthiness in cases like these given that very little information, if any, about the SME will be available in jurisdiction A.[71] In addition, credit reporting can support financers in complying with stricter know your customer (KYC) requirements in connection with legislation on anti-money laundering legislation or the prevention of the financing of terrorism.[72] At present, some cross-border data exchanges on SMEs already take place between private CRSPs under specific agreements.[73]

83. For some public sector activities like banking supervision, regulators themselves may be the main interested party in effective cross-border data sharing to underpin their own activities. In the EU, the common financial market prompted increasing multilateral data sharing between several European credit registries. This arrangement is organized under the umbrella of the European System of Central Banks (ESCB). Most SMEs with current or past financial obligations with banks would be included under the arrangement as the threshold for exchanging credit data is € 25,000. Further details about the exchange of information between European credit registries are included in Box 2.

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[71] Moreover, as identified in the *General Principles* report, in regions or economic blocks characterized by a strong financial and economic integration, authorities may wish to establish as a policy objective that businesses and nationals of the block receive financial services under similar conditions within the block.

[72] To comply with KYC requirements, information that assists in the identification and verification of beneficial ownership and controlling interests and the identification of company officials and directors is essential. Increased data sharing, particularly from public records agencies, can help to address these KYC issues.

[73] For example, under the ACCIS agreements.

Box 2: Cross-Border Data Sharing in the EU

To gain a picture as complete as possible of the total indebtedness of borrowers across the EU and not just in their home jurisdiction, nine national central bank-operated credit registries (Austria, Belgium, Czech Republic, France, Germany, Italy, Portugal, Romania and Spain) signed a Memorandum of Understanding providing for the exchange of credit information stored in national central credit registries on a regular, monthly basis.[74] In addition, reporting institutions are allowed by electronic means to make cross-border inquiries about the indebtedness of their clients on a case by case basis. Based on 2012 data, at present these credit registries exchange credit information regularly on about 20,000 companies.

Recently, given the crucial role of granular data on loans for the tasks of the European System of Central Banks (ESCBs) and the Single Supervisory Mechanism (SSM), the European Central Bank (ECB) is envisaging a project for establishing an Euro Area Database referred to micro data on loans, sourced from national central banks (NCBs) and other national competent authorities (NCAs).

To allow an efficient micro-data sharing at EU level, the priorities of the ongoing initiative are: i) a sound legal framework to support the data collection and dissemination; ii) a minimum degree of harmonization in concepts, definitions and coverage of credit data to be shared across the ESCB/SSM; and, iiii) a proper IT application able to ensure a flexible data sharing between the ECB and the NCBs, an appropriate data quality management and an adequate protection of the data confidentiality.

A further propeller for cross-border data sharing throughout the EU is expected to be European Banking Authority (EBA), established in 2011. The main task of the EBA is to contribute to the creation of the European Single Rulebook in banking whose objective is to provide a single set of harmonized prudential rules for financial institutions throughout the EU. The EBA also plays an important role in promoting convergence of supervisory practices and is mandated to assess risks and vulnerabilities in the EU banking sector, which will require extensive analyses of credit and other data.[75]

Sources: EBA and ECB websites, Banco de España and Banca d'Italia.

84. Cross-border sharing of credit data can be affected by differences in credit cultures, market practices, institutional structures, and multiplicity of laws that may be applicable to credit reporting activities.

85. One of the major specific problems perceived when sharing data across borders is the lack of standardization, which creates difficulties for comparing data from different countries. For historical reasons and the specificity of some local practices, CRSPs and

[74] This Memorandum of Understanding was first signed in 2003 and amended in 2010. It is available at the European Central Bank's website (www.ecb.int).

[75] For example, the EBA and the EU Commission will release standardized reporting requirements for so- called large exposures (exposures >= 10 % of own funds) that banks will have to obey starting from 2014. This data is intended for supervisory purposes only and not to be shared with other banks.

other registries like central bank's balance sheets databases tend to use different definitions for the various data fields they use, both in terms of contents and format.

86. At a more general level, as discussed in the previous section on the legal and regulatory framework, financial accounting and reporting peculiarities in each jurisdiction do not allow for effective and reliable comparison of SMEs (and other firms) across borders.

87. Likewise, the differences in the structure of legal entity identifiers across jurisdictions discussed in Section III.4.1 may also become a significant impediment for CRSPs and users to make an effective use of cross-border credit data transfers.

IV. Possible Actions to Enhance Credit Reporting to Further Facilitate SME Financing

88. As indicated in Chapter 1 of this report, many SMEs face difficulties to access external financing. This report has focused specifically on how credit reporting can better serve the needs of a wide variety of creditors so as to facilitate their decisions about granting trade credit, loans or other forms of financing to SMEs.[76]

89. On the basis of the shortfalls described in Chapter 3, the following *10 Possible Actions* have been identified that could help improve the service and overall value of credit reporting to SME financers, and by this means also to SMEs.

90. Improving credit reporting systems requires the collaboration of all relevant participants in their different roles.[77] In this regard, the credit reporting participant(s) deemed to be in a better position to address each of the *10 Possible Actions* are also identified herewith, and then summarized in a matrix in Annex 2.

91. Possible Action 1

Many SMEs are not included in the credit reporting system, especially if they have not had a loan or other credit facility with a regulated financial institution. Others are included only if they have had late payments or have defaulted their financial obligations. ***Authorities could seek for ways for all relevant data providers, including non-bank creditors, to increase reporting of SME positive and negative data.***

92. Possible Action 2

Detailed and reliable financial statements or comparable information of SMEs is generally not available to CRSPs. Reporting of such information to certain public sector authorities and/or relevant registries is often not mandatory for most SMEs, or some SMEs may hide behind unclear trade secrecy provisions to avoid reporting their

[76] This report nevertheless recognizes that there are several other reasons beyond shortfalls in credit reporting that also explain why SMEs often facing financing constraints.

[77] The General Principles report identified the following as the key participant sin CRSs: i) Data providers; ii) Other data sources, including public records agencies; iii) CRSPs; iv) Users; v) Data subjects; and, vi) Authorities.

information. ***Authorities could therefore seek to increase transparency of SME activities and performance through mandatory reporting of key financial information to the relevant public registers or public sector authorities. Policies to reduce the regulatory burden on SMEs by exempting them from this type of requirements would have to be weighed carefully against other relevant policy objectives.***

93. *Possible Action 3*

SMEs need to be fully aware that in order to obtain external financing from creditors, the latter must have adequate information to facilitate their decision-making. This includes qualitative and quantitative information such as financial statements or financial projections as part of the business plan of a start-up or expansion. ***SMEs could therefore seek to ensure that the information they generate about the business to apply for external financing (and other purposes) is sufficient and reliable. When needed, SMEs could seek training from authorities and any other parties to develop the necessary skills for this. Creditors, in their role as users, could also provide valuable feedback to SMEs by making their credit policies and decisions more transparent.***

94. *Possible Action 4*

Many national tax authorities and other public agencies that provide national identification numbers are usually reluctant to make their ID records accessible to CRSPs. There is increasing demand to access these records for identification verification purposes, which could result in benefits to the general public (e.g. mitigation of fraud). Making these records accessible can also favor the move towards the use of a single ID. ***Relevant public sector agencies in their (potential) role as other data sources could therefore seek to agree with CRSPs a way in which the latter can access national ID databases for verification/validation purposes.***[78]

95. *Possible Action 5*

Data and other information collected by certain public records agencies are key for the evaluation of SME creditworthiness. Practical problems like some of these records being

[78] Eventually this could also include global ID databases like the LEI.

held in paper/physical form impede efficient access by CRSPs to this data. In addition, data quality problems may originate from infrequent updates or lack of integrity of records. ***Public records agencies/public registers in their role as other relevant data sources could therefore aim at improving the quality of their record holdings and ensuring these can be accessed easily and efficiently by all interested parties like CRSPs.***

96. *Possible Action 6*

The legal and regulatory framework underpinning the permissible uses of the information held by public sector agencies, including public records, is often inadequate, or does not exist at all. Where it exists, the relevant provisions usually consider only the case of data subjects accessing their own information and not other potential commercial uses of that same information. ***Governments in their role as other relevant data sources would need therefore to define clear policies regarding the permissible uses of the information that is collected by public sector agencies and information available in public records. This may require changes to the legal framework.***

97. *Possible Action 7*

Most CRSPs focus exclusively or almost exclusively on either consumer or commercial lending. Nevertheless, some data items that are collected by consumer credit bureaus can be useful to commercial credit information companies, and vice versa, to build a more comprehensive picture of debtors or potential debtors. This might be especially relevant in the case of SMEs due to many of the latter being closely held companies. ***Commercial credit information companies and consumer credit bureaus could therefore seek to collaborate and, to the extent permitted by the law, share data among themselves that might be useful to each other and to their respective users, and eventually develop certain credit reporting products jointly.***

98. *Possible Action 8*

Commercial credit reporting systems can benefit from a central agent that coordinates and oversees the actions of the various credit reporting systems participants, and that provides guidance and leadership when changes are necessary and reforms undertaken. ***Authorities would have to therefore scale up their oversight capacity on the commercial credit reporting system. Consistent with the model presented in the General Principles report, one authority should be designated as leading overseer, and should use all the tools available to it to accomplish its oversight objectives.***

99. Possible Action 9

There is a need for further collaboration at the international level to improve the comparability and consistency of SME credit data that is shared (and eventually used) across borders. Differences in definitions, specific data contents and registration criteria used by the various CRSPs makes it difficult for potential SME creditors to make reliable comparisons of applicants across jurisdictions. ***CRSPs and authorities would therefore strive to increase the degree of convergence and harmonization of key characteristics of credit data that is shared across borders to ensure that such data is useful. This may include envisaging a core set of variables to be shared across borders on the SME covering both financial data and credit performance aspects.***

100. Possible Action 10

There is no reliable, up-to-date, comprehensive set of data and other information about the status of commercial credit reporting at either the regional or global levels,[79] and how it may be serving typical SME financiers and the credit market more broadly. In many cases this information is not available even at the domestic level. Statistics and detailed information on the various features of commercial credit reporting and current practices around the world could no doubt be useful to all CRS participants. ***Authorities could therefore push for/participate in a global survey or similar tool to be performed periodically to obtain detailed, comprehensive and systematic information about credit reporting activities both in their jurisdictions and at the global level.***

[79] To date, the only global survey on credit reporting is the World Bank Doing Business survey, which does not specifically cover commercial credit reporting activities. Other relevant surveys include those carried out by ACCIS and BIIA, which by their own nature focus on specific aspects of commercial credit reporting and are not global.

Annex 1: The Global Legal Entity Identifier[80]

The challenges of ensuring proper business identification prompted governments around the world to convene the Financial Stability Board (FSB) to analyze the underlying problems and to create a global legal entity identifier (LEI) to uniquely identify entities that engage in financial transactions, representing the public interest.

Hence, at the Cannes Summit in 2011, the G20 provided a mandate to the FSB to lead the co-ordination of international regulatory work and to deliver concrete recommendations for the appropriate governance framework for a global legal entity identifier (LEI) system, representing the public interest. The LEI system would provide a valuable building block to contribute to and facilitate many financial stability objectives, including: improved risk management in firms; better assessment of micro and macro prudential risks; facilitation of orderly resolution; containing market abuse and curbing financial fraud; and enabling higher quality and accuracy of financial data overall.

The global LEI foundation will act as the operational arm of the system, and thereby support on a not-for-profit basis the implementation of a global LEI in the form of a reference code (20 digit alphanumeric number with no embedded intelligence, partitioning essential: First 4 digits allocated uniquely to each Local Operating Unit (LOU); 5th and 6th digits set to zero; the next 12-digit component is the entity-specific part, last two are the check digits) to uniquely identify distinct entities that engage in financial transactions.

The LEI Regulatory Oversight Committee (ROC) has now agreed on all material issues relating to the development of statutes that will govern the foundation. These statutes have been delivered for review by the FSB in its role as the proposed founder of the foundation and will allow the next steps in establishing the Central Operating Unit of the global system to be taken.

[80] Adapted from the Financial Stability Board's website.

The ROC has also made significant progress in establishing an interim system to provide globally acceptable “pre-LEIs” that can be used in the near term for regulatory reporting purposes. Currently there are fourteen pre-LOUs that have been assigned prefixes to support the planning of pre-LOU services and to facilitate the issuance of pre-LEI codes. The ROC has decided until now to endorse three pre-LOUs – CICI Utility (USA), INSEE (France) and WM Datenservice (Germany) – so that the codes they issue or have issued may be used for reporting and other regulatory purposes in the various jurisdictions represented in the ROC.

Annex 2: Summary of the Roles of the Various CRS Participants as per the Possible Actions

	Data Providers	Public records agencies and other data sources	CRSPs	Users	Authorities	Data Subjects (SMEs)
Possible Action 1 - *Authorities to seek ways to increase reporting of SME positive and negative data*	X		X		X	
Possible Action 2 - *Authorities to seek to increase transparency of SMEs through mandatory reporting of key financial information*					X	X
Possible Action 3 - *SMEs to seek to ensure that they provide sufficient and reliable information to creditors*	X			X		X
Possible Action 4 – *Public sector agencies in their role as other data sources to seek to facilitate access to CRSPs to validate identity data.*		X	X			
Possible Action 5 – *Public records agencies/public registers in their role as other relevant data sources provide easy and efficient access to CRSPs.*		X	X			
Possible Action 6 – *Governments in their role as other relevant data sources to seek to clarify the permissible uses of information collected by public sector agencies and information available in public records.*		X	X		X	

Possible Action 7 – *Commercial credit information companies and consumer credit bureaus to seek to collaborate to improve their products*			X			
Possible Action 8 – *Authorities to seek to scale up their oversight capacity on the commercial credit reporting system.*					X	
Possible Action 9 - *CRSPs and authorities to seek to increase the degree of convergence and harmonization of data that is shared across borders*			X		X	
Possible Action 10 – *Authorities to push for and participate in a global survey*	X	X	X	X	X	

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