



Credit Bureau Development in South Asia

An Analysis Report on South Asian Credit Information Bureau Development based on a two-day conference organized by the World Bank, the Central Bank of Sri Lanka, and the Credit Information Bureau of Sri Lanka (CRIB), on May 10–11, 2004, in Colombo, Sri Lanka

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Chapter 1

Introduction to Credit Information Bureaus

This report follows a two-day conference on Credit Bureau Development in South Asia, organized jointly by the World Bank, the Central Bank of Sri Lanka, and the Credit Information Bureau of Sri Lanka (CRIB), on May 10–11, 2004, in Colombo, Sri Lanka. The workshop focused on promoting the development of credit information systems in the region and covered various topics—the legal, regulatory, and information technology needed to support a credit information sharing bureau and the current and potential sharing of credit information in the region. Presentations and group discussions addressed the efforts in the South Asia region to create the necessary conditions for the development of a bureau and the distinct challenges faced by this region. The goal of the workshop was to provide government officials with a better understanding of the collection and use of credit information and to identify how the international community can help countries in the region develop credit information systems. In attendance were representatives from the private sector and government officials from Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka.

1.1 An Overview

The goal of credit information bureaus is to ease a problem fundamental to credit markets: asymmetric information between borrowers and lenders. Formal information exchanges, as occur through credit bureaus or public credit registries, help lenders to identify good borrowers, thus reducing the incidence of adverse selection. The practical

consequence is better risk management, which enables banks and other financial institutions to increase their lending volume and extend credit to underserved segments of the population, such as small and medium-sized firms (SMEs). Credit reporting helps lenders by reducing default rates and borrowers by allowing them to develop payment histories or “reputation collateral,” collateral they can use in securing more competitive loan rates. Once loans have been provided, credit bureaus release data on payment behavior so as to limit moral hazard (where borrowers do not make a good-faith effort to repay). The cost of paying late or defaulting on a loan for one institution is greatly increased by the effect this has on the cost of, and access to, credit across the financial system.

Credit bureau information is especially useful when lending institutions are making decisions on individuals and SMEs. While lending to large companies requires a detailed analysis of the potential borrower’s financial standing, for smaller loans, payment history is found to be a sufficiently good predictor of the probability of default. The data in credit registries enables lenders to use automated decision systems, including scoring, for consumer and small business loans. By automating the credit decision, lending institutions are able to institute drastic cuts in the costs of and time involved in loan preparation. This in turn allows the total volume of credit to expand. Without a bureau, banks must use flawed, demographically based application scores, which have little success in predicting default rates. Banks are more willing to lend against “behavior scores,” which are based on borrowing and repayment histories and have been effective in reducing credit risk around the

world. The use of scoring systems based on the borrower's credit history allows banks to decrease their costs by, first, lowering the cost of processing loan applications and, second, by improving their ability to predict defaults and successfully manage credit portfolio risk.¹ For example, a 2001–2002 survey of bankers in 34 countries with operating credit registries shows that banks make significant gains when they have access to information from credit registries. More than half the respondents said that when they could use credit history they were able to cut loan-processing time, costs, and defaults by more than 25 percent (Miller 2003).

In many countries, the state plays an important role in credit information, either directly, as in the case of a public bureau operated by the central bank or government ownership of an outside bureau, or indirectly, through bank regulation requiring banks to share credit information. When is government intervention required to promote credit reporting? This is an important public policy question. Credit information has been shown to reduce the ex-ante cost and time of loan processing and the ex-post rate of default, which should encourage banks to share information among themselves, voluntarily. Large (and sometimes public) banks are often unwilling, however, to share proprietary information about their customers in fear of losing their monopoly rents. The banking sector in emerging markets often suffers

¹ For example, rural borrowers in India need to acquire a "no dues certificate" from every other lender in the village (as defined by local lenders) that they do not have a loan outstanding. This is costly and time consuming for borrowers and consequently, if a farmer needs a loan quickly, generally his only option is to go to informal moneylenders. A credit bureau could eliminate the need for these certificates and decrease the time necessary for loan approval and disbursement.

from low competition and high concentration; therefore, large banks may reason that the benefit of credit information from other banks is less than the potential cost if other banks use their credit information to steal their better customers. As a result, it is often necessary for government policy to encourage the responsible sharing of credit information.

The solution is not for the central bank to develop a public credit bureau, which is often limited in the scope of information and services offered. For instance, only 14 percent of public registries offer services such as credit scoring, as compared to 90 percent of private bureaus (Doing Business, 2005). Rather, laws and regulations can be effective to promote the development of private credit bureaus in countries where efficient private bureaus have not been established on a voluntary basis. For example, in India, the government does not have direct ownership of the bureau, but requires all regulated financial institutions to contribute positive and negative information to the privately owned bureau. In Mexico, for instance, the supervisory authority requires banks to examine a credit report before issuing a loan. Since the bureaus operate on a reciprocity basis, Mexican banks are de facto required to provide information to the private bureau. Similarly, in Russia, laws are being considered to require banks to contribute data on a reciprocity basis to a private credit bureau.

Not all private credit bureaus are both trustworthy and effective. A bureau's fundamental obligation is to generate "trust" among its members and borrowers that borrowers' information will not be mishandled or abused. This in part depends on government regulations governing consumer protection, such as the right of borrowers to access their own credit reports and a clear process to challenge incorrect information. In addition, most credit bureaus are prohibited from sharing information on a borrower without written

consent from the borrower on a loan application, which can prevent the cherry picking of good customers. In addition, the private bureau's ownership and governance structure is important; for instance, all members must have confidence in the bureau, which must be perceived as biased in favor of large and dominant banks. This is one reason why private bureaus rather than lenders are more likely to build a wide sense of trust among its members.² But these private bureaus tend to be owned at least in part by a neutral, experienced and international technical provider (with some notable exceptions, such as the bank-owned bureaus in Italy, Germany, and Turkey). This trust, in turn, motivates lenders to contribute their credit portfolio information and helps the bureau to develop more rapidly and effectively.

1.2 Empirical Evidence

Recent research shows that the existence of credit registries leads to increased lending volume and improved access to financing. Results of a study based on information from more than 100 developed and developing countries shows that, on a macro level, the existence of credit registries is associated with a higher private credit to GDP ratio, after controlling for other country-level measures of development (Miller, 2003). A study on credit reporting firms in more than 40 countries shows greater information sharing to increase lending as a percentage of GNP and lower default rates (Japelli and Pagano, forthcoming.)

The impact of credit information sharing can also be seen at the bank and firm level. A 2003 World Bank study finds that more than

50 percent of banks reported that the presence of credit registries cut processing time, costs, and defaults by 25 percent (Doing Business 2004). One study finds that 28 percent of firms are able to obtain a bank loan in countries without credit bureaus—this figure compared with 40 percent of firms able to do so in countries with a bureau (Love and Mylenko 2003). In Chile, the use of credit reports is found to increase the volume of lending, while credit reports with longer historical records and more complete information have larger effects on credit decisions (Cowan and De Gregorio 2003). The importance of comprehensive information is highlighted in a study of the percentage of applicants who are approved for a loan. The study found that the gain from the inclusion of positive information—compared with only adverse information—is more than 90 percent (Barron and Staten 2003).

Improved collection of credit information has most benefited small and new firms. Greater information sharing helps small and more informationally opaque firms by alleviating credit rationing based on the lack of credit history. There is evidence that when credit reports are available, firms use fewer internal funds and are therefore less credit constrained (Galindo and Miller 2001). Another study based on an enterprise survey in 52 countries finds that about half the small firms report financing constraints in countries without a credit bureau; that figure is 27 percent in countries with a credit bureau (Love and Mylenko 2003).

Successful credit information systems can be found in developing countries. South Africa has a mature private credit information environment, which includes two competitive private international credit bureaus, and extensive information sharing takes place on a voluntary basis. Credit reports providing both negative and positive information, along with scoring models, are used to determine a

² International credit information providers include CRIF, Dunn & Bradstreet, Expedia, Experian, Trans Union, etc.

borrower's credit risk. A proper dispute-resolution system is also in place for consumers and the bureau. In addition, information on microlenders is shared with banks and other lenders through a reciprocity agreement with the microfinance information bureaus. Some unique features of the credit reporting system include data collection from a number of sources (e.g., court judgments) and the presence of the Credit Information Ombud for dispute resolution (Singh, 2003).

1.3 Key Requirements

Although credit bureaus can help to accelerate the development of financial markets and the private sector, it is important to create the right framework for credit information sharing—guidelines, for example, to prevent the misuse of collected information. The major issues that need to be addressed are:

Legal and regulatory framework and consumer protection

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

Two concerns must be addressed with regard to the collection and distribution of personal data: privacy and access. Confidence in secure, protected credit information creates more support for credit registry systems. Laws regulating credit reporting should allow credit information to be shared while protecting the legal rights of individuals and firms. Overly restrictive

information sharing, for example, through unnecessarily severe penalties and sanctions or complicated and expensive procedures, may discourage firms from entering the credit reporting business. This would increase the cost of credit reports—costs that will be passed on to borrowers through higher lending rates. Policymakers may choose between laws regulating the industry versus a self-regulating code of conduct.

At the same time, laws and regulations must protect consumers and ensure that data is not misused by creating a balance of privacy protection and effective information sharing. The purpose of laws and regulations governing credit reporting is to allow responsible sharing of credit information while protecting the rights of individuals and firms. For example, only credible lenders should have access to credit information. Credit reports should include only objective data relevant to creditworthiness, not subjective data or rumors. Typically, time limits are imposed on the inclusion, and distribution, of adverse credit information. In addition, laws should safeguard consumer rights by allowing consumers to obtain their own credit report and by providing appropriate dispute resolution mechanisms to correct erroneous information. It is also important that the bureau educate consumers to understand the role of the bureau, how their credit profile is used by lenders, how to access their own credit report, and what their legal rights are in the case of disputes.

Ownership

Credit registries may be established in the private or public sector or operate as a joint venture between the state and member banks (as in the case of Sri Lanka) or between member banks and foreign private bureaus (such as in the case of India). One advantage enjoyed by public credit bureaus is their ability to set up operations quite rapidly because they

rely on established central bank regulation rather than waiting for new laws to be enacted. But private registries are able to collect information from a large number of sources, from financial institutions to firms selling goods on credit. They may also provide a wider range of services including investigative reports as well as value-added services, such as credit scores and ownership links. Since participation in private registries is voluntary, they may, at least initially, not include all financial institutions. For instance, in countries dominated by one or two large private or state-owned banks, the dominant financial institutions may choose not to share their proprietary credit information. Voluntary participation in private registries, however, increases once the value of the registry is established.

Public credit registries are usually established by a central bank. They serve a dual purpose of improving a bank's risk management and strengthening banking supervision. They require all supervised financial institutions to submit data, which allows them to overcome noncompliance issues (i.e., coordination failures). Public registries also allow the central bank to better monitor risks in the system through on-site and off-site supervision. Yet public registries usually collect relatively little data, and their limited resources prevent them from providing value-added services. Since private bureaus are better designed to collect and distribute information to lenders, most developed countries have a private credit reporting system, even though many also have a public registry operated at the central bank. For example, Latin America has the most widespread credit reporting system in the developing world, and most countries have both public and private credit registries, some of which have been operating for decades.

Technology

Some basic questions include: Do banks have the IT ability to submit electronic data to a registry? Are required information fields electronically collected by banks (i.e., are all banks automated)? Can information be accessed in real-time via the internet or a portal? Should a public bureau be operated in-house or should data storage and maintenance be outsourced to an IT firm or private bureau? The timely collection and distribution of data depend on how each country answers these important questions.

Another technological challenge is how to identify borrowers in countries without unique IDs. For example, many bureaus use a string of identifiers, including the names and birthdates of the borrower and his family, location, employee, etc. In order to maintain the integrity of the bureau, an accurate ID system must be developed.

Scope

For bureaus to assess risk in an accurate fashion, they must share both negative and positive information. Credit reports that contain only negative information (such as instances of late payments) have less predictive power than reports with both positive and negative information (Padilla and Pagano, 2000 and Barron and Staten, 2003). Furthermore, countries in which bureaus share positive *and* negative data regarding borrower behavior have enjoy lower default rates (given the penetration of credit cards) relative to countries where bureaus share largely negative information (Bailey, Chun and Wong 2003). Another study finds that bank use of positive information produced lower default rates in Argentina and Brazil (Majnoni, Miller, Mylenko and Powell, 2003). Information should also be collected and distributed on a timely basis, so that lenders can

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have confidence in the accuracy of credit reports.

Credit bureaus should include data from all lenders, including other nonbank financial institutions, retailers, and nonfinancial firms that issue trade credit. The objective of the

bureau should be to increase access to credit and reduce financial risk, which requires a complete borrowing profile. For example, leasing and factoring are important sources of commercial working capital financing, but cannot operate without credit information on firms' customers.

Chapter 2

Credit Information in South Asia

Across the region bureaus show tremendous variation regarding the type of information they collect, the sources of that information, how frequently they collect it, and in the cost of accessing credit reports. Continued efforts must be made to develop self-sustaining, privately owned credit reporting systems in the region that reach a variety of borrowers, are effectively regulated, and provide consumer protection. But the activity in the region is encouraging. See Table 1 for additional information on the regional credit bureaus in Bangladesh, India, Nepal, Pakistan, and Sri Lanka. The table includes three categories of descriptive information: characteristics of the bureaus, the scope of information collected by the bureau, and credit report features.

2.1 Bureau Characteristics

Rows 1–9 describe the institutional characteristics of the South Asian credit bureaus. For instance, the oldest bureau in the region is CRIB, established in Sri Lanka in 1990, while the youngest bureau is CIBIL in India, which started operations in 2004 (Row 1). Five of the eight South Asian countries (Bangladesh, India, Nepal, Pakistan and Sri Lanka) have public credit bureaus, while three countries (India, Sri Lanka, and Pakistan) have privately owned bureaus (Row 4). Only CIBIL, India's private credit information bureau, has foreign ownership participation; Trans Union and Dunn & Bradstreet have minority positions to provide technical

assistance in the collection of consumer and commercial data, respectively (Row 5).

In all countries, central bank–regulated financial institutions are required to participate in a bureau.³ In Bangladesh, Nepal, and Pakistan, the central bank collects the data directly in a publicly operated bureau. In India and Sri Lanka, supervised banks are required to submit data to the private bureau and information is shared on the principle of reciprocity (banks that do not yet provide information to the bureau cannot receive information). Only India and Sri Lanka have legislation that sets guidelines on the operation and sharing of information. In Pakistan, for instance, it is urgent for the government to address the legal procedures governing information-sharing because the private bureaus have started to share positive and negative information, although the law is unclear (Rows 6–7).

However, in all cases, the bureau includes only those commercial borrowers with outstanding loans from supervised commercial and development banks and regulated nonbank lenders; this practice excludes other creditors, such as some non-deposit-taking factoring and finance companies, retail lenders, utility companies, etc. In Bangladesh, for instance, the coverage of consumer loans is very low and does not include credit information on credit cards or

³ Bank membership is mandatory in all regional bureaus, with the exception of the private bureaus in Pakistan, such as DataCheck.

housing loans, although local banks offer both products. The bureaus should also consider including *all* lenders such as finance companies, retailers, cell phone providers, utility companies, etc. (Rows 8–11).

The private and public bureaus offer slightly different products. All credit bureaus in the region—with the exception of DataCheck, which collects only consumer credit information—cover both corporate and commercial borrowers. Although the public bureaus focus primarily on credit reports on individuals and borrowers, the private bureaus in India and Pakistan also provide, or plan to provide, additional services such as credit-scoring models and other credit-assessment guides (Row 12).

The region currently has no microfinance bureaus. Credit information on microborrowers could be important for the cross-selling of other products, such as microinsurance, for example, by allowing borrowers to develop a credit history in the informal markets to ease their eventual transition to formal bank borrowing. In addition, information on microborrowers could help to encourage privately owned microlenders and greater microfinance-bank linkages. In India, microfinance institutions have begun to share information on an informal basis. The development of microfinance bureaus, particularly in Bangladesh, where microfinance activity is relatively high, could help improve the credit culture for microloans.

2.2 The Scope of Bureau Information

The scope of information collected by regional credit bureaus (see Table 1, Rows 13–16), is an important feature to consider. For instance if the bureau collects information only from certain types of institutions or loans of certain sizes, it is neglecting a lot of

information useful in credit appraisals. In order to provide information useful to banks making credit decisions, a bureau must collect and share positive and negative data on all loans, on do so in a timely manner.

With the exception of CIBIL, all bureaus in the region have a minimum loan amount below which loans are excluded from the database. The minimum loan value is lowest for CIB (Bangladesh) and DataCheck. The countries with a higher cutoffs, such as Pakistan and Sri Lanka, should consider lowering it to expand their coverage of borrowers in the economy. In Pakistan, the cut-off is so high it precludes most consumer credit information, which is instead collected by DataCheck, the private bureau. By excluding small consumer and commercial loans, the bureau is hurting small borrowers, who benefit the most from positive credit reports and good reputational collateral (Row 13).

Another troubling law concerns how much of a borrower's payment history goes into credit reports—how far back in time should they go? If negative data are dropped after a certain number of years, those with bad credit histories may be helped, but at the expense of those honoring their debt obligations. CIB in Pakistan and CRIB hold 10–12 years of history, which may encourage a better credit culture. Similarly, DataCheck and CIBIL intend to build credit histories from their inception as they go forward. But the public bureaus in Nepal and Bangladesh only keep three and two months' worth of information, respectively—a practice that makes these bureaus less useful. A few months is not sufficient time to penalize borrowers that default or reward borrowers that pay on time (Row 14)

An important determinant of a credit bureau's effectiveness is the type of information they

collect. It is critical that a bureau collects both negative information (on defaults) and positive information (on repayments). Without positive information, only bad customers are able to build (bad) credit histories, as information on timely repayment goes unnoted. A salutary development in South Asia is that all bureaus, except for Nepal, include positive and negative information. The frequency with which information is collected is also important. Credit information is valuable only if it is provided on a timely basis. All bureaus collect information on a monthly basis, with the exception of Nepal, which collects data quarterly. Yet although information collection is required on a monthly basis, frequent delays are reported either due to a lack of automation in the bureaucracy of collecting information from large public bank (Rows 15–16).

2.3 Credit Report Features

The ability of banks to use credit information in making credit decisions depends on the timely collection and distribution of credit information. This information can be presented either as an aggregate of all loans across all borrowers or by individual credit lines. The CIBs in Pakistan and Bangladesh present information only in aggregate form, for the purpose of providing privacy to

lending financial institutions. In India, Nepal, Sri Lanka and DataCheck, individual credit lines are presented so a much clearer position of the borrower appears. The Credit Information Bureau (CIB) of Pakistan, housed in the central bank, was the first registry in South Asia to go online in early 2003. Except for India and Pakistan, the other credit bureaus in the region are not fully online, which poses significant delays (Rows 18-19).

Critically important are consumer protection laws that give borrowers rights in the case their credit reports contain errors; educational campaigns are also useful in alerting borrowers that their credit information is being collected and shared with other lenders. Consumer rights should be a priority for all countries in the region. For instance, consumer access to individual credit reports are arranged on an informal basis in all credit bureaus. No clear legal rule now enables creditors, about whom information is collected, to access or dispute information held by the credit registry. Similarly, none of these countries have any specific consumer protection law. In addition, only Nepal and Sri Lanka require written consent to obtain a credit report. Although laws should not limit credit information collection, it is important that borrowers be informed of all activity regarding their credit reports in order that their credit information is not misused.

Table 1: Comparison of Credit Information Bureaus in the Region

Name	Bangladesh		India		Nepal		Pakistan		Sri Lanka	
	Credit Information Bureau (CIB)	Credit Information Bureau (India) Limited (CIBIL)	CIB	CIB	Credit Information Bureau (CIB)	Data Check	CRIB			
Bureau Characteristics:										
1	Date established	1993	2004	2001	1992	2001	1990			
2	Number of employees	56	24	13	12	10	31			
3	Sales (in US\$)	—	N/A	—	US\$ 73,634	US\$ 284,644	US \$ 398,400			
4	Ownership type	Public	Public private partnership	Public	Public	Private	Public-private partnership			
5	Foreign ownership	None	Yes (Dunn and Bradstreet and Trans Union)	None	None	None	None			
6	Sources of information	<ul style="list-style-type: none"> • Banks • NBFIs • Other supervised financial institutions (poor coverage of consumer loans) 	<ul style="list-style-type: none"> • Banks • NBFIs • Finance Companies • State Finance Companies • Credit Card Companies 	<ul style="list-style-type: none"> • Banks (17) • Finance Companies (32) • Co-operatives (4) • Development Banks (9) 	<ul style="list-style-type: none"> • Banks (40) • Leasing Companies • Modarabas (131 Islamic Banks) 	<ul style="list-style-type: none"> • Banks • NBFIs • Other financial institutions 	<ul style="list-style-type: none"> • Banks • NBFIs • Other financial institutions 			
7	Is reciprocity required?	N/A; participation is mandatory	Yes	N/A; participation is mandatory	N/A; participation is mandatory	Yes	N/A; participation is mandatory			
8	How many institutions provide data	76 (49 banks, 19 NBFIs, 8 leasing companies)	97 (65 banks, 10 housing finance, 11 NBFIs, 8 financial institutions, 2 state financial companies, 1 credit card company)	62 (17 banks, 32 finance companies, 4 co-op: 9 development banks)	131	28 (20 banks, 5 NBFIs, 3 others)	69 (22 banks, 27 finance companies, 1 leasing companies, National Development Trust)			
9	How many banks provide data?	49 Banks	65 banks (16 foreign, 22 private, 27 public)	17 Banks	40 Banks (including foreign banks)	20 banks (4 foreign, 14 private, 2 public)	22 banks (11 foreign banks, 9 local banks and 2 public banks)			
10	Number of individuals in the database*	169,000	7,000,000	3,477	92,904	300,000	230,142			
11	Number of firms in the database	381,000	N/A	17,003	64,880	—	32,750			
12	Main products	<ul style="list-style-type: none"> • Credit Report on Individuals 	<ul style="list-style-type: none"> • Credit reports on individual and firms 	<ul style="list-style-type: none"> • Credit report on Individuals • List of defaulted borrowers 	<ul style="list-style-type: none"> • Credit report on Individuals 	<ul style="list-style-type: none"> • Credit report on individuals • Scoring Model: 	<ul style="list-style-type: none"> • Credit report on individuals 			

Table 1: Comparison of Credit Information Bureaus in the Region (Cont.)

Name	Bangladesh		India		Nepal		Pakistan		Sri Lanka	
	Credit Information Bureau (CIB)		Credit Information Bureau (India) Limited (CIBIL)		CIB		Credit Information Bureau (CIB)		Data Check	CRIB
<u>Scope of Information:</u>										
13	Cut off amount, if applicable (in US\$)	US \$850	No		US \$ 6,420		US\$ 8,372	US\$ 84		US\$5,227 (for positive information) and US \$ 1045 (for negative information)
14	Historical Information	2 months	None (will build historical information over time)		Last quarter		10-12 years	Since established		Since established
15	Frequency of reporting	Monthly (for credits above US \$ 170,000); Quarterly (for loans above US \$ 850)	Monthly (except for some nationalized banks that will send on quarterly basis)		Quarterly		Monthly	Monthly		Monthly negative information; quarterly positive information (except monthly for two public banks)
16	Positive or negative information	Both	Both		Negative		Both	Both		Both
<u>Credit Report Features:</u>										
17	Number of credit reports issued in 2003	—	N/A		9,029		218,152	433,859		389,171
18	Loan presentation (by individual credit line or aggregated for borrower)	Aggregated	Individual		Individual		Aggregated	Individual		Individual
19	Format in which data is available	Reports (not online)	Online		Reports (not online)		Online	Online		Reports (not online)
20	Is written consent required to obtain a credit report?	No	No		Yes		No	No		Yes
21	Cost of a standard report or subscription fee (in US\$)	Free	Confidential		Annual subscription onl		US\$ 1.70 per reports	US\$ 0.75 per report		US \$ 2.00 – \$ 0.40, depending on speed of delivery

Note: This information is based on responses of the respective credit bureaus.

— : Not available.

N/A : This information is not available because CIBIL (India) started operations only in April 2004.

2.4 Recommended Steps to Improve Credit Information

Although the specific institutional framework of credit bureaus differs across the region, they face a number of similar challenges. These include:

- **More accurate data, more frequently gathered.** In India, for instance, due to the sheer size of many state-owned and nationalized banks, with branches in almost every state, data collection is extremely cumbersome. Furthermore, without computerization at many of these banks, banks cannot provide data promptly. Although most banks are required to report credit information on a monthly basis, many public and nationalized banks are allowed to submit quarterly reports. This practice diminishes the accuracy and timeliness of the information.
- **Improving the IT infrastructure and ensuring data confidentiality and security.** The CIB bureau in Nepal maintains its database on an obsolete software application. The Nepal Reserve Bank has recently invested in upgrading the IT system and it is expected that a first step toward improvement will be to require banks to submit electronic data, originally by sending records by e-mail and eventually switching to online interface. This will reduce the processing time and provide more timely credit information to banks. There is a substantial concern, however, that the current technological skills at the CIB are not sufficient for the successful implementation of the new system. Moreover, while most commercial banks will be able to relay information electronically, the two dominant state-owned banks do not currently have the capacity to submit information electronically. The CIB should also implement their new IT system with the goal of ensuring the accuracy and confidentiality of stored records. The CIB should also consider working with a private credit information provider who could assist with the technology upgrade and international best practice.
- **Expanding consumer awareness.** In Pakistan, for instance, consumers are not allowed to ask for their own credit report from the public registry. Consumers are generally unaware that their credit information is being shared with other lenders. Individuals and firms must be made aware about the collection and distribution of credit information so that they are able to safeguard their rights.
- **Introducing additional products.** For instance, in Bangladesh, the possible use of the CIB as a platform for loans extended by the microfinance sector should be considered, with particular attention to the larger (SME) loans that microlenders are providing. Given the demanding technology and service requirements of credit reporting systems, the CIB may be the most appropriate institution for this job. In the future, microfinance providers could also explore private sector solutions for credit reporting. Attention should also be given to different technology solutions (cell phones, for example) that could be used for basic credit reporting by microfinance institutions.
- **Allow and encourage private ownership.** In order for the credit bureau in Sri Lanka (CRIB) to reach its goals of providing timely, accurate, and electronic data, the bureau should consider expanding its ownership to include an international credit information bureau that could provide the

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necessary technology and technical training. It is also essential to reduce the government ownership stake in order to make the credit bureau autonomous. It is

recommended that a full-time chairman should be appointed and central bank stake be reduced.

Chapter 3

International Experience: The Lessons

The development of credit information bureaus in South Asia faces a number of challenges. But other emerging markets have succeeded in promoting private credit information bureaus. These efforts have led to an improved credit culture, which may provide useful lessons for South Asia.

3.1 South Africa: Improvements in Consumer Protection Laws⁴

South Africa's credit information system has played a vital role in increasing access to financial services, particularly among low-income consumers with little or no history of bank borrowing. The country provides useful lessons for other countries seeking to build or improve their credit registry industry. South Africa has a competitive credit reporting industry, with eight fully privately owned bureaus that collect information from a wide range of lenders including banks, retailers, microlenders, and medical providers.

The industry suffered, however, because of perceived weaknesses in its consumer protection laws. The industry is self-regulated through a Consumer Protection Code of Conduct developed by the South African Credit Bureau. In 1994 the association—in response to pressure from consumer groups and working with the Business Practices Committee of the Department of Trade and Industry—formalized the code, which applies to all credit bureaus in South Africa. The code provides adequate guidelines on fairness and privacy to consumers; calls for accurate and transparent credit information; limits types of information that can be reported; assists

consumers by explaining disclosed information; procedures to deal with disputed information. However, the bureau did not educate consumers on their rights.

In September 2001, the South African media reported complaints from consumer bodies, business groups and political parties against credit bureaus and the Credit Bureau Association. Consumer perception was that the bureaus were simply blacklisting agents, incapable of gathering or sharing positive credit information. Most consumers had little knowledge of the role of credit bureaus and their rights with regard to accessing their credit reports and disputing any incorrect credit information in their files. Consumers also accepted politically motivated comments that overstated the power and influence of credit bureaus, which further fueled anger toward credit bureaus. The misinformation created a political challenge for South Africa to (1) educate consumers about the credit information industry and (2) promote the stricter enforcement of consumer protection laws. As a result, all borrowers are entitled to access their own credit reports for a nominal fee; they are also alerted by cell phone instant-messaging when their credit report receives a negative remark; and they may now dispute wrong information thanks to a simplified dispute resolution process. South Africa's experience illustrates the importance of educating consumers about the existence of the bureau, the collection of their credit information, and their legal rights.

⁴ This section draws upon work by Klapper and Krauss (2002).

3.2 Off-Shore Collection of Credit Information

In a number of small financial systems, credit collection, processing, and disbursement is hosted by bureaus in another country. For example, the Czech bureau is operated by Crif Italy; Trans-Union in Namibia, Botswana, and Swaziland is operated by Trans-Union South Africa; Compuscan Botswana and Compuscan Namibia are operated by Compuscan South Africa (a microlenders credit bureau); and Trans-Union Honduras is operated by Trans-Union Costa Rica. The clear advantage is that smaller countries do not need to invest in or maintain hardware, license software, or staff a bureau. For instance, local limitations can limit coverage (by, for example, excluding small firms) or decrease the rate at which information is updated. But to support an offshore bureau, local banks still require a strong IT backbone and infrastructure (i.e., high-speed internet connections) to support the collection and downloading of information. In addition, countries may have legal barriers, such as privacy laws that prohibit data from leaving the country. Best practice, however, is to allow data transfers among countries with data security and consumer protection laws as least as good as those of the host country. For example, the Czech Republic can be confident that Crif-Italy will not disclose or misuse their data, since Italy meets the EU standards for data protection. This model may be particularly attractive to the smaller South Asian countries, which could outsource their bureau to a regional or international bureau.

3.3 The Case of Chile: Public-Private Cooperation in Credit Information Collection⁵

In Chile, credit information is provided through a mixture of public and private

bureaus. This design helped develop credit information sharing in an environment where banks were unwilling to voluntarily share information. Financial institutions are required, under current bank regulations, to disclose all individual debt information to the Superintendence of Banks and Finance Houses (SBIF), which is the bank regulator. The SBIF maintains records of all borrowers in the financial system. It checks the disclosed information for consistency and distributes it to banks, effectively providing a credit report. Two other sources of information include Boletín de Informes Comerciales, a bulletin of adverse credit information (e.g., bad checks and overdue bills of exchange within the financial system), published by the Chamber of Commerce. Another bulletin is the Boletín de Morosos del Comercio (SICOM), which contains information on individuals in arrears at the country's large department stores.

Private companies have been set up to collect information from these sources, process it and add other privately collected information to it (e.g., court judgments). Although these companies are not credit bureaus, per se, as they do not collect data directly from lenders, they have occupied an important role in the credit information industry in Chile. Furthermore, as unique tax identification numbers (RUT) are assigned to all individuals in the system, it is easier to collate and merge information from different sources. For instance, DICOM is one of the largest private companies, operating in Chile since 1979. Although initially it was providing clients with information from Boletín de Informes Comerciales, SICOM, and internally generated address verification, in early 1980s it was able to provide information services from the SBIF as well. Since 1989 DICOM has directly processed the information collected by SBIF for the banks, which is effectively an outsourcing arrangement by the public registry to the private sector. In

⁵ This section draws upon work by Cowan and De Gregorio (2003).

countries that prohibit the private collection of credit information (or where private banks refuse to participate in a private bureau) this arrangement allows a public registry to provide some of the benefits of a private bureau. Lenders in Chile report, however, that they would still prefer to collect and distribute private information directly and that this is only a second-best solution.

3.4 The Western Hemisphere Credit & Loan Reporting Initiative

The *Centro de Estudios Monetarios Latinoamericanos* (CEMLA), with the support of the World Bank, is launching the Western Hemisphere Credit & Loan Reporting Initiative. This project has two main objectives. The first goal is to set policies and actions for regional integration of

credit-information reporting systems in the region. The second is to assess the credit-reporting systems in seven member countries—Mexico, Colombia, Brazil, Costa Rica, Peru, Trinidad and Tobago, and Uruguay—using a common assessment methodology.

Many of the countries in South Asia face similar difficulties with respect to credit reporting systems, including problems with the legal framework, institutional incapacity to enforce laws and regulations on credit reporting, limited availability of positive credit data and several supervisory weaknesses in the credit registries. This project highlights the need for regional cooperation and the potential benefits of a regional Credit Bureau Association to share international best practice and laws.

Chapter 4

World Bank Involvement

A sustainable, efficient financial sector is critically important for macroeconomic stability and private sector development. The Bank's financial sector strategy for South Asia emphasizes the need to strengthen banking systems in order to achieve the CAS objectives of growth and poverty reduction. This project seeks to improve the credit information-sharing framework in an effort to expand access to financing and reduce bank loan defaults.

Effective and efficient credit bureaus in South Asia are possible in part because of regional advances in computer and telecommunications technologies. Such advances make it easier and cheaper to develop effective databases. In addition, many bank supervisory agencies have established or promoted private credit registries, hoping to improve their information on aggregate exposures and borrower risks. Internationally, decision tools like credit scoring have also made credit histories more accurate and thus valuable, strengthening the banks' incentive to share their credit data.

By helping to assess regional collection and distribution of credit information, the Bank would be able to:

- Help local governments identify the shortcomings of existing or planned bureaus and recommend how credit bureaus could be more in line with international best practice;
- Support Central Bank initiatives to use credit information to strengthen bank supervision;
- Assist with the implementation of local regulation and the supervision of credit bureaus and consumer protection provisions;
- Help governments to promote a “credit culture,” where consumers know and understand their rights and obligations to lenders and with respect to credit reporting. This would include consumer outreach and public awareness initiatives.

The Annex includes more detailed information on regional progress on credit information sharing, by country. These eight case studies present a general overview of the financial sector, including discussions of financial sector concentration, ownership and performance, and more specific information on necessary steps to improve the development of local credit information bureaus.

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Annex A

Country Case Studies

This Annex presents eight country-level case studies for South Asia. The first group of countries—India, Pakistan and Sri Lanka—use private information bureaus. In India and Sri Lanka, public policy requires supervised lenders to participate in the private bureau. In Pakistan, the private bureaus collect credit information, although banks are required to participate in a public bureau. The second group of countries — Bangladesh and Nepal—have public information bureaus housed at the Central Bank; the bureaus are limited in scope and effectiveness and might benefit from private ownership and expertise. The third group of countries—Afghanistan, Bhutan, and the

Maldives—have no credit information bureaus and might therefore benefit from alternative sharing mechanisms, such as off-share collection and distribution of local credit information.

A note of caution: All financial statistics are provided by Central Banks in the region; their methodologies for calculating financial ratios may therefore differ across countries. For example, the levels of nonperforming loans in the region's banking systems are not strictly comparable. This is because different countries use different criteria to determine nonperformance.

Appendix 1

India, Pakistan & Sri Lanka—Private Bureaus

1.1. INDIA

Background

India has a vast and diverse financial sector. There are 288 commercial banks and 1,847 cooperatives, serving a population of more than 1 billion. Of the nonbank finance companies, 613 are also operating in the financial sector. Almost 80 percent of the banking sector is controlled by the government. Foreign and private banks have a significant role in the financial system, but control far fewer commercial bank assets. The credit deposit ratio has not drastically changed over the past few years, owing to the roughly equal growth in deposits and loans. The breakdown of the growth rate of deposits and credit by type of institution shows that, overall, growth in deposits and credit of all commercial banks has declined between 2002 and 2003. Growth in advances given by the State Bank of India (SBI) have however increased. Increases in the growth of deposits is more common, and most commercial banks (including nationalized and foreign) have had an increasing deposit profile in the past 2 years.

Commercial banks extend a disproportionately larger share of credit (71 percent) as compared with cooperative and nonbank financial institutions. Finance companies hold only 13 percent of total outstanding credit due to financial institutions. However, finance companies have the highest level of nonperforming assets as a percentage of advances. Net nonperforming assets are relatively lower at cooperative banks, as compared with commercial banks and other financial institutions. Nonperforming loans are

increasing in the retail sector, pointing to the need for a properly functioning credit bureau that shares information on consumer loans.

Approximately 32 percent of advances are allocated to the fast-growing industrial sector. Small-scale industries receive only 10 percent, while agriculture receives almost 12 percent. Consumer durables, housing loans, and personal loans constitute a very small proportion of total private sector credit. They have grown significantly, however, in recent years owing to a boom in consumer lending.

India has a large consumer market of almost 300 million. The market for consumer finance has grown at a compounded rate of 29 percent in the last three years. Organized finance has penetrated the market for consumer lending and increased by 40 percent. The sectors which have had the highest growth include: credit cards, mortgages and two-wheeler loans. Nearly 10 million credit cards have been issued in India. Automobile finance is also increasingly popular; more than 70 percent of all vehicles in India are being purchased this way. The growth in retail loans is also evidenced by the rise in bank advances of 1,356 billion Rs. (US\$ 27.9 billion), during 2003, almost half of it consumer lending. Despite these positive signals, deeper market penetration is clearly possible, with consumer loans now accounting for only 3 percent of GDP. One possible explanation for this low figure is India's consumer culture in the country; young Indians constitute the predominant borrowing group in the country.

Credit Information Bureaus

Some of the previously identified problems (the level of nonperforming loans, for

example, and the untapped consumer loan market) encouraged the government to promote the formation of a private credit bureau. Most information sharing used to be based on opinions—those bankers had about their existing customers. The Credit Information Bureau India Limited (CIBIL) was created in recognition of the evolving needs of a maturing financial market. After a collaborative effort involving the State Bank of India and the Ministry of Finance and Reserve Bank of India (RBI), CIBIL was produced. It is jointly owned by SBI (40 percent), HDFC, the largest housing finance corporation (40 percent), TransUnion, one of the three large international consumer bureaus (10 percent), and Dun and Bradstreet (10 percent). CIBIL gathers both positive and negative information and serves both commercial and consumer interests. As of August 2004, there are 97 credit grantors that belong to the registry: 65 banks, 11 nonbanking financial companies, 10 housing finance companies, 8 financial institutions, 2 State financial companies and 1 credit card company.

There exist legal restrictions on information sharing between banks and nonbank financial institutions. The State Bank of India Act, 1955, legislates that banks will not share any information. Extensions of this act—the State Bank of India Act 1959 and The Banking Companies (Acquisition & Transfer of Undertaking) Act 1970/80 legislate that foreign subsidiaries and nationalized banks cannot divulge any information about their customers. In order to circumvent this barrier to the operation of a credit information bureau, legislation was enacted to enable banks and financial institutions to share credit information. Amendments in the Reserve Bank of India Act allow the RBI to mandate the collection and provision of credit information from and to financial institutions. The Credit Information Companies

(Regulation) Bill 2004 provides additional support to the functioning of the credit bureau. The RBI has complete authority to accept or reject applications to join the credit bureau. Other amendments seek to develop a regulatory framework for operation of the credit bureau and carefully delineate the responsibilities of the members and operators of the bureau.

Steps Being Taken to Improve the Credit Bureau

As a newly operational bureau, CIBIL faces many challenges. Banks are particularly concerned with guaranteeing the accuracy of the data; ensuring the confidentiality of collected data; and improving consumer protection and awareness. The following measures are being undertaken to address these concerns:

Accurate Information: Banks in India have inadequate electronic-data capture, and the inadequate networking and computerization magnifies the data-collection difficulties. In order to tackle these issues, a number of measures were incorporated as standard practice by CIBIL. For instance, there are mandatory data fields in the data entry forms to ensure that a minimum level of information is extracted from financial institutions. In addition, CIBIL has provided training to IT and risk management teams at member banks. Banks have also been given adequate time to meet data reporting requirements and have received feedback on data analysis.

Reporting Frequency: Due to the sheer size of India's many nationalized banks, with branches in almost every state, data collection becomes exceedingly cumbersome. Furthermore, inadequate computerization at many of these banks diminishes their ability to provide data promptly. Although most banks are required to report credit information

on a monthly basis, the nationalized banks identified above have been permitted to submit quarterly reports. Consequently, the accuracy and timeliness of the information is questionable.

Confidentiality: Data security is another issue of concern to information providers. Proprietary information can be abused. First, CIBIL operates on the reciprocity principle and thus provides information only to financial institutions that share data with it. Second, CIBIL has assured banks that the data will be used only for credit decisions and will be available only to members on demand (e.g., the data cannot be used to cherry pick customers). Finally, within the bureau, information is tightly protected through both IT and physical security measures. Only directly associated staff can access proprietary information.

Consumer Awareness: Because CIBIL is the first of its kind in India, consumers have no experience, and little familiarity, with its functions. India must therefore institute extensive consumer awareness exercises, to help consumers comprehend the utility of an effective credit registry for credit decisions. The Reserve Bank of India has made serious efforts in this regard through presentations, training, and individual meetings all designed to sell the concept of credit bureaus. CIBIL has in addition also developed a code of conduct to increase awareness.

Additional products: In both size and scope CIBIL is an impressive bureau, and as it develops, the bureau will be gathering and sharing additional information, such as court orders and utility payments, and added-value products (e.g., credit scores).

Other Sources of Credit Information

On commercial firms, D&B provides reports on Indian firms as part of D&B's global network. About 50 percent of reports are purchased by foreigners (mostly in the United States) and are used by banks, exporters, suppliers, etc. They use a variety of data on firms—personal interviews with the firm, government company and charge registries, court data (wind-ups, sales-tax suits, etc.), and newspaper reports. In addition, they use the CMIE database, a commercial database that includes detailed firm-level financial information on Indian firms. Another potential source of commercial information is the National Securities Depository Limited (NSDL), which settles all trading in equity and bonds. RBI currently prohibits them from making cash settlements. If this restriction were lifted, they could issue dividend and coupon payments. This would put them in the position of being the only party with information on payment schedules of all firms. For example, NSDL could create a list of firms that make late investor payments; this is important information for creditors, rating agencies, and investors.⁶

Additional negative personal credit information is shared by 16 credit card providers (under the supervision of MasterCard). Increased competition within the private sector (i.e., the entrance of competitive cell phone providers) may suggest a demand for credit sharing in other sectors; the MasterCard technology platform hosting this negative bureau may also be useful for other information collection. For instance, the insurance industry may also be interested in sharing information on

⁶ In addition, it is reputed that some firms intentionally pay late dividend payments to minority shareholders, who have little recourse. The threat of a negative mark on one's credit report may provide incentive for firms to pay their dividends on time.

claimants. In the future, bilateral reciprocity agreements could be made between user groups to share information. For example, as rural cell phone use increases, cell phone providers may want to know the repayment histories of farmers to microlenders. Rural cell phone and microloan payment histories may enable banks to enter the rural market more forcefully.

Some NGOs and MFIs have also begun (informally) sharing negative information on microborrowers. By reducing transactions costs and costs of default, better credit information could directly increase the amount of financing available to rural borrowers. A way forward may be for the National Bank for Agriculture and Rural Development (NABARD) to consider

collecting credit information on micro-borrowers, both for groups and individuals. A first step could be to require the 2,500 NABARD-affiliated financial institutions to contribute default information to a central registry. For example, in many rural areas NABARD arranges for farmers to meet informally to share default information among themselves. It would be helpful if this information—historically and across regions—were kept electronically and made easily accessible. One constraint is the unique identification of borrowers. The current system, however (which includes father's name, and address), is considered accurate in more than 95 percent of cases. In addition, as national IDs become more common, NABARD could require that every borrower have an ID, as is the case in Sri Lanka.

1.2. PAKISTAN

Background

Fifteen foreign banks are now operating in Pakistan, which also has 17 private (and privatized) commercial banks and three nationalized banks. But the top three banks (Habib Bank, National Bank of Pakistan, and Muslim Commercial Bank) control approximately 48 percent of banking assets, and the largest five banks hold 59 percent of all assets (“Banking System Review, 2003,” State Bank of Pakistan, 2004). The privatization of United Bank Limited (UBL) in 2002 and Habib Bank Limited (HBL) in January 2004—two of the largest five banks—has considerably reduced the proportion of assets controlled by state-owned banks. At 21.4 percent, state ownership is now relatively low in Pakistan, compared with its South Asian neighbors.⁷ Similarly, the greatest percentage of loans (35 percent) are extended by state owned banks, although private and privatized banks carry 29 percent and 21 percent of all advances, respectively (State Bank of Pakistan, September 2003).⁸ All commercial banks and development financial institutions are members of the Pakistan Bankers Association, the only organization recognized by the SBP. The mix of private and state ownership among nonbanking financial institutions (NBFI) is lower relative to that of commercial banks. Approximately 44 percent of NBFI assets are controlled by state-owned firms.

Although growth patterns in lending and assets have varied, the advances and assets of private banks have expanded in recent years. State-owned banks have faced a decline in assets and lending between 2001 and 2002

(owing in part to a slowdown in demand for bank advances). Most of the commercial banking sector has been plagued by nonperforming loans (NPL). The proportion of NPLs has been highest with state-owned banks and lowest at foreign banks. Although net nonperforming loans declined in 2002, the picture is different when we disaggregate the figures for all the commercial banks. The Economic Survey of Pakistan (2003) reveals net NPLs of state-owned banks have fallen from Rs. 44.23 billion (US\$740.6 million) to Rs. 33.62 billion (US\$562.9 million) between June to December 2002.⁹ Similarly, net NPLs of foreign banks, which are very small, have fallen by 2.7 percent. Private banks’ net NPLs have also declined from Rs. 13.47 (US\$225.5 million) to Rs. 11.73 billion (US\$196.4 million). But the net NPLs of recently privatized banks have risen from Rs. 17.48 billion (US\$292.7 million) to Rs. 22.54 billion (US\$ 377.4 million).

Consumer lending in Pakistan has also taken off in recent years. Banks used to be conservative with its consumer loans, offering credit cards only to their wealthy clientele. Now banks are expanding aggressively into consumer and automobile loans. The housing loan market is also becoming an important kind of consumer loan. Until June 2003, commercial banks were extending personal loans worth approximately Rs. 100 billion (approximately US\$1.7 billion). There has been big jump since then relative to the earlier, slower growth in consumer loan market from previous years.

Consumer lending growing more important in Pakistan. The amount of credit card transactions jumped from PKR 10.8 billion (US\$ 180.8 million) to PKR 14.2 billion (US\$ 237.8 million) between 2001 and 2002. Most credit card transactions are undertaken by

⁷ 51 percent of UBL and 51 percent of HBL were divested to private business groups.

⁸ These figures predate the privatization of HBL.

⁹ These include HBL as a public sector bank.

foreign banks, followed by domestic private banks. State-owned banks, which have the greatest assets, play only a minuscule role in the country's credit card transactions. A similar picture emerges for other lending such as automobile finance and housing loans, where the large state-owned and recently privatized banks have only recently entered this market. The highest increase in 2004 in consumer credit has been in balance transfer facilities and personal loans, extended mostly by public sector banks.

Under the government's prudential requirements for consumer financing, there are maximum limits on the loans that are extended. Discussions with bankers indicate that, except for housing finance, the average consumer loan is approximately PKR 0.5 million (US\$8372).

Two microfinance institutions are now operating in Pakistan. Their outreach is merely 5 percent of the population, and most of their assets are in the form of investments. Loans are only 16 percent of assets. The relatively fresh entry of microfinance in the lending environment is the reason why neither of these banks are members of private credit bureaus. As their role expands, such a possibility should definitely be recommended.

Credit Information Sharing

Pakistan's credit bureau environment has evolved significantly and rapidly in the past few years. The main sources of credit information include: a publicly operated bureau (called the CIB), which is housed at the State Bank of Pakistan (SBP), and three privately operated credit registries—New-Vis, DataCheck, and International Credit Information Limited (ICIL)—all of which are continually expanding their operations. The CIB gathers both negative and positive

information; DataCheck has begun to collect positive credit information.

Current bank regulations call for mandatory sharing of credit information with the public bureau, and scofflaws are subject to penalties for noncompliance (there have been few cases of this). Still, voluntary compliance with private bureaus has grown over the past two years.¹⁰ The success of private bureaus has prompted a study by the SBP under the Technical Assistance on Banking (TAB) program of the World Bank. The objectives are two-pronged:

- To improve the operational efficiency of the public credit bureau—changing the composition of information stored and reducing the minimum credit ceiling to expand consumer outreach;
- To revive the focus on the private sector and to amend regulations on the operations of private sector bureaus.

With assistance from the Bankers' Association, a study has also been undertaken on cutting the minimum loan size for inclusion in the existing CIB.

Authorities are also promoting credit information-sharing in the private sector, and the State Bank has instituted prudential regulations requiring financial institutions to obtain membership at either of the two registries. Another significant development has been the shift at the CIB to a completely online system. As evident, most of the current development strategies are being coordinated by SBP, although it places credit bureau development at a lower priority relative to

¹⁰ The private bureaus do not include the largest state-owned banks, which include a large percentage of total bank assets, but which have very small consumer lending units.

privatization and other banking sector restructuring projects.

Credit information-sharing functions, under the legal framework of the 1962 Banking Companies Ordinance, and last amended in 1997. CIB operates under Banking Companies Ordinance (section 25-A) requiring banks to share credit information with the SBP. This information is distributed to financial institutions at a fee set by the SBP. The statute includes provisions that “the State Bank shall not disclose the names of the banking companies which supplied the information.” Any information shared with the SBP is considered confidential and cannot be published, disclosed, or requested by court or tribunal for any purposes. It stipulates the nondisclosure of the names of banking companies, and disclosures of only a consolidated aggregate of borrowers’ credit information. Financial institutions must access borrowers’ credit reports for any credit extended over the stipulated credit limits as determined by the SBP. This stipulation is also set out in Banking Supervision Department (BSD) Circular No. 10 (dated March 15, 2001). It requires banks to access credit information on borrowers before extending any fund-based or nonfund-based financing. Loans will not be approved as long as information on any defaults, rescheduled loans, or other basic credit information concerning the borrower is not provided. As the regulation of nonbanking financial institutions, such as leasing companies, is handled by the Securities and Exchange Commission of Pakistan (SECP), the statutes for credit information-sharing also come under the SECP. The coordination between the SECP and the SBP on these matters is effective. In case of breach in compliance with any of these regulations, section 83 of the Banking Companies Ordinance 1962, states: “every director, liquidator and other officer of the company and any other person

who is knowingly a party to the contravention or default shall be punishable with fine/”

The legal basis for the operation of private credit bureaus is as vague as the bank secrecy laws set out in the section 33A of the Banking Companies Ordinance. Under the law, banks are required to protect the privacy of customer information and “observe the practices and usage customary among bankers and, in particular, shall not divulge any information relating to the affairs of its customers except in circumstances in which it is, in accordance with law, practice and usage customary among bankers, necessary or appropriate for a bank to divulge.” The Bank secrecy law exempts sharing of information with the CIB. Also, the rule, based on the customary practice clause, allows private bureaus to circumvent secrecy provisions and permits banking companies to share data with the bureaus. Both New-Vis and Datacheck operate as bank agents under a signed agreement with the financial institutions operating in the country. In this situation, an ideal solution is the use of customer waivers given to financial institutions that share loan histories. No formal provision for private credit bureaus exists within the outdated Ordinance. One essential need, therefore, is legislation that allows the financial and nonfinancial sectors to share information. Furthermore, names of financial institutions in the credit reports cannot be disclosed by the State Bank—another impediment to information sharing.

An important development in consumer finance and for the growth of private bureaus is the Prudential Regulation for Consumer Financing, which comes into effect on January 1, 2004. It requires that all banks or development financial institutions that are “desirous of undertaking consumer finance will become a member of at least one Consumer Credit Information Bureau.

Moreover, the banks/DFIs may share information/data among themselves or subscribe to other databases as they deem fit and appropriate.” Still unclear is the matter of who—which body—is regulating the private bureaus. The SBP prudential regulation, requiring banks to share data with private bureaus, is mainly to increase outreach of credit information sharing, since CIB has a cutoff of PKR 500,000 (US\$8372) on loans.

No legal framework exists for consumer protection, or data sharing practices, or on the reporting of erroneous data. Informal mechanisms do allow consumers to question the quality of reported data either with the financial institution in question or directly with the SBP in case of the CIB. In the case of private credit bureaus, issues of data accuracy must be raised directly with the banks. Previous cases (of which there are only a handful) have been settled between the banks and borrowers and have not been referred to the judicial system. Another shortcoming in the existing legal framework is that consumers do not have the right to access their own reports with the public bureau. There is also no data protection or information law present. The study that is being initiated under the World Bank TAB program, will also consider recommendations to develop a data protection law.

Public Credit Information Bureau (CIB)

The credit information bureau (CIB) has been operational since 1992. Housed within the SBP, it primarily collects loan-repayment status information and distributes it to financial institutions. The registry collects information that meets the credit-analysis needs of financial institutions, but the information is sometimes used to supplement bank supervision that tracks associated lending. Presently CIB collects information from more than 130 financial institutions—

including commercial banks, development banks, leasing companies and *modarabas* (Islamic banks). Private commercial banks comprise the largest chunk of the institutions that provide information to the bureau. There is a minimum limit of Rs. 500,000 (US\$ 8372) on loan size for which information is collected. But this limit reduces the bureau’s outreach, principally large corporate loans; the consumer loan market is limited in Pakistan. In recent years, credit cards, home loans, and automobile finance have grown. Some of these larger consumer loans also fall under the purview of the CIB, but most go unreported. These developments have prompted authorities to revise the minimum loan size for inclusion, over the next five to six months, to include SME and consumer financing. On average, the database is consulted 18,179 a month. Other developmental activities include the inclusion of credit histories and separate reports for individual and corporate borrowers. CIB is also integrating its database with NADRA (National Database and Registration Authority), by which each individual will be identifiable through the unique ID number.

The data made available provides information on outstanding group and nongroup liabilities, recoveries during the month, write-offs (during the past five years) and the number of rescheduling. The name of the reporting financial institution is not divulged. Other salient features include:

- All loans overdue for more than 90 and 365 days are identified.
- Individuals or firms with first-time overdue loans are issued a letter notifying them to settle the amount within 60 days. The issuance of such a letter is noted in the reports.
- Also highlighted are defaulter directors or those convicted by the accountability bureau and barred from taking loans for

any financial institution for a specific period.

The principal development in the credit bureau has been its shift to a fully online system since April 2003, making it the first in the South Asian region to do so. The shift to a real-time online system has been undertaken in collaboration with the banking industry. CIB has switched from a Unix-based Informix system on a Dec-Alpha system to a Windows based Oracle on Acer Altos 21000 Server, which has also helped to improve its capacity to deal with a growing demand for consumer credit. Officials have taken measures to ensure security of the data by building firewalls around the system. CIB has a workforce of 12 individuals, which is efficient for an electronic system. Financial institutions make data available via an online form at the end of every month. The data is subsequently processed and available for access in a report format by the 10th of the next month. It is accessible online by authorized personnel at each financial institution. The officials also keep a log of each request, which is used for on-line billing and can also monitor compliance with access rules. The use of electronic data transfer facilities has reduced the processing time by approximately five days. Earlier, data was shared via written documents that were made available by the 15th of each month.

There has also been a notable increase in the bureau's outreach. The number of individuals listed in the registry has almost doubled—from 54,563 in December 31, 2001, to 92,904 as of October 31, 2003 (though overall growth in consumer finance is also a contributor here). The rise in number of firms covered has not been so marked over the period, with number currently at 64,880. The number of credit reports issued by the bureau till October 2003 has been a little more than

150,000 compared with approximately 123,000 in 2001.

Private Credit Bureaus

The private credit bureaus supplement the CIB by covering a distinct segment of the borrowing population. They have also been successful in creating a successful credit environment in the country, by creating awareness of the virtues of credit sharing. Although under the BCO sharing credit histories on loans below Rs. 500,000 (US\$8,372) is not mandatory, many banks have voluntarily reached agreement with the private bureaus. Only since January 1, 2004, have banks engaged in consumer finance been required to belong to one of the two bureaus. The databases of information carried and circulated are richer and complements the public bureau. Their growth has also necessitated a significant study on viability of private bureaus and formulation of the legal framework defining and formalizing their operation.

Three privately operated credit bureaus operate in the country: Datacheck, New-Vis Credit Information Systems, and ICIL. The latter two bureaus focus only on individual borrowers and do not provide information on corporate borrowers. The sharing of information takes place under signed agreements with participating financial institutions. The number of institutions that are using these services have rapidly increased in the past few years concurrent with the expansion in consumer banking in Pakistan. New-Vis is the older registry, established in 1999, while Datacheck has been functioning since 2001.

New-Vis primarily operates with leasing companies and *modarabas*, although the credit card, auto finance, and home loan units of some commercial banks have also joined.

As of May 2004, 15 financial institutions were registered members. New-Vis is a negative information bureau, collecting information only on nonperforming loans, i.e., overdue and rescheduled payments. They are distinguished from other bureaus in their use of public sources of information. The bureau is owned by a large newspaper agency in the country, giving it access to large public sources of information on bankruptcies, defaults, court notices, and court proceedings, since 1996. These public sources supplement the credit reports produced by financial institutions. The online reporting is quite sophisticated and allows users to search for individuals and firms in the shared member database or in the public sources database.

DataCheck is a traditional (and true form of consumer) credit bureau, currently with arrangements with 21 credit card units of financial institutions. It began by providing verification services to financial institutions until becoming a full-fledged credit registry in 2001. The distinguishing factor between the two private bureau reports is that DataCheck provides default information for individual borrowing lines which is then aggregated for each borrower. Credit information is given for each financial institution that the individual has borrowed from, which is a useful feature as it identifies the number of institutions that individual may have defaulted at (i.e. the extent of default). Along with negative information it also provides information on enquiries made, which is a good indicator of credit activeness of individual borrowers and is also accurate in determining credit risk. Datacheck has also recently expanded its outreach significantly and receives information from most major retail lenders. Presently it has a hit-rate (defined as probability of finding a borrower in database) of 68 percent. In 2003, there were 282,330 enquiries made and 14,329 defaults were reported. 9,327 (value of PKR 682 million or

US\$ 11.4 million) of these defaults were identified after enquiries and 1,260 were paid off after the enquiry. Datacheck has also embarked on collecting positive information from banks, being the only credit bureau of its kind that does that.

The IFC has provided technical assistance to Datacheck in 2003 and is also currently considering an investment in the firm. It is also negotiating a deal between Datacheck and Experian for value-added services that include fraud detection, credit scores, and so forth. These features differentiate Datacheck from CIB, which is limited by its public ownership, and New-Vis, which requires significant manual application and has a more limited outreach because as fewer banks report to it. The other private credit bureau, International Credit Information Limited (ICIL), a licensed operator of Dun and Bradstreet, is purely commercial. It is a business and credit information provider that distributes Dun and Bradstreet products.

Recommended Steps to Improve Credit Information

The private bureaus currently operate in a vague and undefined legal environment. It is imperative that the government give explicit legal permission to the private bureaus to collect positive and negative information from commercial banks and non-bank creditors. The development of private bureaus and the availability of improved and more comprehensive credit information could help financial sector development and greater access to financing.

Most banks and leasing companies were quick to join the private credit bureaus, especially those that are expanding their consumer banking operations. Banks depend on the private bureaus for their analysis of creditworthiness of small borrowers, since the

public bureau only covers borrowers with loans higher than Rs. 500,000 (US\$8,372) and many consumer loans do not fall within this limit. The advent of the two private bureaus is a landmark in Pakistan's credit environment, providing accurate and up-to-date information on default or overdue payments of any borrowers. For example, bank officers report that the timely sharing of negative information and the blacklisting of defaulters now prevents credit card defaulters at one bank from receiving credit at other banks. The focus of current reform efforts should not be to improve the public bureau but, rather, to enable a legal and credit environment that encourages the development of private bureaus.

The following summarizes key features of the private and public bureaus and suggests reforms needed to improve the quality of credit information and encourage the growth of private bureaus:

Information Content: Although the CIB intends to provide both positive and negative information, the only positive information present concerns recoveries. CIB gathers no information on timely loan repayment, an omission that weakens the informational content of the registry. CIB has been wary of instituting far-reaching changes, thinking consumers might not be willing to absorb the new set of information and it will raise questions of data quality. The private credit bureaus operate primarily as negative bureaus only and in part have been unable to provide positive information due to banks' unwillingness to share proprietary information that may reduce their rents. However, the success of the credit bureau in providing information for consumer lending has reduced initial concerns felt within the banking circles and DataCheck is already collecting positive information from banks. However, this is being done under the

assumption that the law permits it, although this is no clear ruling on this matter. A clear ruling that permits sharing of positive information by banks, with consumer consent, is therefore essential.

Credit Histories: CIB maintains approximately 10-12 years of payment history in its database, but the reports available for financial institutions only reflect the borrowers status at a particular point in time. The public credit bureau (CIB) generates reports with fresh payment histories every month. Therefore borrowers who have defaulted in earlier periods but have cleared their payments will have a clean credit history in subsequent reports that are generated. In essence borrowers are not blacklisted. The reports, therefore, do not provide a comprehensive analysis of creditworthiness of borrowers. They are ineffective to a certain extent in a country like Pakistan that has a weak legal contracting environment, as they do not reduce borrowers' incentives to default on loans. Financial institutions do not receive a complete picture of borrower's credit history, so that loan defaulters may still not be precluded from receiving loans as long as they have settled earlier loans. The reports only provide current information on whether a borrower has been overdue for more than 90 or 365 days, but the number of times in which he has been overdue is not given. This information is important and should be included as a bare minimum.

The private credit bureaus are relatively new and carry information only for the two to five years since their inception. However, they plan to gather seven-year credit histories, in keeping with international standards, which will eventually provide a richer database of information. The database now identifies only defaulters from the past few years, which is also worthwhile information. Defaults and other adverse credit information are not

deleted in the reports generated at the private bureaus. Therefore, although a complete credit history is available for consumer loans of participating institutions in the private bureaus, no similar reporting exists for larger loans at the CIB.

Consumer Awareness: Most credit reports are being produced by three separate bureaus. Still, consumers have little awareness about how credit registries function. For instance, consumers who default on loans obtained from one financial institution and then borrow from another are unaware that their credit histories are being shared across companies and have therefore rarely asked to see their reports at the private bureaus (consumers may not see their credit reports compiled by the public registry). In addition, consumers learn of changes in their credit reports slowly (for instance, defaults or other negative information) owing to lack of awareness. It is essential that individuals and firms whose credit histories are shared are made aware about the use of this information so they may safeguard their rights.

Consumer Protection and Data Quality: The practice of sharing information for credit analysis purposes must honor consumer confidentiality. Consumers cannot presently access their own reports, at least those kept by the public credit bureau, although they can access their reports kept by the private bureaus. This avenue is important for consumers to correct any erroneous data, to protect use of information and safeguard against misuse. Once consumer awareness increases, privacy laws will be essential.

Frequency: Information is collected every month and is processed relatively quickly due to the online system of credit information. The information obtained is therefore considerably up to date and facilitates credit analysis. In the case of CIB, reports are

available 10 days after being submitted. New-Vis, the private credit bureau, provides real-time access once data is provided each month by the financial institutions. Datacheck also updates credit information monthly.

Lender Practices: The State Bank requires financial institutions to access a CIB credit report before advancing new loans. But both corporate and consumer lending practices are largely based on the analysis of loan applications, the potential of the project, and borrower's credit risk, which is determined through referrals and phone calls. Consumer lending is based predominantly on the use of internal systems and detailed criteria regarding, for example, occupation, location, and salary. In the case of corporate lending, the business's overall reputation and standing count heavily in credit risk determinations. Car loans are extended on proof of regular income. Corporate bankers report that the new real-time access to CIB reports is efficient and useful in their efforts to identify defaulters. But they view the deletion of any credit history, particularly adverse information, with disapproval. The regulation should allow banks to access credit reports from "approved" private credit bureaus, which could encourage their growth.

Current World Bank Support

Under the TAB program, the World Bank is helping the State Bank to promote a private credit-reporting environment by:

- Enacting legislation that allows financial institutions to share information because the current laws do not provide explicit provisions for the operations of private bureaus;
- Creating consumer awareness on the credit information sharing environment;
- Developing a consumer protection law that would allow consumers to access

I Credit Bureau Development in South Asia I

- reports and to correct erroneous information;
- Drafting a data protection law to ensure the confidentiality of collected data;
- Convincing financial institutions to voluntarily share with private bureaus positive as well as negative information

1.3. SRI LANKA

Background

The banking sector in Sri Lanka is heavily dominated by the state, with state-owned banks controlling nearly 80 percent of assets; serious non-performing loan problems, however, are burdening the large state-owned banks. The state also owns two insurance companies and a pension fund.

Twenty-two banks were operating in Sri Lanka as of year-end 2003, comprising 11 domestic and 11 foreign banks. There are 15 specialized banks, including six regional development banks, a national savings bank, two long-term lending institutions, three housing finance institutions, and three private savings and development banks. The country has more than 1,300 commercial bank branches and over 350 specialized bank branches of (Central Bank of Sri Lanka, Annual Report).

The total resources of commercial banks increased by Rs. 97,024 million (US\$1.01 billion) in 2003 (12.3 percent). Private sector credit grew with the revival of domestic economic activity. Loans and advances grew by 12.7 percent to Rs. 48,757 million (US\$ 09.7 million), compared to a growth of 1.5 percent in 2002. Although credit extension to the private sector continues to grow, nonperforming loans (to total loans and advances of all banks) decreased to 12.6 percent in 2003 from 14.2 percent in 2002. However, the wide disparity between deposit and lending rates appears to stem from some unsound credit management practices, as well as delays in the legal process against defaulters; significant nonperforming loans at commercial banks have not helped matters (Central Bank of Sri Lanka Annual Report, 2003).

As of September 2003, total commercial bank loans and advances were Rs. 411.4 billion (US\$4.30 billion), about a 15 percent annual increase. About 37 percent of loans went to the commercial sector; 15 percent were made for housing and consumption. Most foreign lending was in the form advances to Board of Industry (BOI) enterprises, credit to the government, and funding nonresident enterprises. In 2003 foreign credit to the government amounted to US\$ 343 million; BOI firms received US\$ 870 million. More than 50 percent of credit was collateralized, mostly by immovable property, plant, and equipment, and personal guarantees.

In 2003, both lending and deposit rates declined, in line with international markets, but the decline in lending rates was lower, thus widening the interest rate spread. These developments are symptomatic of the banking sector lack of competition—state control, which as noted earlier is mainly controlled by the state with little competition between the largest financial institutions. The interest rate margin also reflects the high level of nonperforming loans in the financial sector and the legal impediments to the recovery of defaulted loans.

Most recent advances have been in the form of new lending and deposit facilities and better service delivery; also noteworthy is the introduction of lending schemes such as consumer loans that allow the purchase of durables over a period of time, car leasing, and housing loans. Although some of these lending schemes work on the principle of group insurance, others provide car and motorcycle loans to full-time public sector employees, whose permanent employment signals their minimal credit risk.

A technological innovation has been the installation of a network of ATMs in major

cities—705 at end of 2003. Another development is the widespread usage of credit cards. The total number of credit cards outstanding in 2003 was 321,145, an annual increase of 23 percent. Outstanding credit also increased to Rs. 8.1 billion (US\$84.7 million) in 2003, an annual increase of 27 percent. Credit information provided by the bureau can be instrumental in reducing overdue payments and defaults on credit card debt.

The total assets of finance companies was Rs. 9 billion (US\$94.1 million), an annual growth rate of 20 percent. This growth was mainly driven by leasing operations of these finance companies, which comprises two-thirds of total finance company activity. Fifty-six finance leasing companies registered with the Central Bank at year-end 2003, comprising commercial banks, specialized banks, finance companies, and specialized leasing companies. The total assets at all leasing institutions (excluding commercial banks, finance companies, and merchant banks) grew by 43 percent to Rs. 23.7 billion (US\$247.7 million) in 2003 and the total loan portfolio of leasing companies increased by 49 percent. About 75 percent of total leases were for commercial and passenger vehicles.

Credit Bureau Environment

The Credit Information Bureau (CRIB) was established in 1990 by the Credit Information Bureau of Sri Lanka. An initiative of the Central Bank of Sri Lanka and the ministry of finance, CRIB was a response to the 1980s debt crisis and inordinate number of nonperforming loans. Borrowers' reluctance to reveal their true financial status and the weak debt-recovery laws make ex-ante screening of credit histories very important for loan decisions. Furthermore, the government hoped the disciplining mechanism provided by a credit information bureau would help improve the country's

weak credit culture (including a high rate of tax defaults).

The credit information bureau is a public-private partnership, with the Central Bank holding 49 percent of equity stake. The rest is divided among creditors that are regulated by the Central Bank. CRIB currently has 82 shareholders, including all licensed commercial banks, specialized banks, finance companies, leasing companies, and the central bank. The factoring company (LOFAC) and other nonregulated creditors are not allowed join. The Chairman of the Board is always a deputy governor of the CBSL and the remaining board seats are shared between the lenders.

The CRIB Act makes information sharing by financial institutions mandatory and gives the bureau the authority to provide information to shareholder-lending institutions upon request. It also protects the CRIB for any actions undertaken in good faith and lending institutions for genuine mistakes in reporting. However, in other cases, misreporting carries a maximum penalty of five years imprisonment or Rs. 100,000 (US\$1,045). Borrowers are allowed access to their credit information, if a request is made by their financial institution. The modest fees for requesting a report are Rs. 200, 70, and 36 (US\$ 2.00, 0.75, 0.40) for express, fax, and post delivery, respectively.

CRIB includes both negative and positive information. It holds positive information of performing loans of Rs. 500,000 (US\$ 5227) and over and negative information on irregular loans of Rs. 100,000 (US\$ 1045) and over. As of year-end 2003, the bureau included 159,500 records, of which about one-third were irregular. This is estimated as about 80 percent of the value of total loans in the system. The bureau includes both corporate and personal borrowers. As of year-

end 2003, the bureau included credit information on 32,750 corporate borrowers and 230,142 personal borrowers. The number of credit reports issued in 2003 was 389,171, a 36 percent annual increase. Information on corporations includes the name of the firm and registration number, names and national identity numbers of all directors, partners, and owners, and the name and registration number of all subsidiaries and associate companies. The bureau has been profitable since 1999 and profits in 2003 increased to Rs. 32.9 million (US\$ 344,000), an annual increase of 34 percent.

Recommended Steps to Improve the Credit Information Bureau

To improve the scope and effectiveness of the credit information bureau in Sri Lanka, reforms are needed in the following areas:

Private ownership: To reach its goals of providing timely, accurate, and electronic data, the bureau should consider expanding its ownership to include an international credit information bureau capable of providing much-needed technology and technical training. It is also essential to reduce the government ownership stake in order to make the credit bureau autonomous. It is recommended that a full-time chairman should be appointed and central bank stake reduced to a maximum of 10-20 percent.

Scope of information: An objective of the bureau is to help lower the high rate of non-

performing loans in Sri Lanka. However, in order to reduce their risk of default, banks must have timely and comprehensive data on all borrowers. To reach this goal, the bureaus should include all outstanding loans, including small loans. Since small borrowers are most informationally opaque, they have the most to benefit from building a credit history with the bureau. Data should also be collected on a more timely basis. In addition, CRIB can expand its data sources by collecting data from public sources, such as commercial data from the Registrar of Companies and court judgments against individuals or firms, and public utilities to supplement the existing information. CRIB should also expand its membership to include other non-bank financial institutions (such as factoring companies), retailers, and non-financial firms that issue trade credit.

Automation of credit collection and disbursement: Credit information needs to be collected and distributed electronically in order to increase the speed of delivery and reduce mistakes. The registry should shift to an online system catering to the growing demand for consumer credit reports. Credit reports are currently manually processed and sent by fax and post, which causes delays.

Additional products: As the bureau develops, the bureau may consider adding products such as credit scores and ownership links across firms.

Appendix 2

Bangladesh & Nepal – Public Bureaus

2.1. BANGLADESH

Background

In Bangladesh, the formal financial sector revolves around the banking sector, which comprises four types of banks. In terms of both assets and deposits, the nationalized banks (NCBs) are the most important. As of December 2001, the four NCBs held 51 percent of deposits and 45.5 percent of loans. As government-owned institutions, the NCBs are known for their lax credit policies; their nonperforming loans in 2001 stood at 38.5 percent. These figures are significantly higher than those reported by private or foreign commercial banks (17.4 percent and 2.7 percent respectively). These institutions are being restructured.

Specialized development banks (SDBs) are a second kind of financial institution in Bangladesh. In 2001 the five SDBs held 5.6 percent of deposits and 9.5 percent of assets. Their nonperforming loans exceed even those of the NCBs—56.9 percent in June 2002. The SDBs suffer from weak lending technologies and from loan practices that discourage a healthy credit culture. For instance, one SDB examined had many loans that are to be repaid in full nine months after being extended, in line with agricultural cycles. This all-or-nothing lending methodology doesn't help borrowers to schedule and plan for the loan repayment, increasing the likelihood of late payment or default. According to standard practice at some of the SDBs, a loan due nine months after disbursement is not in arrears until a full year after the payment was originally due. It is not written off as bad until five years after disbursement. These

unusually generous terms for loan classification communicate that repayment failures are acceptable and discourage prompt, diligent repayment of loans.

SDBs require modernization; they lack basic banking tools—management information systems to help them to track customer performance over time or develop appropriate lending strategies based on risk. Because some of these institutions serve a rural and poor clientele, they face infrastructure challenges. One SDB reports that 80 percent of their branches are in locations without electricity. Specialized development banks also face a less-competitive environment because they divide the country among all the SDBs geographically and do not compete head-on with other state banks. They encourage exclusive banking relationships with their borrowers and thus assume they have relatively little to gain from information sharing because their borrowers use only one bank.

The better-performing banks in Bangladesh include the private commercial banks (PCBs) or branches of foreign commercial banks (FCBs)—the performance of both these segments of the banking sector is very good. For example, as of December 31, 2001, adjusted return on equity was 21.6 percent for PCBs and 30.2 percent for FCBs. As noted previously, nonperforming loan rates at both of these are far below those of the NCBs and SDBs. But only the best borrowers are able to access credit through these institutions. In the financial system as a whole, small business borrowers obtain only about 3 percent of credit while the public sector obtains about 44 percent, as of 2001.

Limited credit is also provided to consumers through retail chains, which sell domestic appliances on installment credit (hire purchase) plans. Most of the cell phones in Bangladesh operate on a prepaid basis, however, so payment data is quite limited. Of those plans that are not prepaid, nearly half are corporate accounts so relatively little consumer data is available from these sources.

Credit Reporting in Bangladesh

As of mid-2004, there is no private sector credit reporting in Bangladesh. Banks must therefore check the creditworthiness of individual borrowers in other ways, for example, by asking for documents like prior bank statements, wage receipts, proof of payment of other obligations such as rent, utilities, etc. Banks also pay for background checks to verify the address, employment, and other data their prospective borrowers provide. Even when lenders require their borrowers to provide extensive background information, they do not gain the same the certainty about creditworthiness that a complete credit report provides. In systems without credit reporting, borrowers are unlikely to volunteer unfavorable credit histories—histories that a functioning credit bureau system would easily collect. So, the lack of a credit reporting system contributes to the poor credit culture in Bangladesh, where failing to repay a loan has become far too commonplace. The incidence of nonperforming loans (NPLs) is extremely high—especially, as we have noted, in the nationalized banks (NCBs) and specialized development banks (SDBs).

For corporate (business) borrowers, the Bank of Bangladesh (BB) runs a public credit registry known as the Credit Information Bureau (CIB) which provides useful information for the application review

process, but which is not complete or agile enough to enable banks to automate any lending functions. It covers between 75 to 100 percent of all private, public commercial banks, financial, and leasing companies, and public development banks.¹¹ Some of the problems cited with respect to the CIB include delays in data entering the database, problems with data quality, cumbersome procedures for obtaining data, and delays in receiving reports once they are requested. Discussions are under way to strengthen and expand the CIB.

There is no credit reporting in the microfinance sector either, although the establishment of some type of database has been discussed. The apex agency, PKSF, is in the process of developing a database for its participating organizations (POs). The design of this database, however, is more focused on the type of general financial reports, which PKSF requires for its supervisory role than on credit reporting data. Further limiting the development of credit reporting for microlenders is the lack of electronic data in many of these institutions. Although some are in switching over to electronic records, others view their current lending technologies and practices as best suited to the environment, especially those lending in rural areas that lack basic infrastructure.

Bangladesh has no private sector credit reporting activity; there is, however, a privately operated ratings firm, Credit Rating Information and Services, Ltd. (CRISL). CRISL provides ratings for debt instruments and for companies issuing on the capital markets as well as for firms requesting bank credit and for banks and insurance companies themselves. CRISL focuses on relatively large borrowers, not small enterprises, and does not maintain a credit bureau as part of its functions.

¹¹ Doing Business Report (2003)

***The Public Credit Information Bureau
(Bank of Bangladesh)***

The only credit history data available in Bangladesh is captured by the Bank of Bangladesh (central bank), through its public credit registry, known as the Credit Information Bureau (CIB). It was established in 1992 and began operating in January 1993. Approximately 550,000 borrowers are reported in the CIB—approximately 169,000 of these individual records. About 45 percent of the 550,000 borrowers are active, meaning that they currently have more than Tk. 50,000 in credit outstanding—equivalent to about US\$850.00. Borrowers whose credit exposure falls below Tk. 50,000 (US\$850) are not reported to the CIB and thus become inactive in the database, even though they may continue to have loans in the financial system. As of 2004, approximately 28 percent of the loans reported to the CIB were in a classified or irregular status, down from 43 percent in 2001. These high figures correspond to the very high rates of nonperforming loans discussed above.¹²

The CIB collects data from both banks and nonbank financial institutions on a quarterly basis (for loans between Tk. 50,000 or US\$ 850 and Tk. 10 million or US\$ 170,000) and on a monthly basis for loans above Tk. 10 million (US\$ 170,000). The Bank of Bangladesh requires institutions to report to the CIB as mandated by central bank regulation. The CIB is collecting data from almost all lenders in the formal financial sector, with the main exceptions being microfinance institutions and retailers offering installment credit (hire purchase).¹³

¹² Data provided in interviews with officials of the Bank of Bangladesh, March 2004.

¹³ The Grameen Bank has the legal status of a bank and accordingly should be reporting to the CIB. However, since Grameen focuses primarily on very small loans

Although some consumer loans should be captured by the CIB, in practice, lenders report that, for the consumer loan segment, coverage is poor but reasonable for commercial loans. The CIB requests both positive and negative information from lenders and thus is able to get a fairly complete picture of the financial behavior for borrowers who are in the system. Financial institutions can request a credit report of a prospective borrower in writing. The report that lenders receive includes the borrower's total outstanding exposure for both loans and advances and the amounts classified as substandard, doubtful, and bad/loss. The identity of the reporting institutions is not disclosed in the report. Although historical data are preserved for more than 10 years, only the current month of information is reported.¹⁴

A database of firm owners managed by the CIB also enables the Bank of Bangladesh to link individuals with the companies where they have an equity stake. Credit information on other firms having common ownership with the borrowing firm in question will also be included in the credit report—this results in some very extensive reports. Banks reported that the CIB is a useful first check for business credits and are generally supportive of the plans put forward by the Bank of Bangladesh to modernize and expand the database.

But the CIB currently has several significant limitations, beginning with the lack of a historical archive. The CIB maintains information only for the previous two months, which means that banks often create their own mini-databases (sometimes referred to as “default lists”), archiving reports for later

and is viewed as a microfinance institution more than as a private commercial bank, it is not currently participating in the public credit registry.

¹⁴ Doing Business Report (2003)

reference. In some instances, banks discussed how they shared these default lists with each other. Apart from the inefficiency of these types of make-do solutions, they pose a significant problem for borrowers because erroneous data are very difficult to correct without a centralized system. Because default lists are an informal arrangement, most consumers are unlikely to even be aware that they exist.

The CIB is also not yet automated, so requests for information cannot be made through online or batch systems. Adding to the difficulty in accessing data are cumbersome procedures for requesting the. For example, branch managers must authorize the request for information in writing and present the actual signed document; when the authorizing officials are not in Dhaka this adds days to the time needed to process queries. The CIB statistics indicate that they are fielding most data requests in two or three days, but the entire process of requesting a CIB report takes much longer—averaging one to two weeks and in some cases, even longer.

Another complication facing the CIB is its dual use; it functions both as a database for credit applications and as a screening mechanism for people aspiring to public office. A CIB report is required for individuals seeking public (government) positions, desiring to issue stock in the capital markets, or assume leadership positions in financial institutions, trade associations, or chambers of commerce (known as Commercially Important Persons, or CIPs). The Bank of Bangladesh fears it would face a legal liability, particularly if commercial-screening data were inaccurate. The key concern is whether the report contains data covering the same reporting period from all reporting institutions, not necessarily the absolute quality or accuracy of the data, which we will discuss below. In order to

avoid issuing an incomplete report for this official review (with data from different time periods), CIB reports are not updated until all reporting institutions have submitted their data for the most recent reporting period. Just one institution can therefore delay the prompt availability of current information, which could be useful to lenders. For example, in March 2004, banks in Bangladesh reported that the CIB data they were currently receiving was from September 2003—two quarters back. Based on previous reports of the CIB, this delay does not seem to have changed much in the past five years. From a credit-reporting perspective, it is best to provide the most accurate and up-to-date information that is available to the market but because of the official background check function of the CIB, this is not done.

The Bank of Bangladesh has taken some additional steps to strengthen data quality in the CIB including requiring borrowers to provide additional information, such as their mother's and father's names, to facilitate correct identification and cross-referencing of data. At this time Bangladesh has not developed a uniform system of unique identification numbers to track borrowers through the system. The Bank of Bangladesh's concern with liability for CIB reports appears not to have prompted them to undertake standard steps to improve their data quality. In the credit market, lenders voice concerns about the accuracy and integrity of the data being reported. As mentioned above, data on consumer loans even in excess of Tk. 50,000 (US\$850) are not being reported consistently. Credit card debts, for example, are not routinely included in the database; lenders with large credit card businesses have approached the CIB about including their credit data in the public registry—mainly the foreign commercial banks. Some banks also indicated that they questioned the accuracy of the data and felt, at times, it was manipulated

by lenders. Although the Bank of Bangladesh has enforcement tools to penalize banks that report late or provide inaccurate information, they have not used them; this alone contributes to a lax attitude regarding the reporting of data. As a point of comparison, western European nations with functioning public credit registries report the use of sanctions to enforce standards on data quality.

The Bank of Bangladesh is modernizing the CIB. It has redesigned the data entry forms for better information capture. Future plans include making the data available to lenders online by the end of 2004, expanding the database to include consumer credit and possibly reducing the minimum loan size, which now stands at Tk. 50,000 (US\$850). The Bank of Bangladesh will also be increasing the frequency of reporting for all loans by moving to a monthly report. In order to fund these improvements, the CIB has asked the lenders to pay these costs on an equal-share basis; discussions are under way. Senior officials at the Bank of Bangladesh are also considering the privatization of the CIB, although this does not appear to be a near-term option.

The Legal and Regulatory Framework for Credit Reporting in Bangladesh

The legal and regulatory framework for credit reporting in Bangladesh is not developed. Chapter IV of the Bangladesh Bank Order establishes the legal basis for the central bank to collect information, including in the CIB, but this does not extend to private credit reporting activities. As with many countries in the British common law tradition, Bangladesh includes confidentiality provisions in law pertaining to financial and commercial dealings but has no bank secrecy law. Thus, a lender would have adequate legal protection under the confidentiality provisions of the law if they obtained the borrower's express consent to provide loan-repayment data to a

credit reporting firm and/or requested their data from such a firm. But in the absence of a clear legal and regulatory framework for credit reporting, such consent provisions could be challenged, especially if banks denied credit to borrowers who refused to consent to a credit bureau report.

The development of a credit-reporting law would likely facilitate the development of private credit reporting firms for several reasons. The first is that a well-written law would remove the legal uncertainty surrounding the sharing of credit data. Because this activity has been developed only by the central bank to this point, lenders may be wary of joining a private credit bureau unless there is a clear legal basis for the activity. Potential investors in credit bureaus may also be deterred if the risk posed by an unclear legal environment is too great.

The development of an appropriate legal framework for credit reporting should provide reasonable privacy and consumer protection provisions while at the same time fostering access to the accurate and reliable data required by lenders. A case could even be made for laws or regulations that actively promote participation in credit reporting, especially with regard to the provision of positive credit data. Dominant lenders or those with poor portfolio performance may have little incentive to participate fully in credit reporting systems unless compelled to do so. Mexico, Chile, Peru, Switzerland, and Hong Kong all have created legal and/or regulatory provisions to compel participation in private credit reporting systems.

Microfinance and Credit Reporting

Since 1976, when the first Grameen Bank project was established to demonstrate that lending to the poor was economically viable, microfinance institutions in Bangladesh have

proliferated. Three other dominant players which started microfinance operations in the 1970s include the Association for Social Advancement (ASA), Bangladesh Rural Development Committee (BRAC), and Proshika. The Credit and Development Forum (CDF), the national network of microfinance NGOs, has since 1996 compiled information on these NGOs. CDF's data highlights that since 1996 the number of NGOs working in microfinance has increased from 351 to 656 in 2002.

The Second Poverty Alleviation Microfinance Project is one of the few stand-alone microfinance projects the Bank is supporting. The project is being implemented by the apex agency Palli Karma-Sahayak Foundation (PKSF), which was founded in 1990 as an apex microfinance-funding and capacity-building organization. The project was designed primarily to provide assistance to microfinance institutions that meet PKSF's eligibility criteria. At the end of 2003 PKSF had enlisted 189 partner organizations (POs). The project was designed to include a component on a credit bureau database. Although the progress of this component has been slow in the initial years of project implementation, PKSF in its 2002-2003 fiscal year started work on user requirements for setting up of this credit bureau database. The original plan for this database was to have information at the borrower level for all microfinance institutions in the country, including PKSF's POs and Grameen Bank (which is not a PKSF PO).

PKSF is working with Datasoft (a local software firm based in Dhaka) on the reporting format for the database. In March–April 2004, the trial period for the database began with the participation of five MFIs. A sample of borrowers from the participating MFIs will be used to create the database for the trial in order to complete the design stage

of the database by July–August 2004. The pilot test will include data on approximately 30,000 borrowers. ASA, BRAC, and Proshika (three of the largest MFIs and all three are PKSF's POs) are expected to participate in the pilot test.

With PKSF's work on the credit bureau database in the pilot stage, key design issues require further work—these include concerns that the end product meets the objectives of the credit bureau database. The preliminary design of the database seems suited more to PKSF's monitoring function as an apex of its POs than the credit-reporting function needed at the borrower level. The foundation of a credit-reporting system is to capture accurate borrower payment histories. In addition, the microfinance institutions collect loans on a frequent basis (some MFIs collect payments on a weekly basis). Yet this database is not designed to handle weekly payment information. To fulfill the requirements of a credit-reporting system, the database will need to be designed to provide up-to-date information on borrower payment history. It is also not clear if data collection will take place on an annual, semi-annual, quarterly, or monthly basis. In addition, where will the database be housed (PKSF or other entity)? What is the funding structure and pricing of the services provided? How will unique borrower ID numbered be assigned (no unique identification number is now in place). Poor communication between the apex and the POs may reduce POs participation in the database, affecting the usefulness of the data being collected.

MFIs have reported that MIS capabilities are very uneven from one institution to another. Even some of the largest MFIs, which provide the bulk of financial services to the poor in Bangladesh, are not fully computerized. MIS capabilities are the cornerstone of a credit reporting system—yet only one institution

(BRAC) is fully computerized. Grameen Bank, which has 1,178 branches, is now computerizing its records and expects this work will be completed this year. It is entering borrowers' data using regional centers for data entry and communication. Although ASA is one of the largest MFIs, it is not computerized, and a high percentage of its branches operate in areas without electricity. Buro Tangail is now testing a MIS system in one branch and is planning to computerize its operations over the next three to four years.

The POs have little enthusiasm for credit information-sharing, possibly because the overlapping clients causing problems a few years ago is not so prevalent now. In addition, as noted earlier, the objectives and status of this credit bureau database have not been communicated to the POs. Moreover, the POs have had no opportunity to participate in decisions about the database, and no way to know how the data will improve their operations at the borrower level. BRAC was positive on sharing data if a credible mechanism to share such data can be put into place and if other large players also participate. Grameen Bank did not seem interested in sharing data, nor did it see the utility of such data sharing for its operations. Both ASA and Buro Tangail were not interested in sharing data on poor clients, as both institutions noted that their lending methodologies factored in risk management tools required to assess low borrower default. Both ASA and Buro Tangail saw the value, however, of sharing data on borrowers in the microenterprise segment, as these loans are expected to comprise a growing share of their loan portfolios in the coming years. In Bangladesh, microenterprise loans fall in the range of Tk. 20,000 (US\$340) to 150,000 (US\$ 2550).

It should be noted that in the absence of a credit-reporting system, some MFIs in

Bangladesh have tried informal information-sharing mechanisms. In the mid 1990s, ASA and BRAC agreed to share data on clients to avoid overlapping of borrowers. Although this informal mechanism worked for about a year, ASA ended this practice because it was felt that BRAC was using this data not to avoid the overlapping issue but to steal ASA's clients. BRAC has a memorandum of understanding (MOU) with ten MFIs. These MOUs are not a standard document as each MOU is created on the terms that the correspondent MFI is willing to sign. The main purpose of the MOU is to deal with the overlapping of client issue. It appears that of the ten MOUs, BRAC is satisfied with only how one is working in practice in the field – the MOU between BRAC and Grameen Bank.

Challenges to Credit Reporting

The development of credit information bureaus given the Bangladesh financial markets present a number of challenges. The prime challenge is the very structure of the banking sector, dominated by relatively few institutions. Dominant financial institutions with significant market share are reluctant to share credit data, especially positive data, thinking they are giving more information than they will get, relative to their new, smaller rivals. In Bangladesh, the four NCBs are responsible for nearly half the outstanding credit. The experience of other countries also suggests that government-owned institutions tend to resist credit information-sharing activities, (1) because they often have large market share, and (2) because they are reluctant to reveal of the extent of their nonperforming loans (NPLs), particularly given the discussions over the future of NCBs and SDB, where NPLs are significant problems that these institutions would prefer to conceal. Moreover, the public banks employ a huge workforce—and rigid labor practices make staff reductions difficult—so

the banks have little incentive to invest resources in innovative labor-saving technologies.

Lending practices in Bangladesh—corrupt practices and insider lending, for some examples—also depress credit reporting. If loan repayment is doubtful, then access to credit information is irrelevant. For most loans, of course, this is not the case – the loan officer wants an appropriate evaluation of the applicant. The development of credit histories is further complicated by the way loans are structured classified. As noted above, loan repayment schedules in Bangladesh can vary—monthly payments, quarterly installments, or even payments that occur less frequently. Some loans require only a single payment at the conclusion of the loan term—such single-payment loans are easier to “evergreen” when there is nonpayment because no one records the poor payment behavior over time. Irregular repayment schedules encourage lax repayment behavior, making it more difficult for borrowers to develop reputational collateral. Loan classifications, or ratings, are also unusually generous in Bangladesh. In some cases, as many as 12 months of nonpayment are required (mortgage loans are an example) before the loan is considered substandard. These lax standards are disincentives to diligent repayment and, depending on the reporting criteria, make credit report data very difficult to analyze.

Banks have developed lending practices that compensate for the lack of information sharing, but these alternatives are significantly more expensive than a credit report. Banks require borrowers to document their creditworthiness quite extensively—including bank statements, wage receipts, proof of payment of other obligations such as utilities or rent. Many banks pay for background checks of prospective borrowers

with whom they are unfamiliar; requiring that a borrower’s place of residence, employment, and other pertinent data be verified in on-site visits. One bank estimated these costs at between US\$50 and US\$100—a very high figure making only large loans worth the appraisal expenses.

In the future, nonbanks, such as cellular telephone companies, may become a fruitful source of information on payment behavior and purchaser of credit reports. As of 2004, only a small fraction of cell phone customers have “open” accounts, meaning accounts that are not prepaid. For example, one cell phone provider reported that of 1.4 million customers, only 100,000 were open, that is postpaid, accounts. Between 30 percent and 40 percent of postpaid accounts were to corporations, and still open account customers need to have a cash deposit with the company (a type of collateral) against which they can make calls. Without adequate credit information, the cell phone firm is virtually unable to provide services in advance of payment. This reduces the volume of calls and thus profits for the firm. Some cell phone providers have demonstrated interest in a credit registry, especially for negative data, hoping to encourage clients with payment problems to clear their accounts.

Recommended Steps to Improve Information Sharing

In spite of the present credit environment, several trends are promising. First, private lenders in Bangladesh want to develop and strengthen the credit reporting system. Private commercial banks and branches of foreign commercial banks were both enthusiastic about the possibility, while realistic about the difficulty of rapid improvement. PCBs and FCBs are interested a private sector solution, and one SDB is also looking to the central bank and CIB for an expansion of credit data.

Second, the Bank of Bangladesh is taking concrete steps to strengthen the Credit Information Bureau, which has a reasonable reputation in the financial market. They plan to use World Bank funds to support some modernization of the CIB and they visited public credit registries in the region to learn from their experiences. Third, while the country's legal and regulatory environment is not inimical to credit reporting, it remains true that more work must be done on the legal and regulatory framework for private sector credit reporting. Without a robust or at least functioning system, it will be difficult to foster bank participation and to attract investors. Fourth, Bangladesh is a populous country in a dynamic region. Private credit bureaus from both South and East Asia would expand their regional presence in Bangladesh, under the right conditions. This prospect should serve as an incentive for the country's formal financial sector.

Yet constraints remain. The lending institutions themselves constitute the most significant constraint, especially the poorly performing nationalized banks and specialized development banks. Until a solution for NPLs is developed, underperforming banks are unlikely to participate in more credit reporting exercises. Absent better lending practices and information systems, the NCBs and SDBs will not be able to provide accurate data in a timely manner.

Most of the largest microfinance institutions, (BRAC, Grameen, ASA) are set to computerize their records; computerization will allow them to participate in a credit reporting system in the future. Unlike the banking sector, with its natural demand for credit data, microlenders do not seem to view credit reporting as a priority for several reasons. First, they have exclusive relationships with their borrowers (so there is

limited customer overlap) and are satisfied with their existing lending technologies. The situation is different, however, with respect to the SME loan market, which many microlenders are now entering. The SME loan market is more competitive, and business and firms are able to work with an array of lenders. Microfinance institutions also want more comprehensive credit evaluations of their SME borrowers because their exposure per customer is substantially higher.

To develop and strengthen credit reporting in Bangladesh, we recommend the following measures:

Strengthen the Credit Information Bureau at the Bangladesh Bank: The Bangladesh Bank must develop a strategic vision for credit reporting and the role of the CIB, both in the short and medium term (the next five years). The principal issues are: the CIB's loan classification system, the frequency of CIB data updates, the development of effective credit data histories, the design of incentives and enforcement actions to improve data quality, heightened consumer awareness, and improved use of CIB data for bank supervision. The use of CIB data to vet public office seekers, or to support commercial ventures should also be reviewed and modified; these ancillary uses should not, in other words, handicap the CIB's ability to meet the needs of the credit market.

Improve the legal and regulatory environment: Bangladesh must bolster its legal and regulatory framework for credit reporting. An external consultant could help with basic guidelines for credit reporting laws and regulations. Policy alternatives to encourage and even compel participation in the credit reporting system should be considered.

Promote a microfinance credit bureau:

Could the CIB serve as a platform for loans extended by the microfinance sector? Particularly the larger loans to the small and medium enterprises? Bangladesh should consider such a proposal. Credit reporting systems have demanding technology and service requirements. This means CIB, rather than PKSF, is the most appropriate institution for this job. In the future, microfinance providers could also explore private sector solutions for credit reporting. microfinance

institutions could use different technology solutions (cell phones, for example) to perform basic credit reporting. According to the Bangladesh Bank, it has discussed using the CIB as a platform for microlending data—perhaps to be received via PKSF.

Extend educational programs: Develop a joint public / private outreach and education campaign to strengthen and support a strong credit culture and eventually, credit reporting.

2.2. NEPAL

Background

Nepal has 17 commercial banks, which include two large state-owned banks, along with 18 development banks and 58 finance companies. In addition, there are five rural development banks, 34 savings and credit cooperatives, postal savings banks, and many NGOs. Nonbank financial institutions (NBFIs) include a stock exchange, 18 insurance companies, an employee provident fund, and a citizen investment trust. All of these financial institutions, with the exception of the stock exchange and insurance companies, are regulated by the Central Bank, the Nepal Rastra Bank (NRB). The Insurance Board regulates insurance companies, while the Security Board regulates the stock exchange.

Deposits and advances of private banks have recently expanded. The private banking sector saw a 94 percent increase in loans and advances, while nonperforming loans were curtailed to just less than 8 percent at year-end 2004 [[AU: 2003?]]. Statistics for state-owned banks show that loans and advances over the same period grew at a meager 14.7 percent, highlighting the weaker performance of state-owned banks. Similarly the credit deposit ratio has not risen much; except for state-owned banks, credit extension relative to deposits by private banks has seen a significant improvement. The steady decline in nonperforming loans is attributed in part to the increasing use of credit information to predict default.

Most commercial credit extended by commercial banks is advanced to the production sector and service industries. Consumer finance, falling under the umbrella of retail banking, is growing more important

in the lending portfolios of commercial banks. Loans for the purchase of durable goods, automobiles, and homes represent a major source of competitive strength for the banks. The growing microfinance sector is served by a range of institutions with a number of microfinance products. Most commercial banks provide microfinance loans, either directly or indirectly, through to lenders with individual customers. The microfinance programs are in large part a response to government directives that require priority sector lending by commercial banks. Because of the sector's low repayment, however, banks often prefer to pay the penalty rather than provide microfinance. Other retail players include six regional microcredit development banks, NGOs, and savings and credit cooperatives.

Credit Information in Nepal

The original legal basis for CIB operations was an NRB directive. Several court cases then questioned the legality of the CIB operations requiring the disclosure of information. In response to the legal challenges, the Central Bank Act was amended in 2002 authorizing the NRB to establish a Credit Information Center (CIC). This was followed by the Directive on Credit Information and Blacklisting that regulates CIC operations. The directive stipulates that the current CIB be renamed "CIC." The financial sector reform program includes capital injections by financial institutions and efforts to restructure the CIB—strengthening its independence and increasing its operational capacity. The CIC is being reorganized into a public company; shareholders are the NRB (10 percent), commercial banks (60 percent), finance companies (15 percent), and development banks (15 percent). The registration process will be completed within next two months.

The CIC will be expected to perform two main functions: (1) collecting information on loan repayments and making that data available to financial institutions upon request; (2) maintaining a list—the so-called blacklist—of defaulted borrowers. Under the previous reporting system, only banks participated in the registry; they submit adverse loan repayment information only on credit in excess of Rs 500,000 (US\$6,420), and blacklist defaulted borrowers with credits in excess of Rs 2 million (US\$25,682). The new directive increases the scope of participating institutions and requires finance companies and development banks (in addition to banks) to report to, obtain reports from, the CIC. It is expected that under the new directive, the CIC will collect information on loan type, amount approved, amount outstanding, amount overdue, and security, for all loans in excess of Rs 1 million (US\$13,000) on a quarterly basis.

Financial institutions are required to obtain a CIC credit report when issuing a loan in excess of Rs 500,000 (US\$6,420). The report includes the borrower's name and address, the names and addresses of owners or shareholders (in the case of firms), the amounts sanctioned, outstanding, and overdue for each credit facility. The names of other lending institutions are not identified.

Interviews with banks and finance companies suggests that the standard practice for assessing borrower creditworthiness involves an analysis of the loan application and financial information about the potential borrower, informal requests by phone regarding past or current loans with other lenders, checking auction notices published in the media, and blacklist information from CIB. Other information contained in CIB reports—such as loan amounts and delinquencies collected on quarterly basis—is

generally not found to be useful because of the long lags in reporting and processing information; the records banks obtain from CIB may be up to nine months old. No credit scoring or other standardized measures for making credit decisions are used. All loans require collateral.

In October 2003 the CIC contained information on 20,300 borrowers. The number of reports issued has increased from 6,500 in 2001, to 8,165 in 2002 and 10,114 in 2003. At the end of October 2003 nearly 10 percent or 2,123 borrowers registered in the CIB were blacklisted. The number of blacklisted borrowers could skyrocket after the new directive is introduced.

Information on credit repayment contained in the CIB is very limited. Poor compliance on the part of the two large state-owned banks means inadequate record-keeping; the CIB gets quarterly reports, on paper, and even this is delayed. Once received, the information takes three months to process, making some information four to six months old. In the case of information on NLB and RBB loans, the information lenders get is nearly nine months old. Registry requires banks to submit a written request for credit information. CIB responses take from five business days—or two weeks or more when records are out of date. The bureau receives 300 requests per day, from about 20 to 30 a day, ever since the new directive mandated that other financial institutions must obtain credit reports on potential borrowers. The registry currently employs only 13 staff members; it processes information manually and is not able to respond timely to the increasing number of requests. The CIC is updating its IT system, but it is not clear when the modernized system will be in place and to what degree banks will be able to comply with the new requirements.

Dun & Bradstreet has official representation in Nepal, a presence that began operations two years ago. It focuses mostly on issuing credit information reports on foreign and domestic companies involved in export and import activities. NRB Circular No. 295 issued in January 2002 requires that banks obtain a credit information report on companies when opening an import letter of credit in excess of US\$50,000. Currently, D&B issues about 30 to 40 reports a month on foreign companies and 15 to 20 reports on domestic companies. All reports are prepared in response to customer enquiries.

The legal and regulatory framework

Nepal has no broad law that regulates information sharing. Until recently CIB operations were governed entirely by the 1989 NRB directive. But legal challenges, poor compliance, and inadequate enforcement meant the regulatory framework needed to be strengthened. As a result, the NRB Act was amended in 2002; the new directive on credit information exchange was issued accordingly.

Article 88 of the new act authorized NRB to establish or “cause to establish” the CIC. Key provisions include (i) obligatory participation of financial institutions in the CIC (ii) a requirement to obtain a credit report before extending a loan (iii) NRB oversight and regulatory authority over the operations of CIC.

Detailed provisions as to operations of the CIC are found in Directive on Credit Information and Black Listing pursuant to Art. 88 of the NRB Act (2002). The directive stipulates that existing Credit Information Bureau (CIB) will change its name to Credit Information Center (CIC) and comply with the requirements of the new directive. Some of the key provisions include:

- Commercial banks and financial institutions must submit reports on all newly issued loans for borrowers with exposure in excess of Rs 1 million (US\$13,000) at the end of each month. A quarterly report must be filed on all outstanding loans.
- Prior to granting a loan of Rs 500,000 (US\$6420), or more, banks are required to obtain a credit report. CIB must provide a report within five working days
- The directive mandates that banks must, in addition to their regular reporting, report, or blacklist, customers with (i) outstanding loans of Rs 1 million (US\$13,000) or more, (ii) when a payment is overdue by six months or more, (iii) when the value of security does not cover principal and interest, and so forth.
- The blacklist includes borrowers, firm owners and management, guarantors, shareholders holding 10 percent or more, any other company in which blacklisted individual or firm holds 10 percent or more shares, and so forth.
- Banks are prohibited from granting new loans and from extending or renewing existing loans to blacklisted entities, relatives of blacklisted individuals, owners or directors of blacklisted firms, and shareholders holding more than 10 percent in blacklisted company
- Notification and consent of the borrower is required for inclusion into a blacklist
- CIC may conduct inspections of financial institutions
- The blacklist must be published semiannually
- The NRB Act exempts operations of the CIC from bank-secrecy provisions.

The regulatory environment is raising concerns, first, that the scope of blacklisting is too wide, and may discourage outside investors from financing small firms. In

addition, there is no legal framework in Nepal for the consumer rights, including the right to access and correct information.

Recommended Steps to Improve the Credit Information Bureau

To improve the public credit information bureau, reforms are needed in the following areas:

Legal and regulatory issues: The current Directive on Credit Information and Blacklisting, issued by NRB, has blacklisting as its main focus. By cutting off a defaulter's access to credit, blacklisting may be an effective tool to encourage better repayment behavior and to assist banks in improving collections in the short run. But the new directive may have the unintended consequence of preventing financially constrained firms and individuals from obtaining credit. Lenders should be informed when a certain borrower is related to a defaulted loan. In the following cases, however, parties should not be blacklisted, (i.e., automatically denied credit), in the following cases:

—Owners of a limited liability company should be exempt from blacklisting, unless they have provided a personal guarantee for a defaulted loan, since this contradicts the concept of limited liability.

—Shareholders holding 10 to 25 percent of shares in a company. The directive now requires blacklisting shareholders with more than 10 percent in a defaulted company, which may significantly suppress loan demand.

The practice of blacklisting assists loan officers only as leverage over a borrower; when the borrower has repaid or worked out a loan, the name is removed from the list. But blacklisting does not provide comprehensive

information about a borrower's creditworthiness and limits the lender's ability to properly assess potential credit risks. The credit information system should focus on creating a full picture of payment history by strengthening the non-blacklist component of the CIC.

Existing legislation regulates information exchange only within the context of the CIC. Economic research shows that the registries are most effective when they are able to collect information from many sources, including bank and nonbank financial institutions as well as firms selling goods on credit. The legal framework should be able to support such a system; it should not restrict ability of some creditors to participate in a credit bureau. A functioning, effective exchange of information among financial entities and other entities providing credit—such as retailers, utility companies, cell phone providers, etc.—requires laws that promote not only information exchange but also the rights of consumers. Such laws are essential for an independent CIC to operate. A borrower must have a right to review his own credit record, challenge the accuracy of his own data, and file a complaint with the appropriate authority. These rights are a major self-enforcing mechanism that improves data quality and encourages more complete reporting by creditors.

Finally, Article 15 introduces a conflict of interest whereby the CIC—which is now a public company with partial ownership by banks, finance companies, and development banks—will conduct inspections of commercial banks. Inspection authority should remain with the NRB alone, or another authorized government authority.

Institutional framework: The existing CIB infrastructure poorly serves the needs of lenders. The blacklist is the only CIB

information regularly consulted by banks because the list is used to cut off lending to bad borrowers. With the changes introduced by the new directive, discussed above, the number of blacklisted borrowers will increase dramatically and suppress access to credit among constrained borrowers. To improve the risk management capability of its lenders, Nepal must strengthen the CIB's non-blacklist component. Several areas for improvement are identified below:

Frequency: Information is now collected on a quarterly basis. Given the data-processing lags, credit information available to lenders is often obsolete and therefore of no use in making lending decisions. It is critical to introduce monthly reporting and cut information processing time.

Scope of information: The CIC information must provide complete, accurate historical information on borrower repayment. The registry does not now provide historical information on a borrower, only the status of the borrower at the end of the last reported quarter (which may be up to six months old, as noted above). Again, the registry must give lenders historical information. In most countries, a five-year history is reported to lenders. At a minimum, the report would provide information on current status and a summary of historical repayment behavior—for example, how many times a borrower was more than 90, 180, or 360 days past due and when. Positive as well as negative information should be included in the report, which is to say, not only data on defaults and delinquencies but also on loans paid on time. Information on paid loans must be stored in the registry and made available to lenders. For example, if a borrower has defaulted on the loan but eventually repaid the full amount, the record should reflect these facts. Deleting information on repaid loans lessens the value of information in the registry. This is because

it prevents a lender from distinguishing between a good borrower who always pays on time, and a bad borrower.

Technology and Accuracy: The CIB database is run on obsolete dBase application. NRB has recently invested in upgrading to an Oracle database software system. The likely first step to improve the CIC's functioning, banks will supply information in electronic format, originally by sending records by e-mail and eventually switching to an online interface. This will reduce processing time, but the move raises questions about staff training: the skills and knowledge about credit information operations may not be sufficient for the successful implementation of the new system. Moreover, the two dominant state-owned banks do not have the capacity for such modernization, although work is under way to computerize these banks. CIC should therefore develop a phased approach in modernizing the IT system: (a) cutting processing time; (b) ensuring accuracy of the records stored; and (c) ensuring completeness of the records. CIC should work closely with banks to assist them in the new applications for submitting and receiving information from the credit registry. It should consider working with a private credit information provider that could assist with the technology upgrade and international best practice.

Confidentiality and customer relations: The need for information for making lending decisions must be balanced with the protection of borrower confidentiality. Proper procedures for access to the information are essential. Access to the credit information records should be restricted to authorized parties—including the borrower, the lender, authorized CIC personal, and supervisory authorities. In order to monitor compliance with access procedures, the registry should maintain a log of requests made on each borrower. The ability of a borrower to view

his own records (including the log of requests) to correct mistakes in the record is a critical element in ensuring the accuracy of records in the registry. The registry should have a mechanism for correction of erroneous

data within a fixed period of time. A borrower's credit history record should reflect the nature of dispute and the result of the CIC investigation to resolve the issue.

Appendix 3

Afghanistan, Bhutan, and the Maldives

3.1. AFGHANISTAN

Background

Since the fall of the Taliban regime, the financial sector of Afghanistan has undergone rapid reorganization. With assistance from the World Bank and other international organizations the Central Bank, Da Afghanistan Bank (DAB), has been significantly restructured. New central banking and commercial banking laws have been implemented. The commercial banking law regulates prudent entry, conduct, and exit of banks. The banking supervision function has also been enabled; on-site inspections of the banks have been implemented. In March 2004, one-third of the central bank branches were connected electronically for domestic payments. However, significant progress still needs to be made for the Central Bank to assert its independence and to make a gradual exit from commercial banking activities.

The state-owned banking sector comprises six commercial banks: Bank Millie, Banke Pashtany, Industrial Bank, Agricultural Bank, Export Promotion Bank, and Mortgage and Construction Bank. All six existing commercial banks have been required to apply for relicensing and also to submit a restructuring plan to comply with the new prudential and management standards specified in the banking law. At end of 2003, all banks have positive capital and a majority had positive net liquid assets.

The microfinance sector has gained importance in the last few years, as a response to the gap created upon the collapse of the formal financial sector. Microfinance Support

Facility for Afghanistan (MISFA) has been established to coordinate microfinance investment by channeling donor funds to appropriate microfinance providers. As of 2003, MISFA had \$25.2 million of committed funding from CGAP, the United States, Canada, Great Britain, and Sweden.

Afghanistan also has a large informal financial sector—better known as the *hawala* system, which developed as an alternative to the formal banking system. These informal money changers offer an efficient, low-cost, and reliable means to transfer money. They also offer microfinance, trade finance, and deposit-taking facilities. But because customer records cannot be accessed, the *hawala* system is subject to abuse. It does not leave an audit trail making it difficult to trace illegal flows of money.

Afghanistan has also begun to issue licenses to foreign banks. Six foreign banks are now operating, including three Pakistani banks (Habib Bank, National Bank of Pakistan, and First Microfinance Bank), along with Standard Chartered and Hong Kong Shanghai Bank. A local bank, Afghanistan International Bank, which is owned by international investors and has ING management, has also begun operating.

Nevertheless, despite rapid progress, Afghanistan's financial sector is weak and reforms must deal with the issues constraining the financial sector. Key areas are: strengthening the legal and regulatory environment, increasing access to finance for small and medium enterprises, and improving corporate governance of state-owned financial institutions. Licensing criteria for new banks

must be stronger, with detailed examinations of the bank's business plan, financial condition, and capital base.

The Importance of Developing a Credit Information Bureau

It is too early to expect a private credit information provider to operate in Afghanistan. However, credit information sharing among banks could improve the

lending environment, which in turn may help the privatization process of state-owned domestic banks and attract additional foreign banks. In addition, as the Central Bank rebuilds its clearing system and other financial infrastructure, it may consider collecting loan-level positive and negative credit information for supervisory purposes—information made available, eventually, to lenders through a public or private bureau.

3.2 BHUTAN

Background

Bhutan has a relatively small financial sector, with one state-owned bank, The Bank of Bhutan, and one private commercial bank, Bhutan National Bank (BNB). There are three nonbank financial institutions—one insurance company, a development corporation, and a pension fund.

The government has an 80 percent stake in the Bank of Bhutan, and the State Bank of India (SBI) owns the remaining 20 percent. Established in 1968, the Bank of Bhutan and is the largest commercial bank in the country, with 26 branches, 489 employees, and Nu 12 billion (US\$246.9 million) in assets at year-end 2002. BNB was created from the Unit Trust of Bhutan in 1996. The Royal Government, Asian Development Bank (ADB), and Citibank were the largest equity holders at the time of inception. Since then, Citibank sold its share to the government (World Bank Bhutan Private Sector Survey, 2002) so that currently the government holds a 14 percent equity stake. It has six branches and an asset base of Nu 6 billion (US\$123.4 million). Commercial banks and nonbank financial institutions are regulated by the Royal Monetary Authority of Bhutan, which was formed in 1982.

The Royal Insurance Corporation of Bhutan is controlled by the government, which has a 39 percent stake. Aside from financing housing construction and transportation, it has also helped to develop industrial units and trading activities. The Bhutan Development Finance Corporation (BDFC) focuses on providing agricultural loans and meeting microfinance needs of the rural population. The government owns 87 percent of equity and the other 3 domestic financial institutions hold the

remaining 13 percent (World Bank Bhutan Private Sector survey, 2002). Concessional loans and grants from international agencies constitute the main source of funds for BDFC—from UNCDF and ADB—as it is not a deposit-taking institution. It has 21 offices throughout the country and Nu 1.1 billion (US\$ 22.6 million) in assets. It recently introduced mobile banking and a simplified lending system, which eases lending procedures and time for loan approval. Under the simplified system, borrowers are able to obtain a loan within one month of the application. The National Pension and Provident Fund (NPPF) were only recently established in 2000. It is not under the regulatory and supervisory ambit of the Royal Monetary Authority. It mainly deals with pension, provident fund, real estate, housing, and educational loan schemes.

Total assets have grown on average at 17 percent between 1995 and 2002. Financial sector assets registered an increase of 38.08 percent between September 2002 and 2003, rising from Nu 16.28 billion (US\$334.9 million) to Nu 22.48 billion (US\$462.5 million). Almost 89 percent of these assets are controlled by the two commercial banks. Much of this growth has derived from credit growth due to increased lending, with total loan portfolio increasing by 83.81 percent (from Nu 4.88 billion or US\$100.4 million in 2002 to Nu 8.97 billion or US\$184.5 million at end of September 2003). Reserves with the Royal Monetary Authority are 39 percent of total assets. Loans and advances comprise approximately 32 percent of assets. Equity investments in nonfinancial firms are less than 1 percent of the total. Banks are also allowed to maintain foreign assets consisting of rupees and convertible foreign currency. At end of June 2003, banks held Nu 2.5 billion (US\$51.4 million) in Rupees and Nu 2.7 billion (US\$55.5 million) in foreign currency.

The combined assets of the two nonbank financial institutions also grew by 24 percent, with private sector credit rising 20 percent.

The Bank of Bhutan is the largest provider of credit, followed by BNB. The Bank of Bhutan provides 37 percent of total lending. On a sector basis, on average, the largest proportion of advances goes to the trade and commerce, construction, transport, and manufacturing sectors. In 2003, however, service and tourism registered big increases. Agricultural loans are only a small percentage of total loans, with most credit being extended by the development bank, BDFC. Credit to the private sector had a high growth of 35.7 percent. Sector-wise credit extended by nonbank financial institutions went primarily to building and construction, followed by manufacturing.

In terms of the quality of advances, non-performing loans (NPL) have grown—an increase of 26.29 percent between 2002 and 2003. The growth in loans and advances, however, has produced a small decline in NPL as a proportion of total loans—falling from 13 percent to 9.23 percent in the third quarter of 2003. Most of the NPLs (approximately 21.57 percent) come from the housing sector, followed by manufacturing and industry (20.16 percent), personal loans (11 percent) and agriculture (10.87 percent). The high level of NPLs within the agriculture sector may suggest a need for better microfinance facilities through private microfinance lenders and community-based programs. Personal loans also have a high default rate of 11 percent (down from 13 percent in 2002), which highlights the role a credit bureau could play to improve information sharing among financial institutions on high credit risk borrowers and defaulters.

Across banks, 79.31 percent of total loans were classified as standard (i.e., no default) in September 2003, an improvement from 68 percent in December 2002. Under the “watch” category (within one to three months of default), fall 11.46 percent of the loans; 4.99 percent are substandard (4 to 12 months of default), 1.02 percent are doubtful (13 to 24 months of default) and 3.22 percent are classified as losses (more than 24 months of default or term-expired loan accounts) (Royal Monetary Authority of Bhutan, Financial Sector Performance Report, 3rd Quarter 2003).

In 2003, deposits grew by 34 percent, propelled by current account and foreign currency deposit increases, which grew at 89 percent and 307 percent respectively. Government interests are also entrenched in bank deposits, holding almost 42 percent of all deposits, followed by individuals who hold 30 percent of the total. In September 2003, the breakdown was Nu 6.76 billion (US\$139.1 million), Nu 6.63 billion (US\$36.4 million), and Nu 2.07 billion (US\$42.6 million) of time, current, and savings deposits, respectively (Royal Monetary Authority, Financial Sector Performance Report, 3rd Quarter 2003).

Key Issues

It is evident that the small financial sector of Bhutan has an entrenched government interest. There is ample empirical evidence that government involvement contributes to inefficiencies and slower growth. The share of the financial sector in contributing to GDP was 6.8 percent in 2002. For the financial sector to grow stronger, the government needs to privatize or divest its stake and to focus its attention on the regulatory prescriptions. Furthermore, by fostering competition, Bhutan may also be able to expand and deepen the financial sector by developing a wider range of financial products such as

lease financing, mortgage financing, and factoring. This will increase lending and borrowing capacity of firms that are constrained by collateral requirements (Bhutan Private Sector Survey 2002).

A common problem the financial institutions in Bhutan face is inadequate investment opportunities, forcing excess liquidity. In 2003, excess liquidity continued to plague the financial sector and only 68 percent of total assets at the two commercial banks (Nu 12 billion or US\$246.9 million) was available for investment. Most excess funds are deposited mainly in noninterest-bearing accounts of the Royal Monetary Authority. Recently there has been a trend of investing in interest-bearing deposits in commercial banks in India. The poor investment opportunities in the country proceed largely from the high collateral requirements, weak financial products, conservative lending practices, and high interest rates. In 1998, the highly regulated financial sector was somewhat liberalized by deregulation of interest rates. But rates began to decline only in 2000, when the Bank of Bhutan lowered interest rates on all lending facilities except a few term loans.

The banking sector has experienced declining profitability partly because of a fall in interest income on deposits held in Indian commercial banks. The reduced interest rates in Bhutan are another reason for the lower profitability. The interest income from domestic lending has, however, actually increased in recent years. In 2003, interest income on loans and advances increased by almost 31 percent to Nu 586 million (US\$ 12.1 million). Prudential rules require banks to maintain large provisions for bad loans, which has also affected profitability. The implementation of new provisioning requirements is expected to increase profitability within a few years (Royal Monetary Authority, Financial Sector Performance Report, 3rd Quarter 2003).

The financial sector review carried out by the Royal Monetary Authority under the aegis of the Asian Development Bank in 2002 highlighted several other problems. The report indicates that Bhutan's geographical isolation is the primary reason for weak private and financial sector development. In addition, weak legal infrastructure and slow development of the domestic debt and capital markets are other factors. Finally, human resource development in the financial sector is poor. As always there needs to be stronger emphasis on promoting sound accounting practices and good corporate governance. There is also the need to improve credit assessment techniques and better surveillance mechanisms for risk management of financial institutions. Concurrently, non-bank financial institutions must also be encouraged that focus on housing, leasing and insurance (Royal Monetary Authority, Annual Report 2002–2003).

The Importance of Developing a Credit Information Bureau

Although there is no formal credit information registry, clients that request loans from one financial institution are required to obtain a 'No-Objection Certificate' from other financial institutions. This makes a loan application more difficult and may delay loan approval. Other credit checks in the system include collateral security verification that screen for a double mortgage of collateral security and a verification of loan status.

On August 6, 2004, the Central Bank, the Royal Monetary Authority of Bhutan, held the first meeting for the Credit Information Bureau (CIB) Task force members to discuss the establishment of a Credit Information Bureau in Bhutan. The task force is formed jointly by representatives from the Royal

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Monetary Authority of Bhutan and the financial institutions.

In order to improve customer service, the Bank of Bhutan has automated the functions

of numerous branches and computerized its fourth branch in 2002. The trend towards computerization will facilitate the collection and distribution of credit information both within and among lenders.

3.3 THE MALDIVES

Background

The financial system of Maldives is narrow, being largely dominated by commercial banks and a few non-banking financial institutions. Commercial banks are the main institution for mobilizing savings and for providing credit to the private sector. There is one locally owned commercial bank and four foreign banks. Among the nonbank financial institutions, there is one finance leasing company, two insurance companies, one provident fund, and one housing finance corporation.

The Bank of Maldives (Plc) is the partly state-owned bank. The government has 51 percent holding in the bank, 25 percent is held by the general public, and 9 percent by the government employees provident fund. The state-owned trading organization, Maldives Transportation and Contracting Company plc., and Island Communities each hold 5 percent. The Bank of Maldives has 14 branches and 5 mobile banking units. An additional lending institution is the State Trading Organization (STO), which is designed to lend to state employees. About 12,000 employees borrow loans of about 2-year maturity. The Treasury also makes loans directly to Civil workers.

There are no restrictions on operations of foreign banks, both in obtaining licenses or in their activities in the Maldives. An off-shore banking license was given to First International Bank (Maldives) Pty. Limited, but was then revoked in 2000, because of non-operation. The 4 foreign banks are branches of State Bank of India (SBI), HSBC, Bank of Ceylon, and Habib Bank. HSBC started its operations most recently in March 2002. The foreign banks only provide short-term to medium term loans up to 3-4 years,

while the Bank of Maldives provides long-term loans. Foreign banks are significant players in the tourism sector and also play an important role in mobilizing savings and providing foreign exchange to the private sector (Annual Report 2002, Maldives Monetary Authority).

The leasing company is a joint venture between 5 private and public sector parties and 2 international parties, basically to finance long-term equipment needs. Out of the two insurance companies, one is owned by the Bank of Ceylon of Sri Lanka.

The banking system is regulated by the Maldives Monetary Authority, which serves the functions of issuing licenses, supervising and regulating activities of commercial banks issuing currency, and providing finance for government operations. Reporting of credit information by banks to the MMA is done on a consolidated basis rather than individual. In other words, the MMA does not receive information on total lending by size or sector.

The stock of deposits held by commercial banks amount to 55 percent of the GDP, while the credit extended is 29 percent of GDP. In recent years deposits have grown at a high rate. Rufiyya deposits account for 42 percent of the total, and have grown at a quarterly rate of 2 percent. The commercial banks hold a large amount of assets in the form of reserves. Private sector credit account for 90 percent of all advances that are made. Although there has been an increase in advances to the private sector, the rise has been largely insignificant. For instance, in 2002- 2003, the growth was merely 7 percent, although it was 15 percent in the previous year. The growth in deposits has been much larger at 16 percent. Personal loans constitute a high proportion (21 percent) of total commercial bank advances. However the non-business loans

i.e. consumer loans are a much smaller proportion, though they have risen by 63 percent between 2002 and 2003. The main collateral for loans is real-estate, however, the lack of private ownership means that bank loans are restricted. Furthermore, transferable leaseholds are not available and legal framework insufficiently deals with loan recovery.

The Maldives economy is highly dependent on tourism, whereby almost 56 percent of credit advanced is for the tourism sector. Commerce (21.9 percent), construction (6.5 percent) and fishing (6.8 percent) are also important, but relatively less so. Most advances are secured on real estate, 43 percent of all advances out of which 26 percent are commercial buildings and 17 percent advances are secured on housing. Unsecured advances are a very small proportion of total credit extended.

The recent growth in private sector credit growth in 2001-2003 is in part a result of the removal of credit ceilings in July 2001. In the year 2001, a series of important policy measures were undertaken, which included abolition of bank-specific credit limits, removal of an interest rate band of 7 percentage points on rufiyaa loans and deposits, and establishment of a Lombard window to provide liquidity to the banks. In addition, earlier directed credit policies were dismantled in 1995. Foreign currency interest rates were also liberalized.

In 2003, net foreign assets of the banking system improved by 57 percent. This was a result of an increase in foreign assets provided by the MMA and improvement in the foreign asset positions of commercial banks, which turned around from negative to positive. Foreign assets which were previously 8 percent of total assets registered a 29 percent

growth. Consequently liquidity in the bank system has increased by 15 percent.

Non-Bank Financial Institutions

While commercial banks seem to dominate the Maldives financial sector, the importance of NBFIs has been increasing over the years. For instance the high demand for insurance cover in recent years has led many regional insurance agents and brokers to flock to this business. The Maldives finance leasing company also started operations in May 2002, as an initiative of the Government to meet the increased needs for short and medium term financing in tourism, construction, and other business areas. The leasing company has been established upon recommendations and backing of the International Finance Corporation (IFC), with the National Development Bank (NDB) of Sri Lanka as a partner. IFC holds 25 percent and NDB has 35 percent equity stake in the venture. Other shareholders are the Bank of Maldives, the Maldives transport corporation and contracting company. Since the year of its start, the company has financed equipment worth 27.8 Rf. million (US\$ 2.2 million), mainly in the tourism sector. The lease period for majority of the financing arrangements has been 60 months (Annual Report 2002; Quarterly Review December 2003, Maldives Monetary Authority).

The Importance of Developing a Credit Information Bureau

No formal public or private credit information registry exists in the Maldives. Yet an informal system has been developed that allows information sharing among financial institutions and other agents. Credit proposals are considered only after a “Confidential Opinion Report” has been completed by all other creditors. This includes the commercial banks, mortgage and housing development

banks, the leasing company, as well as the Treasury (that makes loans to civil workers), and the Central Bank (that keeps a blacklist of firms that defaulted on BCCI). In general, it takes about a week to get responses from all lenders. The information collected in the Confidential Opinion Reports is not available on-line, which poses additional significant time delays in sending requests for and receiving credit reports. This process is time consuming and costly for the borrower. An additional venue for the sharing of credit information is a monthly meeting of commercial banks at the Bankers Forum (hosted by MMA), which involves a periodical exchange of a list of non-performing loans.

The existing environment for loan approval certainly necessitates the formation of a credit bureau. First, there are no secrecy or bank privacy laws in the Maldives preventing the collection and distribution of credit information. Second, audited information is generally unavailable, except for the few large companies that are required to disclose their accounts, which makes loan due diligence even more difficult. Third, restrictions on the collateralization of private residences makes

the pledging and seizing of collateral difficult, so the value of “reputational collateral” provided by a credit bureau is even more important. Finally, in order to limit bank exposure to a single customer, a limit of 15 percent of capital is set by the MMA. A credit bureau, which could consolidate borrowings across banks by owners and business groups, could help MMA enforce this regulation.

In addition to bank data, the credit bureau should include additional available credit information. For example, the bureau should include data on court judgments, which is currently unavailable and slows down the appraisal process. In addition, default information from the telephone, electric and water companies (state monopolies) should be shared. For example, Durago, the national phone company, has historical credit information on over 40,000 customers. Since many residents with utility bills do not currently borrow from the formal banking sector, establishing credit histories in non-banking payments may promote new lending. In addition, linking repayment of utility bills to bank borrowing can improve the overall credit culture.

Annex B**Contact Information***Credit Bureaus*

Country	Bureau	Ownership	Contact Name, Title	E-Mail Address
Bangladesh	Credit Information Bureau: Bangladesh Bank	Public	Mr. Jasim Uddin Ahmad, General Manager	gmcibbb@bangla.net
India	Credit Information Bureau of India, Limited (CIBIL)	Private	Mr. Satish Mehta, Managing Director	satish@cibil.com
Nepal	Credit Information Bureau: Nepal Rastra Bank	Public	Mr. Prem Shanker Shrestha, Chief	nbacib@wlink.com.np
Pakistan	Credit Information Bureau: State Bank of Pakistan	Public	Mr. Muhammad Saleem, Joint Director	muhd.saleem@sbpp.org.pk
Pakistan	DataCheck (Pvt) Ltd	Private	Mr. Tariq Nasim Jan, Managing Director	datacheck@cyber.net.pk
Sri Lanka	Credit Information Bureau of Sri Lanka (CRIB)	Private	Mr. N P H Amarasena, General Manager	amarasena@crib.lk

Additional Contact Information

Country	Affiliation	Contact Name, Title	E-Mail Address
Afghanistan	Afghanistan Bank	Mr. Abdul Qadeer Fitrat, First Deputy Governor	aqfitrat@msn.com
Bhutan	Royal Monetary Authority of Bhutan	Mr. Phajo Dorjee, Designated Officer in Charge	phajodorjee@rma.org.bt
Maldives	Maldives Monetary Authority	Ms. Aishath Zahira, Manager, Operations Division	lubna@mma.gov.mv