

RURAL CREDIT BUREAU

“A Road Map to Rural Development Thru Accessible and Regulated Credit Delivery”

While the use of credit bureaus has long been implemented in many developed countries, this information system has barely been adopted in the Philippine banking sector. The main reason for this is that the personal credit history available to lenders for assessing risk is typically limited by custom or law. Historically, credit reporting began with the sharing only of so-called *negative information*, or reports on bad experiences from borrowers such as delinquencies, charge offs, bankruptcies and other similar types of information.

Only gradually and recently has information about the successful handling of accounts (prior and current) been added to the data repository of some Philippine banks. These, on the other hand, are the *positive data* that include such information as account type, account age, current balance, credit limit, and others.

Majority of the banks that presently practice the sharing of positive information are commercial banks situated in the urban areas. These banks have organized a common screening system and a depot of information primarily to keep records of corporate as well as personal accounts.¹ Among other things, this system can provide banks with information on how much a borrower owes other banks. With the ready availability of this type of information, the risks to the entire banking system can be minimized.

The management of data on good and bad bank borrowers started with the founding of the Credit Information Bureau, Inc. (CIBI) and the Bankers Association of the Philippines (BAP)-Credit Bureau in the mid-80s to early 90s. However, these credit bureaus mainly serve the information requirements of banks in Metro Manila. Although, now, both the CIBI and BAP are planning to expand the area coverage of their credit bureaus to the countryside by encouraging the cooperatives and rural banks to participate in their respective credit bureau systems.

Credit Bureaus Around The World That Allow Organizations/Lenders To Pool Data/Information

REGION	COUNTRY	OPERATOR
ASIA PACIFIC	China	Central Bank Pilot
	Hong kong	TransUnion/banks
	India	Reserve bank
	Thailand	TUA
	Taiwan	Private/banks
	Philippines	Private/banks
	South Korea	Private/banks
AMERICAS	USA & Canada	TransUnion
		Experian
		Equifax
EUROPE	United Kingdom	Experian/Equifax
	France	Central Bank
	Germany	Cooperative
	The Netherlands	Cooperative
	Italy	CRIF
	Spain	Equifax/Trans Union
AUSTRALASIA	Australia	Data Advantage
	New Zealand	Baycorp

¹ Particularly those holding credit cards.

A Credit Bureau From Experts' Standpoint

The core idea of a credit bureau is the exchange of information, but what do we really mean by a credit bureau? A *credit bureau* is also known as a credit reporting agency which is an independent business company that compiles a public record data, statutory information, credit transactions and payment histories of individual consumers and businesses. In other words, it is a cooperative repository of information.²

By keeping track of both personal finances and business affairs of business owners, these institutions provide valuable information to the financial sector. They allow lenders to a) know the people who are behind the small business seeking loans, b) know their credit histories, and c) discover signs of incompetence or dishonesty that may lie hidden behind the corporate curtain.

The resources needed in setting up and maintaining a credit bureau require that it should be a private sector undertaking. However, the government can serve as a catalyst by promoting the adoption of the technology among financial institutions.

Importance and Key Roles of a Credit Bureau

According to Bangko Sentral ng Pilipinas (BSP) Deputy Governor Alberto V. Reyes, the credit bureau helps banks in tracking the true exposure of existing and prospective borrowers. Through this valuable information, the risk of banking crisis may be prevented.

The benefits of a credit bureau can particularly be derived from its performance of the following key roles:

- Facilitator of information sharing;
- Bridge between formal lenders and the borrowers;
- Protector to financial institutions, by helping (a) prevent banks from making bad loans (non-performing loans) and (b) limit fraud;
- Protector to bank clients, by helping lenders ration credit resources based on borrowers' capacities to pay;

² Information which is contained in a credit report comprises four sections namely: a) Identifying information or profile – this includes name, social security number, address, previous addresses, civil status; b) Credit payment history – list of transactions with time and dates; c) Public record/collection activity; and d) Inquiries.

- Facilitator of access to large volume credit without security, particularly by helping in the evaluation of borrowers' ability to pay and diligence in loan repayment;
- Reporter of information that either positively or negatively affects creditworthiness;
- Enforcer of borrower discipline, by impelling them to settle their loan obligations on time.

Presently, the existence of a credit bureau is already part of the pre-requisites to the implementation of the Basle Capital Accord II by the Bank for International Settlement (BIS) in 2005.³ The Philippines recently became a member of the BIS, which is among the stronger and more prestigious advocates in international fora on bank supervision (Malaya, November 3, 2003).

The Value of Credit Bureaus to the Lending Institution

Unlike the traditional method of screening the creditworthiness of borrowers, several advantages are inherent to utilizing a credit bureau:

- **Control Risk.** Lending is always associated with risk. This downside which results into accumulation of bad debts (or non-performing loans) put the lender's business in jeopardy since the poor returns of investment do not allow improvement of their capitalization. When the credit bureau comes into the picture, the risk is controlled to a minimum because delinquent borrowers are kept at bay. Moreover, the amount of loan the lenders can dispose depends entirely on the risk factors (risk-based pricing) the credit histories of their clients tell.
- **Increase Revenue/profits.** A credit bureau is a convergence of prospective lenders and borrowers. The exchange of information allows the lender to search for good borrowers (weeding out the delinquent ones) which will optimize his investments giving him more profits in the process. Eventually, the increase in sales

³ Also known as the Basle Committee which is composed of senior representatives of bank supervisory authorities and central banks. Among the original member-states are Belgium, Canada, France, Germany, Italy, Japan, United Kingdom, Netherlands, Sweden, Switzerland and The United States. To obtain public policy benefits, the New Basle Capital Accord focuses on improved capital adequacy framework zeroing in on developing capital regulation and increasing substantially the risk sensitivity of minimum capital requirements.

will make the business grow further which will translate into bigger capital for more lending.

- **Administrative Savings.** Before the dawn of credit reporting agencies, the method used in compiling information about the borrowing clients was done manually. Huge amounts of data were kept in folders and usually maintained by several personnel. Retrieval of information takes time in this system; laborious so to speak. Hence, the use of a database system solves these problems by providing a quick, accurate and single source of information using less people, which translate to savings and improved efficiency for the business.
- **Improves customer loyalty.** A standardized decision format, which is a common feature of a credit bureau, facilitates fast approvals of loans in comparison with the old method which normally takes some time before a loan gets evaluated and approved. The speed of approvals translates into greater number of approvals and, consequently, into greater number of satisfied borrowers. This efficient service enriches continuous patronage and customer loyalty

How a Credit Bureau Works

A credit bureau operates mainly by maintaining and screening data stored in an information depot (see Figure 1). When a borrower secures a loan from a Financial Institution (1), the latter requests for a credit clearance from the bureau (2). In turn, the bureau culls the profile of the borrower from its database. The bureau then sends back a report to the RFI (3 and 4). The report shows either a bad or good credit history (5). A bad credit record would usually be the basis for the denial of a loan request, while a good record oftentimes results in approval. In any case, feedback on approval or disapproval is then relayed to the borrower (6).

Some Issues That Hinder the Development of Credit Bureaus in the Country

Some of the initial issues that have been identified by the CIBI, BAP-Credit Bureau, National Credit Council (NCC) and the Bangko Sentral ng Pilipinas (BSP) in the operations of credit bureaus in the country are the following:

- Credit bureaus could not take-off in the countryside because rural and cooperative banks are **unwilling to share information**. Little appreciation for new technology, additional overhead cost to the maintenance of database (e.g. training and hiring of new staff), and perceptions that their current and prospective clients are open to piracy are among other reasons why the setting up of an information depot is difficult to launch.

- The current set up of BAP Credit Bureau and CIBI are mainly catering to the needs of commercial banks. Viability of the business is their primary consideration at this time and, hence, hesitant to venture to the rural financial market which they believe could not sustain the financial requirements of maintaining the services of a credit bureau.

- Credit bureau as a disciplinary tool to those who are delinquent in repaying their loan obligations may further steer away the small borrowers such as the small farmers and fisherfolk in obtaining credit from the formal institutions like banks. The instability and seasonality of the nature of the incomes of the rural borrowers make it difficult for them to repay their obligations on the agreed time which, consequently, prohibits them from obtaining any subsequent loans because of their bad records. As recourse, they have often-times the tendency to borrow from the informal lenders. Unfortunately, this is contrary to the objective of the government in encouraging the private sector to actively participate in agricultural lending.

- Making it mandatory through legislation for banks to participate in the credit bureau is **unnecessary**. The **Bangko Sentral ng Pilipinas (BSP)** may elect to indirectly require these banks by giving incentives such as additional points in their respective performance ratings should they join in the said bureau. The **BSP** that pushes for the establishment of credit bureaus, under the existing laws, is in itself legally constrained from financing a subsidiary or undertaking for private or commercial purposes such as this. Recently, the BSP through a news release urged anew the banks to form their credit bureaus to allow sharing of vital credit information and blacklist notorious borrowers. It also encouraged the participation of other government agencies in this undertaking. On the one hand, banks can form an independent organization where each of them is represented and has a voice in the administration of the credit information system. The sharing of

authority and responsibility gives the formed body a level of independence and neutrality in as much as the whole operation is concerned.

■ According to the National Credit Council (NCC), the existing credit bureaus in the Philippines still operate with great limitations and weaknesses like the non-availability of information on the total debt of a borrower. The credit database of BSP itself is limited only to loans of not less than one million pesos while the information from private credit bureaus only cover delinquent accounts. Meanwhile, loan exposures from non-regulated financial institutions such as cooperatives and microfinance NGOs are commonly not included since these institutions do not participate in the credit bureaus. In other words, there is yet ***no effectively functioning credit bureau in the country***. That is why, at present, only a limited number of financial institutions avail of the services of a credit bureau.

■ The quality of information from credit bureaus is being jeopardized because of legal impediments to use the databases of different government agencies such as the Social Security System and Bureau of Internal Revenue which are rich in credit information. This is not to mention the lack of identification number unique to the borrowers which they can use in every transaction and the issue on confidentiality of such information.

■ The government has no effective incentive mechanism to attract more lenders and encourage the non-regulated financial institutions such as the credit cooperatives and microfinance NGOs to participate in the credit bureau. Non-participation of most of these organizations can be attributed to inadequate information and poor campaign of the government.

■ The existing bureaus in the country have not clearly identified the role of institutions such as the Bangko Sentral ng Pilipinas (BSP), Securities and Exchange Commission (SEC) and Cooperative Development Authority (CDA). These agencies perform regulatory functions crucial in the delivery of financial services.

■ The loan portfolios of rural and cooperative banks mostly benefit the big borrowers than the small ones. This is a clear example of small borrowers being slighted in the process because the current trend in the banking sector is to go main-

stream in order to achieve business and financial viability. The banking sector is unanimous and unequivocal in saying that countryside lending is too high a risk because rural farmers and fisherfolk have no stable source of income and subsist only on seasonal harvests thereby compromising their ability to pay their loan obligations.

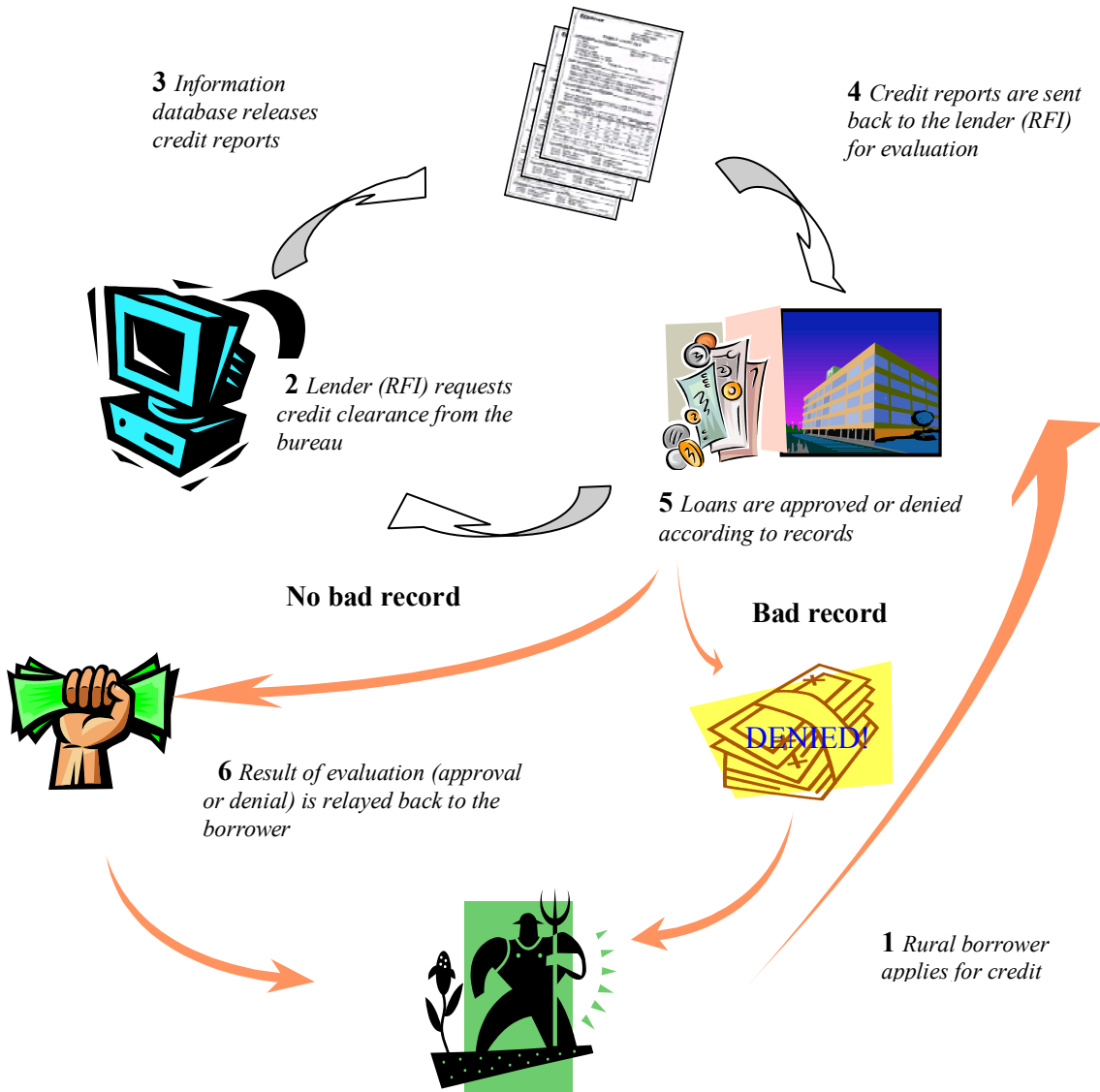
■ There is no clear distinction between the big and small borrowers in terms of loan amounts. This poses a problem when you treat them as both delinquents with a large rift in the amounts of their respective loans. More leeway should be given to small borrowers since the amounts they borrow are relatively easier to pay. Separate criteria for this group should be formulated in order not to discourage them from borrowing from the formal sector.

Recent Developments

At present, the Bangko Sentral ng Pilipinas (BSP) and the National Credit Council (NCC) are jointly spearheading a project to provide an appropriate policy environment and identify the most viable business model for the effective functioning of credit bureaus. This study is being undertaken through the technical assistance of the Credit Policy Improvement Program (CPIP) of the Department of Finance. In connection with this, the BSP is seeking a legal mandate to initiate the creation of a centralized credit bureau, which is crucial in curbing loan delinquency and credit pollution. The move of the BSP to create a central credit bureau is to enhance the monitoring of credit risks of banks which is in consonance with the Basle-based internal rating approaches.

Likewise, the ACPC plans to help in the promotion of the credit bureau among rural financial institutions by providing support to the piloting of a rural credit bureau. The implementation of the mentioned project shall take into account the results of the BSP-NCC study. This project is chiefly geared at promoting a sustainable and effective delivery of financial services to the countryside through information dissemination, strengthening the market base of the rural and cooperative banks in the countryside by fusing its technical resources to the existing credit bureau operating in Metro Manila and instilling discipline and diligence in making payments especially to the small borrowers like farmers and fisherfolk.

Figure 1. How a Credit Bureau Works



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Agricultural Credit Policy Council, 3/F Agustin I Bldg., Emerald Avenue, Ortigas Center,
Pasig City Tel. Nos. 6343320/21, 6363390/91 E-mail Address acpc@manila-online.net