K C Chakrabarty: Credit information companies – seeking new frontiers

Inaugural address by Dr K C Chakrabarty, Deputy Governor of the Reserve Bank of India, at the Experian India Conclave 2013, Mumbai, 5 July 2013.

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Dr. Richard Fiddis, Managing Director – Strategic Markets, Experian; Mr. Vikram Narayan and Mr. Mohan Jayaraman, Managing Directors, Experian Credit Information Company of India Pvt. Ltd.; senior members from the financial services industry; delegates to the conference; members of the print and electronic media; ladies and gentlemen. It is a pleasure to be here this morning to deliver the inaugural address at the Experian India Conclave 2013. As you know, this Conclave has been organised by Experian, one of the leading credit bureaus with operations spread across 19 countries. The Credit Information Companies (CICs) have been in India for around a decade now and I believe it would be appropriate that in today's address, I focus not just on the role which the CICs like Experian have played in India, but also dwell on the next higher level the CICs should aspire to achieve through innovative practices, capability enhancement and improved efficiency. This would also be in line with the theme of the conference: The Next Frontier for Innovation, Competition and Productivity.

Our society transformed itself from an agrarian society to an industrial society and is, now, getting transformed into a knowledge society. An essential ingredient for sustenance of a knowledge society is widespread information literacy. I believe that the CICs have an important role to play in dissemination of awareness about credit information. The ability of CICs to effectively perform this role will determine the future growth of the CIC business and that of individual companies within this industry. I would also be dwelling upon the information literacy function of CICs during my address today.

The credit information services have witnessed impressive growth over the last two decades. I understand that between 1990 and 2011 the number of credit bureaus in the world has tripled. While the Asian crisis in the late 1990s triggered the growth of bureaus in Asia, Eastern Europe saw significant activity in early 2000s and the Middle East and Africa in the late 2000s. A recent survey showed that 134 countries across the globe either had a credit bureau or a credit registry at the end of 2011.

Value of a robust information infrastructure in an economy

The World Bank's "Ease of Doing Business Report 2012", mentions that there is a strong linkage between depth of credit information index and credit penetration. Credit information index is influenced by the institutional mechanisms in an economy for gathering and disseminating credit information. Public registries and credit bureaus play a very important role in boosting the information infrastructure. Key developed economies like the US and UK demonstrate a strong and mature credit bureau environment.

In developing economies, lending, especially to retail, is, in a large measure, made possible by credit bureaus, which perform the vital task of collating and distributing reliable credit information to the underwriter. As you all know, reports from the bureau contain information about the payment behaviour of consumers and commercial entities, including data on timely fulfilment or delinquency behaviour pertaining to financial obligations. Let me emphasize that credit bureaus can serve at a micro as well as at a macro level. While at a micro level they help credit underwriters make an informed decision about a credit applicant, on a macro level, they assist the senior management understand the broad credit market tendencies and also help the banks benchmark their performance against the industry on various dimensions such as sourcing, portfolio quality, delinquency, etc. At the level of a regulator, bureaus can play a pivotal role in providing insights that can drive effective policy changes. They can also provide important inputs for the banking supervisors in monitoring systemic risks. A further use of the bureau at a regulatory level may be to analyze appropriate capital and provisioning strategies for banks and, in particular, to assess whether current capital and provisioning regulations match up to actual risks. At the level of the society, as I mentioned a little while ago, the CICs have to work towards making individuals and financial entities credit information literate. This would involve generating awareness about the importance of credit history and the need for maintaining a healthy credit record.

Credit bureaus also provide other benefits for both borrowers and lenders. For example, if borrowers know that lenders have access to their credit histories, they would have a greater incentive to repay loans to maintain access to credit in the future. A 2010 World Bank study indicates that half of all customers would be more likely to pay their bills on time if they knew that those payments were reported to credit bureaus. Further, borrowers who have established a good credit record with a credit bureau may gain bargaining power for the terms of credit. Information sharing between lenders reveals borrowers' debt exposure to all participating lenders, thereby generating a view about their aggregate indebtedness.

Lending in emerging economies like India, while presenting unique opportunities, also brings in attendant challenges. While India has a large work force and an increasingly affluent middle class with rising disposable incomes, the extent of credit penetration is still quite low compared to global standards. One of the key reasons for this is the information asymmetry between the lender and the borrower. Lenders have limited financial information and cannot undertake automatic screening. Average loan amounts are also curtailed to address this information risk. Contract enforcement and repossession norms are certain other issues that plague lender confidence and, thus, in the process, hinder credit off-take. It is in this context that the role of the CICs assumes significance. The CICs should help identify the credit worthy people in the system. Based on the information that they have, the CICs should develop appropriate analytics, help lubricate the credit market and facilitate the provision of credit to the people who, otherwise, don't get credit from the formal financial system. The purpose of having CICs in the system would be best served when the credit needs of deserving people are met in a timely manner and at a reasonable cost.

For lenders, credit bureaus' collection and transformation of borrower information into a credit score also helps reduce transaction costs associated with lending by providing a standardized benchmark that a lender may use to judge a borrower's creditworthiness. This can also help in cutting down the turnover time in processing credit requests, thereby promoting operational efficiency. In fact, banks and the CICs have a symbiotic relationship where both can help each others' business processes and, thereby, improve their respective efficiencies.

Positive and negative data sharing

Credit history data can be broadly categorized as: negative data and positive data. The negative reporting includes information pertaining to unfulfilled financial obligations such as defaults, amounts in arrears, court judgments, and other adverse information. Typically, these serve as inputs for generating a black list. Positive data, on the contrary, contains information on an individual's open and closed accounts and this repayment history can be used to create and classify credit profiles of borrowers. Similarly, banks can identify premium borrowers and provide more customised service to them. According to Doing Business survey data, approximately 70 percent of all bureaus and registries surveyed provide both positive and negative data, often referred to as "comprehensive credit reporting" or "full-file credit reporting".

Research has shown that full file reporting has significant benefits over negative data. In simulation exercises carried out in some countries, the approval rates have increased by up to 88% when using full file reporting.

RBI has been rather proactive in adopting some of the global best practices of positive data sharing right from the inception. Even mature bureau markets like Brazil and Australia have started witnessing a move towards a limited positive data sharing environment only as late as 2013. Several other jurisdictions have also started evaluating the possibility of increasing the scope of credit reporting.

History of credit reporting in India

We have seen significant progress in strengthening the credit infrastructure in India since the advent of the first credit information bureau about a decade ago. The Credit Information Companies (Regulation) Act, 2005 (CICRA) was introduced to provide for the regulation of credit information companies and to facilitate efficient distribution of credit. Further, the entry of Foreign Investors, i.e. companies with an established track record of running credit information bureaus in well regulated environments was permitted. With the realisation that competition will bring better technology and efficiency in the system, four companies were issued "in-principle" approval to set up CICs.

Indian experience of credit reporting

Let me now briefly allude to some of the key patterns of bureau usage in India during the first decade of their existence. The bureau data has been primarily used in the retail segment, especially while approving credit cards, personal loans, home loans and auto loans. A major chunk of this has been accounted for by the private banks and foreign banks, with the public sector banks only recently starting to use them in a significant way. The credit reports have been the main product of use by banks. The banks have predominantly used inputs from the CICs during loan origination or for the occasional portfolio review and the use of value added products and services has been marginal and only recently started gaining importance.

Key challenges facing credit information companies

Let me now highlight some of the common challenges facing CICs today. If the CICs have to seize the opportunities that the future holds for them, they need to overcome these challenges and come up with effective solutions, particularly to the problems concerning the quality of available data.

(i) Accuracy of data

The quality of the credit reports and other products given to credit institutions is dependent on the consistency and quality of the data reported by financial institutions. In fact, reliable and accurate data is the foundation on which the edifice of a successful CIC business can be erected. Submission of inaccurate and incomplete data to CICs is a common occurrence which, in turn, leads to inaccuracies in the credit reports and resultant consumer disputes. Credit Institutions should put in place mechanisms to improve the quality of data captured in their source systems which will not only improve their own operations but, in turn, also translate into improved data submission. The issue of furnishing of timely and accurate credit information on their borrowers by the credit institutions has been engaging the attention of Reserve Bank of India. As you might be aware, RBI has set up a Committee under the Chairmanship of Shri Aditya Puri, Managing Director, HDFC Bank Ltd. to examine the available formats for furnishing of credit information by credit institutions to the CICs in respect of different sectors. Additionally, the Committee's mandate also includes suggesting best practices for the guidance of credit institutions in respect of usage of credit information as a part of their credit appraisal process.

(ii) Need for maintenance of up-to-date data

The CICRA mandates that the data should be submitted by credit institutions on a monthly basis. While most of the Scheduled Commercial Banks, large NBFCs and Housing Finance Companies are submitting data on a monthly basis, the co-operative banks and smaller

NBFCs submit data intermittently. The use of CIC inputs during the credit appraisal process at lending institutions can only be effective if the data is up-to-date.

(iii) Complete data

The CICRA mandates that credit information pertaining to all credit facilities should be reported. However, evidence suggests that due to limitations of use of technology in banking systems, entire data, often, does not get reported. Further, for certain banks, data gets rejected due to lack of proper identifiers like PAN, Passport, Voter ID, driving licence, etc. The incompleteness of data is observed not only in old or previously opened accounts but also in new accounts across various credit institutions. These gaps in data could lead to certain credit facilities not appearing in an individual's credit report, thus giving an inaccurate picture of his indebtedness/credit worthiness and, thereby, failing to achieve the very objectives for which the CICs exist. In order to ensure completeness of credit data, it is essential that data is collected on a regular and comprehensive basis from all institutions performing the lending function. This includes not just the commercial banks, but also the NBFCs, RRBs, co-operatives, including urban co-operative banks and rural co-operatives, etc. The ability of CICs to bring together all the pieces of the jigsaw would determine the utility of the resultant credit information. I again see a major role for the CICs here as they can assist banks in data quality diagnostics and data improvement based on their expertise.

I would like to emphasize that the job of CICs is not just to act as a collector and distributor of data. Instead, they need to fulfil the mandate of being a perpetuator of information literacy by processing the data collected from various sources into credible and usable credit information and by helping the users of information, both lenders and borrowers, to integrate this information into their decision making processes.

The CICs, I understand, receive raw credit data and provide processed credit reports only to entities that are enlisted as their members I have a fundamental question with regard to this practice. What if the customer has never sought any credit facility from the enlisted members of that CIC or, else, has a good credit history with them. The customer would, then, have a good credit report even when he might have been a defaulter elsewhere. A pertinent question to ask, therefore, is what is being done to address the issue of sharing of information across the CICs. I understand that in the mature markets like the US, there are institutions that generate credit reports about an individual by accessing databases maintained by all the three major CICs present there. I believe we would need to work out a similar mechanism if the objective of having CICs has to be fully served and the credit intermediation process in India has to become efficient. Let me emphasize that ownership of credit data should not be the basis of competitive advantage among CICs. Instead, innovations in the way the data is used and the value added services that CICs may provide based on the processed information ought to be the basis for seeking competitive advantage in this industry.

Another basic issue that needs attention is the availability of a unique identifier for individuals. We have instructed our banks to assign unique IDs to all their customers for easy identification and monitoring. I must admit, however, that the progress has been far from satisfactory. The magnitude of the problem gets further accentuated when it is considered on a system wide basis, especially when one takes into cognizance alternative sources of finance for individuals/companies in the shadow banking space. I believe that unless the individuals/entities are recognized with a unique identifier, for example, an Aadhaar (for individuals) or a Legal Entity Identifier (for entities), a work in progress under G-20 mandate at present, there would always be a shadow of doubt over the quality and accuracy of the credit reports and, consequently, a cause for discomfort for the lenders in using them for credit decision making. I would solicit your wholehearted support for the success of the initiatives of the Government and regulators towards introduction of a unique identifier through Aadhaar and the Legal Entity Identifier, as and when the latter becomes operational.

(iv) Consumer disputes

Another very important challenge for the sector is handling the consumer grievance. It is incumbent upon CICs to put in place a responsive public grievance redressal mechanism for swift and transparent redressal of grievances. In accordance with the CICRA, the credit information company can make correction, deletion or addition to the credit information only after such correction, deletion or addition has been certified as correct by the concerned credit institution. It is essential that both CICs and banks address consumer complaints in a swift, comprehensive and time bound manner as this would have repercussions for the potential borrower in accessing timely credit. Though the source of the data is the lending institution, CICs also need to adopt a proactive approach by taking up customer complaints with these institutions and working towards their expeditious resolution.

Way forward

With a decade having passed since the setting up of the first credit bureau in India, the time is appropriate for the industry to debate on how to take the business forward and how to ensure that it delivers on its critical mandate in the coming days. For me, the future for the CICs lies in greater innovation and offering more value added services. Leveraging on the data available with them, the CICs need to create and customize reports as per the needs of its user groups. As part of this, the CICs could give reports on industry sectors, geographic areas and also issue triggers/warnings to lenders on likely credit events. The CICs would progressively need to enlarge their information database by bringing more and more customer segments under their fold. Thus, besides focussing on individuals, midsize and large corporates, they must make efforts to build information on the credit histories of SMEs, NGOs, Charities, Not-for profit organizations, etc. In preparation for providing value-added services, the CICs would need to build elaborate databases on additional information not directly linked to the credit information. Other than broad basing their information system so as to include data from utility companies, retailers, etc., CICs may need to collate specific information like details of mortgaged assets, previous defaults, recoveries, write-offs, involvement in frauds or other criminal activities, etc. The value-added services by the CICs based on classified information mentioned above, would support more advanced risk management capabilities at the lending institutions.

I believe that data available at CICs can be effectively used by banks and financial institutions to assist in credit risk management at various stages across their customer's life cycle. Its use in customer acquisition and customer monitoring has been quite prevalent. With regard to customer acquisition, with technological advancement, the stage is getting primed for multi-bureau decision making. For credit exposures above certain threshold, reports from multiple bureaus could be considered while underwriting. At the monitoring stage, CICs can furnish a 360 degree view of customers, thereby enabling portfolio risk assessment and early warning triggers to identify and address delinquency. Further, at the collection stage, CICs can help entities in reaching their not so easily contactable base, thereby improving recoveries.

From a strategic perspective, CICs, which represent the collective aggregates of the banking industry, can be a useful source of benchmarking performance with respect to peer categories or the segment as a whole. CICs can also provide a geographical profiling of credit growth and delinquency that can help banks in deciding their expansion or consolidation strategy.

In the commercial segment, the use of the bureaus has not been to the same extent as in the consumer banking domain. SMEs are a big growth driver of any economy accounting for a majority of jobs and exports. Inadequate credit flow has been one of the factors constraining the growth of the SME sector. One of the reasons for banks' reluctance to lend to this group is the unavailability of reliable information for banks to assess the creditworthiness of SME units. In fact, contrary to popular perception, the levels of impairment in case of SME borrowers are far lesser than that in case of other larger borrowers. Hence, there is a strong case for providing greater credit to this business segment. Here, I see a significant role for the CICs in building an information base on SMEs and assisting banks in their credit decision making. I would urge the CICs to take urgent steps to bridge this information void and help facilitate flow of credit to SMEs, which would provide an impetus to the overall economic growth environment.

Identity fraud – an emerging threat and role of the CICs in combating it

According to the Norton Cybercrime Report 2011 more than two thirds of online adults (69 percent) have been a victim of cybercrime in their lifetime, and every second 14 adults become a victim of cybercrime, resulting in more than one million cybercrime victims every day. The situation is equally alarming in India. Fraud, especially in the banking domain, assumes great significance due to the associated reputational and monetary losses. Incidence of frauds can severely dent the confidence in the financial system, particularly at a time when we are trying to use technology as the medium to bring more and more of the excluded masses into the formal financial system. Fraudsters employ innovative ways of impersonating others using altered KYC documents. They also apply for credit at multiple banks at the same time by exploiting vulnerabilities in banks' systems and processes. Alternately, fraudsters can also apply for credit from the same bank at multiple locations assuming different identities.

While guidelines around KYC norms have been strengthened and the banks are being encouraged to provide unique customer IDs at the institutional level, the credit bureaus have capabilities to play an important role in preventing such frauds by providing a holistic view of the individual and highlighting the different variations of ID information, as provided to different credit providers. Also, data sharing mechanism amongst banks can help in identifying serial fraudsters by picking up inter-temporal and inter-bank inconsistencies of application data to provide an early warning mechanism to identify potential risk cases.

Further, in a robust KYC system, banks could consider using multi-database checks on an individual's identity at the time of underwriting that encompasses different identifier databases like UID, PAN, Voter ID, Passport, etc. This will help in rooting out many cases of identity frauds through fraudulent documentation.

From a consumer's perspective, CICs hold key information on the enquiries made towards obtaining credit. If a fraudster assumes someone's identity and applies for credit across institutions, this information can be transmitted to individual banks as triggers or warning signals. I foresee that the next wave of innovation would be around developing tools and analytics in preventing frauds arising from identity thefts and I am glad to note that the conference has devoted a session for deliberating on the issue of frauds.

Role of alternate data sources as supplement to banking data

The current banking policy places a lot of emphasis on financial inclusion. A key enabler tying up with the theme of financial inclusion is the information infrastructure and decisioning architecture necessary to bridge the information asymmetry divide for individuals who are first-time borrowers from the banking system. In order to reach out to individuals who never had any access to traditional banking channels or who have no credit footprint, some indicator of payment behaviour demonstrated by such individuals in their day-to-day lives need to be analysed during the process of underwriting. This could be the payment of utility bills such as water or electricity, telecom bill repayment, rental payments, healthcare payments, etc. These data sources are, typically, called alternate data which are supplements for banking repayment data. With alternate data, the coverage of people with some kind of payment history increases. Including alternative payment data is an effective method to build or restore/rebuild a good credit history, something which the industry could consider in the future as it evolves further and matures in terms of competitiveness and customer sensitivity.

From this perspective, low-score is always better than no score – Unscoreable persons are almost always rejected by mainstream lenders when applying for credit. For such people, many of whom might actually be credit-worthy, the sole recourse would be to borrow from the money lenders. By virtue of being scoreable, a person greatly improves his/her chance of entering the credit mainstream. Regulators across the globe have started acknowledging the role of alternate data sources in improving financial inclusion and, hence, bureaus in those geographies have started collecting non-traditional, non-credit data to augment the banking data.

Conclusion

Before I conclude, I must reemphasize that the Credit Information Companies have a herculean responsibility towards developing a vibrant credit market and spreading consumers' awareness about the importance of credit and its responsible use. Consumers need to be sensitized through awareness campaigns about the importance of credit information reports as a means for knowing their financial liabilities and about its importance in determining their credit worthiness. This is especially important for the young population who are new to the credit market. To my mind, the key deliverable for the CICs in the coming days would be to facilitate a smoother credit decision making process and, thereby, bring down the cost of financial transactions and credit intermediation in the banking/financial system for the benefit of the masses, especially for the retail and SME segments. A major spin-off benefit for the banking industry would be in terms of better quality of credit portfolio.

I believe that the next wave of financial innovation would be around providing financial services to a large section of the unbanked population. This would require presence of the necessary tools, techniques, processes, technology, infrastructure and enabling regulations. As most of the target population would be first time credit seekers, it would require an aggregation of information on credit proxies on these individuals. Scoring and evaluation techniques will follow. Banks, Insurance and Telecom companies will do well in making the best use of the presence of existing CICs in India, during their credit appraisal processes. CICs should, on their part, continuously remain engaged in innovation to support these entities at multiple levels through various value added services and products encompassing their customer's entire life cycle.

From the day's schedule, I observe that several technical sessions are lined up around improving the credit information mechanism and increasing its usage. I hope today's Conclave helps in generating awareness and throws up practical ideas on the subject. I am hopeful that committed entities like Experian, through their linkage with the overseas parents and also backed by experience gained in matured markets, would be able to bring in technical knowhow and expertise into India and, in the process, ensure availability of easier, quicker and cheaper credit for the people at the bottom of the pyramid. I once again thank the organisers for inviting me and giving me an opportunity to share my thoughts with you. I wish the conference deliberations all success.

Thank you!

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