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**Credit Reporting and Financial Information
Infrastructure in Colombia: An Action Plan**

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Credit Reporting and Financial Information Infrastructure in Colombia

Building on Past Success to Achieve Excellence: An Action Plan

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Abstract

This paper analyzes the current state of credit reporting and financial information infrastructure (FII) in Colombia and presents specific recommendations to reform, strengthen and extend the system. Suggested reforms include the establishment of a legal and regulatory framework following international good practice guidelines, extending the scope of information available in the market (especially data relevant for microfinance and small business), improving access to credit scoring and other decision tools and strengthening public outreach and education efforts to familiarize consumers and other key constituencies (press, legislators, etc.) with the role of credit reporting and FII in a modern financial system. This paper is part of a series on financial sector reforms managed by the Latin America Region of the World Bank in cooperation with the Colombian Ministry of Finance.

* This document reflects several years of dialogue with Colombian authorities on credit reporting and FII and also incorporates findings from sector work sponsored by the World Bank. Research for this paper was undertaken during an October 2005 mission. This document also reflects the findings of a World Bank led mission to Colombia in November 2004 under the Western Hemisphere Credit Reporting Initiative (WHCRI, www.whcri.org) and on the report “Improving Access to Credit for SMEs: An Empirical Analysis of the Feasibility of Pooled Data Small Business Credit Scoring Models in Colombia and Mexico” by Miller, Margaret and Rojas, Dina. This paper benefited from comments from Augusto De la Torre, Leora Klapper, Giovanni Majnoni and Andrew Powell. The opinions expressed do not necessarily reflect those of the World Bank, its Executive Directors, or the countries they represent.

Table of Contents

Executive Summary	2
I. Introduction	6
II. Description of Colombia’s Credit Reporting System and Financial Information Infrastructure	9
III. Assessment of Colombia’s Credit Reporting System and Financial Information Infrastructure	14
Overview.....	14
Legal and Regulatory Framework	14
Data Availability and Quality	19
Improving Data Quality in the Microfinance Sector	20
Improving Data Quality in the Small Business Sector	20
Improving Data Quality in the Public Sector.....	21
Strengthening Credit Decision Tools.....	23
Public Perception of System	24
System Oversight	25
IV. Recommendations	26
Legal and Regulatory Reform.....	26
Data Quality and Data Tools.....	26
Improving Public Perception	27
Role of the Public Authorities and Cooperation	28
Appendix 1. Principles for Credit Information Systems	29

Figure and Tables

Figure 1. Use of SBCS in Brazil, Colombia and Mexico, 2005	23
Table 1. Elements of Financial Information Infrastructure.....	9
Table 2. Monthly Consultations to Private Credit Bureaus for Selected Countries	11
Table 3. Credit and Loan Reporting Institutions and other Relevant Databases for Credit Activities.....	12
Table 4. Index of Financial Information Infrastructure for Selected Countries	20

Executive Summary

Credit reporting is at a critical juncture in Colombia. Public policies adopted toward the sector will be critical in defining whether progress is reversed, at considerable cost to the financial market and economy, or whether the credit reporting system, and broader financial information infrastructure, further develop the quality and availability of data required to make Colombia a leading regional, and even international, example of best practice.

Credit reporting is an integral part of Colombia's financial system. The private credit reporting industry in Colombia has been in place for more than 20 years¹. Millions of dollars have been invested in developing reliable databases and tools to exploit them, and banks and other *lenders obtain millions of credit reports each month* to support their risk assessments and lending decisions. Other important sources of data include the public credit registry managed by the Superintendent of Banks and Financial Institutions and the firm data collected & distributed through Chambers of Commerce.

The most significant challenge to the further development of credit reporting in Colombia is the absence of an adequate legal and regulatory framework. Consideration of a new law to govern credit reporting is at the forefront of the current policy debate. How lawmakers balance consumer demands for privacy and for leniency relating to negative data with the needs of the economy for information and transparency will be a major factor in determining the future direction of the industry. Specific recommendations related to the content of the law, based upon international good practices, are presented in this document, including an abbreviated version below in this Executive Summary.

The public policy agenda for credit reporting and financial information infrastructure must, however, extend beyond legal reform. Other priorities for public policy include the following: (i) increasing the coverage of the credit reporting system beyond the 25% of the population who already have credit files (with a focus on marginal borrowers such as low-income consumers and micro and small enterprises); (ii) strengthening data sources including some public sector data; (iii) promoting expanded use of analytical tools to make better use of credit and financial data; and (iv) educating consumers about their rights and responsibilities with respect to credit reporting and communicating with key constituencies (press, legislators, academics, etc.) about the importance of credit reporting and other aspects of financial information infrastructure in a modern financial system.

Recommendations for Legal and Regulatory Reform:

Pass a law to provide a clear legal and regulatory framework for credit reporting. The key elements of the legal framework should include the following international good practices:

- Maintaining data for a reasonable time period – at least five years;
- An obsolescence provision which enables consumers to make a fresh-start and erase

¹ CIFIN, operated by the Bank Association, and the privately owned firm Datacrédito, are the two main credit reporting firms in Colombia. They received data from commercial banks and other financial institutions and commercial firms.

- negative data once the time period for maintaining it (point a above) has been reached;
- Developing an effective strategy for alerting data subjects to problems associated with their report which balance the cost of notification and consumers' need to review their data – adverse action notification is recommended; (i.e. where consumers receive notices when they are denied credit based, at least in part, on information in their credit report rather than notification every time positive or negative data is reported);
 - Establishing broad rules for who has access to the data and under what circumstances;
 - Providing consumers with effective and actionable protections under the law including means to access their own data and dispute resolution mechanisms which are appropriate for consumers with varying levels of education and access to technology; and
 - Developing a regulatory structure capable of system supervision. The law should specify the instruments and mechanisms which regulators will have for supervision of the credit reporting industry including tools such as the ability to bring court cases on behalf of a class of plaintiffs, to require external audits, to require reports and access to the database, and to specify penalties and sanctions.

Recommendations for Improving the Quality and Usefulness of Credit and Financial Data

Promote the development of credit and financial data from the microfinance sector. Specific actions to take include the following:

- Clarify the legality of sharing credit data by microfinance institutions in the credit reporting legislation discussed above;
- Implement a standard consent clause for data sharing in microfinance contracts; and
- Reinvigorate the initiative in the Ministry of Commerce, Industry and Tourism to create a microfinance credit bureau and other similar efforts to encourage data sharing on microfinance clients.

Strengthen information on trade and supplier credits which provide vital information on micro and small enterprise payment behavior. Specific actions include:

- Establish a protested documents registry where non-payment of invoices and other firm to firm credits could be formally filed, such as exists in other countries in the region; and
- Develop a strategy to educate firms about the value of sharing trade credit data.

Modernize and strengthen public data sources important for risk evaluation. Specific improvements include:

- Strengthening corporate registry data collected by the Chambers of Commerce, including both modifications to the reporting format and clear rules on access to the information;
- Establish a moveable collateral registry;
- Reform of the fixed asset collateral registry to streamline filings and queries; and
- Increased access to some basic court data.

Encourage the development of analytical tools to make better use of credit and financial data including, in particular, small business credit scoring (SBCS) tools and other empirically derived tools for micro and small business lending and microfinance consumer loans. Specific actions include:

- Encouraging the development of pooled-data SBCS models, which are created using data

- provided by multiple financial institutions and which were shown to be feasible in Colombia by a recent World Bank study (participation of government owned banks in a pooled-data SBCS project would be one way to promote this kind of valuable tool);
- Building upon small business models being developed by the Superintendent of Banks and Financial Institutions as part of the move to risk based supervision; and
 - Reviewing experiences to date with decision tools in the microfinance sector to identify weaknesses in the data and develop strategies to strengthen the predictive power of the information.

Develop outreach and education activities for smaller banks, non-bank financial institutions and other credit-granting firms to acquaint them with the appropriate use of automated lending technologies and decision tools such as credit scoring.

Recommendations to Improve Public Understanding and Support for Credit Reporting

The credit reporting industry in Colombia (credit reporting firms and creditors) should consider funding a joint public relations campaign to inform the public about the role of credit reporting in the country's financial system. The objective of the campaign should be to increase awareness among consumers of the value of establishing a positive credit history and the specific steps they can take to build a positive credit history and avoid or reduce the impact of negative information. It must be recognized, however, that no public outreach campaign will be successful until the system is truly transparent to consumers and their rights are fully enforced.

Credit reporting firms should increase the transparency of the services they offer to protect consumer rights. Web sites should give clear and easily accessible information about consumer rights with respect to accessing and disputing information in their credit reports, who may access their credit report and under what conditions, etc. Other communications mechanisms should be sought for segments of the population who do not have widespread access to the internet.

The credit reporting industry should consider adopting common policies and procedures for their interaction with consumers to simplify consumer participation in the system. At a minimum, adopting similar procedures for requesting copies of credit reports and disputing information should be considered. An example of even greater cooperation that could yield beneficial results would be the formation of a common call center to receive and route customer inquiries and disputes could be established and maintained by the credit reporting firms.

Recommendations on Public Oversight, Cooperation and Strategy for Credit Reporting and Financial Information Infrastructure

The Superintendent of Banks and Financial Institutions should coordinate efforts to develop credit reporting and the broader elements of Colombia's financial information infrastructure with other institutions in both the public and private sectors. Initially, the Superintendent needs to focus their energies on establishing a basic regulatory capacity and working with the other legally identified regulators, if any exist, for credit reporting. Once the basic institutional capacity for regulating the industry is established, it would be advisable for the Superintendent to take a leadership role on the reform agenda for credit reporting, via an advisory committee. Developing a strategy on

strengthening public data, enhancing consumer protections and consumer outreach activities and contributing actively to the legislative debate on this topic are several of the objectives of enhanced cooperation among authorities.

I. Introduction

1. **Credit reporting is at a critical juncture in Colombia. Public policies adopted toward the sector will define whether progress is reversed, at considerable cost to the financial market, or whether the credit reporting system further develops the quality and availability of data required to make it a leading regional, and even international, example of best practice.** Over the past 25 years, Colombia has developed a private credit reporting industry, a public credit registry in the Superintendent of Banks and a variety of other important financial and commercial data in both the public and private sectors. Lenders and businesses have come to rely upon credit reports to evaluate customer risk. There are still many types of financially relevant data, however, which remain incomplete, underdeveloped and/or inaccessible. Tools to analyze the data, such as credit scoring programs, have only recently begun to be adopted by any but the largest and most sophisticated banks and firms. Credit reporting is also viewed negatively by many Colombians. Popular perception of the industry is that of a black list that limits opportunities for credit or business rather than a valuable tool to document good payment behavior and facilitate credit and trade.

2. **The absence of an effective legal framework makes the further development of credit information especially vulnerable.** Consideration of a new law to govern credit reporting is at the forefront of the current policy debate. How lawmakers balance consumer demands for privacy and for leniency relating to negative data with the needs of the economy for information and transparency will be a major factor in determining the future direction of the industry. Achieving balanced legislation will be particularly challenging given the negative perception of the industry in the population and limited understanding of the vital role these information systems take in modern finance.

3. **Legal reform is only one aspect, however, of the policy agenda for credit reporting and financial information. Other issues include** developing credit data on a broader subset of the population (esp. micro and small enterprises and low-income consumers) so they too benefit from credit histories, strengthening data in the public sector, such as court records and collateral registries, improving access to firm-level financial and payment data, and promoting expanded analysis and use of credit and financial data including via the implementation of automated decision tools such as credit scoring. Finally, education and outreach activities will be critical for creating support for a reform agenda in key constituencies (consumers, bankers, lawmakers, journalists, etc.) and public acceptance of increased transparency and responsible information sharing by lenders and firms.

4. **The further development of credit reporting and financial information is important for increasing access to credit and other financial services in Colombia.** When compared to other countries in Latin America, Colombia presents a mixed picture, with some market segments (finance of consumer durables) and some payment mechanisms (checks) well-developed while others (SME finance – factoring, leasing) lag behind. While access to credit information is not the only explanation for these differences, the evidence suggests it is a contributing factor. For example, many retailers and service providers contribute payment data on their customers to Datacredito and obtain information from that source, enabling them to offer consumer financing. Access to credit for small businesses, however, is much more constrained.

Although short-term credit is available to companies in good standing through commercial banks and Commercial Finance Companies (CFCs), demand for loans outpaces supply. Medium- and long-term financing is scarce, often restricted to foreign companies and local blue chips. Unlike some other developing countries in Latin America, factoring and credit granted by suppliers are not substantial financing sources. This may be in part due to the absence of information on inter-firm payments and the lack of mechanisms for registering non-payment, such as registries for contested documents (protestos), which are common in other Latin American countries. Microcredit is also underdeveloped in Colombia and information on this market segment is also limited.

5. The development of a country's financial information infrastructure (FII) contributes to three important development objectives: economic growth, sound and sustainable financial institutions and greater access to credit (discussed above for the specific case of Colombia). Research by the World Bank and others has shown a relationship between the extent of development of credit reporting in an economy and private credit to GDP². Research has also shown that firms are more credit constrained in economies with less developed credit information systems³. Credit reporting activities also address a fundamental problem of credit markets, asymmetric information between borrowers and lenders. By documenting a borrower's payment behavior and other relevant information, credit reports make it possible for lenders – and bank supervisors - to more accurately predict risk. With more accurate risk assessments, lenders can increase access to credit and reduce the price. In terms of supervision, risk-based models provide opportunities to adjust capital and provisioning levels so as to strengthen system soundness. By sharing information on who is not paying, lenders increase the cost of non-payment and strengthen the incentives for reputable behavior. At least as important, however, is the ability of the system to develop positive data (information indicating a person or firm is faithfully discharging a loan or paying bills in a timely fashion). Positive data is a powerful indicator of willingness to pay and can help open doors to credit and services which would otherwise be closed to low-wealth, low-income individuals and small or micro enterprises. Credit reporting thus helps to democratize credit markets and improve access to finance.

6. However, the development of FII is not without controversy. A major concern is violation of an individual's privacy, via transmission of sensitive information among unauthorized third parties. Financial intermediaries in many countries are also loathe to lose their "information rents" from their exclusive knowledge of their customer base and invoke bank secrecy laws to discourage the development of credit registries. Very dominant lenders may believe they have more to lose than to gain by sharing their data, having benefited from "information rents" related to their substantial knowledge of their clients' payment and business histories. The challenge is to move these financial institutions toward more modern, competitive business models where they grow the market, view information as a tool and compete on the basis of service, product quality and price. Delinquent borrowers can also be a powerful lobby against increased financial transparency. In some instances delinquent borrowers may organize

² See Djankov, McLiesh and Schleiffer (2005), "Private Credit in 129 Countries".

³ See Love and Mylenko (2003) "Credit Reporting and Financing Constraints", World Bank Policy Research Working Paper No. 3142, October. And Galindo and Miller (2002), "Can Credit Registries Reduce Credit Constraints? Empirical Evidence on the Role of Credit Registries in Firm Investment Decisions", Paper Prepared for the Annual Meetings of the IADB, Santiago, Chile, March.

to try to obtain financial relief. The reputation of credit registries has also suffered in nations where data quality is poor and consumer protections are either limited or nonexistent; some registries are plagued by inaccuracies, others have a narrow scope so only a partial picture of a person or firm's debt situation is possible, still others are relatively new and have limited historical data on which to base credit ratings.

7. **As a result, concerns with the use of credit reports and other financial information can create obstacles to their development and expansion.** For example, lenders who are unfamiliar with credit reporting and who have limited capabilities for risk analysis tend to be overly cautious when first using credit reports. They may interpret any negative information as reason for rejection. If these policies are widely applied by lenders then there can be short-lived credit constraints and popular resentment and distrust of the system. However, over time, the increased availability of credit data leads to better risk analysis and the ability to expand lending. In a similar vein, if the system includes even minor payment infractions, such as being one or a few days late for paying a bill, consumers may view this as an unnecessary and un-called for intrusion into their private affairs. Data should focus on real risks, such as more serious delinquencies (30 days and more) in most cases, with microfinance being an exception due to the very short maturities in that market. It is also vitally important to insure that sensitive data are maintained in a secure environment and provided only to authorized users, so as to limit opportunities for misuse such as fraud, identity theft and other criminal activities.

8. **There is a public policy role for creating the adequate incentives for credit information sharing to overcome some of the obstacles, mentioned above, for the development of the FII.** The sharing of credit information generates significant externalities for the financial sector and other economic sectors and increases access to credit. On the other hand, the lack of information sharing and coordination failures due to the existence of conflicts of interests (and information costs) as well as the intermediaries' unwillingness to cooperate can lead to "sub-optimal" equilibria in the organizational arrangements which affect the system's reliability and efficiency. These are the reasons why in many countries the authorities' involvement in the credit reporting area is an integral component of their overall mandate to ensure stability of the financial system and access to financial services. In this context the authorities (central bank, banking supervisor, Ministry of Finance, etc.) perform a number of different functions in their national credit reporting systems. These functions may include direct involvement in managing public credit registries and in supervising the systems. The role of the authorities is particularly relevant to ensure an adequate legal and regulatory framework, a competitive environment for private credit reporting activities, efficient operation of public databases and an adequate level of consumer protection.

9. **The rest of this paper is organized as follows.** Section II presents a brief analysis of the current status of credit reporting and FII in Colombia including basic statistics, comparisons with other countries and a description on how the system is currently used. Section III undertakes an assessment of credit reporting and FII including issues such as coverage, information sharing, right to privacy, positive/negative information, data obsolescence, scoring tools, etc. Finally, Section IV presents some recommendations for the key areas identified: legal and regulatory reform, data quality and tools, improvement of public perception and role of the public authorities.

II. Description of Colombia’s Credit Reporting System and Financial Information Infrastructure

10. **Financial Information Infrastructure (FII) is the broader context in which the credit reporting systems, and private credit bureaus, operate.** Thus, the analysis of the FII in a country needs to go beyond the private credit bureaus, and include other private and public institutions which provide credit and financial data on firms and individual consumers. There are also public data sources, such as court records, identification information, collateral registries and corporate registries, which are vital sources of data for private sector credit reporting firms. In addition, understanding the legal, regulatory, supervisory and, in general, institutional environment in which these systems are operating is vital to a sound approach to their development. The technical infrastructure, including telecommunications infrastructure, state of computerization and automation by providers and users of the data and the level of development of tools to use the data, such as credit scoring technologies, are also elements of FII. Last, but not at all least, public perception, understanding and support of credit reporting and FII are critical inputs to the development of these systems. Table 1 below presents a summary of the various elements of FII, and the rest of this section addresses the status of these FII elements in Colombia.

1. Institutions	Institutions and firms which collect and distribute credit information (i.e. private credit bureaus, public credit registries, business credit information suppliers, etc.)
2. Legal and regulatory framework	Legal and regulatory framework that allows for sharing credit data and other data relevant for predicting risk while respecting privacy issues.
3. Banking supervision & market oversight	Use of credit information in banking supervision, broader policy considerations related to development and use of credit and related data (effect on competition for the financial system, competition in the market for credit reports, access, etc.)
4. Tools	Analytical tools which facilitate the analysis of financial data, such as credit scoring
5. Public sector data	Public databases which are important for predicting risk and which can contribute to credit reports (i.e., collateral registries, court records, corporate registries, etc.)
6. Technical infrastructure	Telecommunications, MIS and data processing capabilities, quality of data security, etc.
7. Public perceptions & support	Understanding and support for credit reporting by consumers, business associations, press, legislators, etc...

11. **In terms of credit reporting *institutions*, Colombia has a competitive market, with many private firms providing credit information and other financial data on both firms and individual consumers.** Colombia has two private credit reporting companies, CIFIN, owned by the Bank Association and Datacredito, a privately held firm with no ownership by financial entities. These firms have data from banks and non-banks including retailers and

service providers, and report on both firms and consumers. The Superintendent of Banks also collects extensive credit data in the public credit registry, for the primary purpose of supporting supervision. There are also other providers of business information, which include credit and financial data in their reports when available. These include Byington (a D& B affiliate) and the credit insurance firms Coface and Informa. For small retailers, FENALCO provides significant data (much of it related to check verification and returned checks) and COVINOC has data assembled from its collection activities. While all of these institutions provide important data for financial and commercial transactions, CIFIN and Datacrédito are the main sources of credit information for the banks and other financial institutions and thus will be analyzed in greater depth.

12. **CIFIN: The first centralized credit information system to be established in the country was the *Central de Información Financiera* (CIFIN), owned and operated by the Bankers' and Other Financial Entities Association of Colombia (Asobancaria).** CIFIN was established in 1980 as a service for commercial banks represented in Asobancaria to share the payment histories and behaviors of bank debtors. CIFIN initially began collecting only negative payment data. Over the years, CIFIN has expanded its database to also include positive payment data and has broadened its scope so that it now receives and provides data from/to firms in the real sector of the economy and not only from/to members of Asobancaria. At the end of 2004, CIFIN's database comprised approximately 41 million records covering 11.5 million individuals and 1.7 million firms. CIFIN currently receives information from all commercial banks as well as from other regulated financial institutions, "solidarity" institutions (e.g. credit cooperatives), insurance companies and real sector firms. CIFIN is particularly strong in terms of data on firms. CIFIN has an agreement with Experian for the provision of some credit scoring tools and has recently established an agreement with CONFECAMARAS to provide data for a new small business scoring tool.

13. **Datacrédito: Datacrédito is a privately owned credit reporting firm which initiated operations in 1982.** Traditionally its focus has been on consumer credit data and it began by collecting data from credit card issuers and real sector credit grantors. Even today, Datacrédito's relative strength is seen to be in its consumer database. Beginning in 1995 Datacrédito began to receive data from regulated financial institutions and now includes data from all banks. Datacrédito has information on approximately 8.5 million individuals and about 350,000 firms and collects both positive and negative information. In 2001 Datacrédito initiated a joint venture with the international credit reporting firm, TransUnion. The main result of this alliance so far has been the creation of TransData, a firm that develops and markets predictive models of credit behavior for different economic sectors.

14. **The two main credit bureaus in Colombia, CIFIN and Datacrédito, have similar modes of operation.** Both receive data on a monthly basis from financial institutions and other data providers. Data is received electronically. Consistency checks are performed on the data to identify data quality problems. Banks can request information from the bureaus via on-line systems. Some lenders have automated loan procedures that automatically pull data from the bureaus as part of the credit assessment process. In other cases, institutions request files on a case-by-case basis. Retailers and service providers have similar arrangements, where data can be

requested on-line using secure technology. The main data which are collected are name of the individual or firm, address, ID number, and payment information.

15. **The two main private bureaus also have similar policies on access to the information in their databases.** In terms of the banking sector, decisions of the Constitutional Court require customer approval in writing for providing data and obtaining access to the credit bureaus. This approval is part of the typical credit application signed by customers and is maintained by the banks. From an operational point of view, banks are able to request data on any customer, as long as they can provide sufficient information on the customer so as to process the request. In the retail sector, there are no bank secrecy laws or specific judicial guidance on the form of communication required with customers so provision of data and access to data as part of a commercial relationship typically involves less disclosure. Datacrédito does not require that firms provide information in order to be able to access their data. In the case of CIFIN, only lenders who provide data are able to access the database.

16. **The financial sector relies heavily on information from the credit bureaus in Colombia, as can be seen by the reasonably high level of monthly consultations to the two databases.** In Table 2 below, the level of usage of the two Colombian private bureaus is compared with experiences of private bureaus in other countries in the region and internationally. CIFIN reports approximately 600,000 consultations per month, virtually all of which are from the banking sector. Datacrédito has a significantly more elevated number of consultations, 2.2 million, with roughly half of these coming from the real sector and half from banks and other financial institutions. These levels compare very favorably with other regional experiences, especially when the size of the population is factored in. For example, in Argentina the number of monthly credit reports is equivalent to less than 1% of the population and in Mexico the corresponding figure is 1.5%. However, when compared with developed countries like Spain (6.5 million inquiries monthly, equivalent to 16.7% of the population) the potential for growth is obvious. This is especially true when considering that Spain has developed private credit reporting within the last decade. Comparison with the U.K. makes the potential for growth in Colombia even more apparent. In the U.K. there is long tradition of using credit reporting data extensively for both financial and commercial transactions and a correspondingly high level of use, (51 million consultations per month, equivalent to approximately 85% of the population).

Table 2. Monthly Consultations to Private Credit Bureaus for Selected Countries

Country	Monthly Consultations	Monthly Consultations / Population
Argentina	300,000	0.8%
Mexico	1,500,000	1.5%
Spain	6,500,000	16.7%
United Kingdom	51,000,000	85.0%
Colombia – CIFIN	600,000	1.4%
Colombia – Datacredito	2,200,000	5.2%
Total Colombia	2,800,000	6.7%

Source: World Bank, Financial Sector Indicators (FSE-OPD)

17. **There is also a public credit registry in Colombia, established in 1990 by the SB.** Regulated financial institutions are required to report both positive and negative information on

all their borrowers (consumer and commercial) on a quarterly basis to the *Central de Riesgos Superintendencia Bancaria* (CR-SB). The main function of the CR-SB is to support bank supervision. It does not work as a credit bureau as the data entered into the CR-SB system by supervised institutions is used solely by the SB and is not redistributed to reporting institutions, however, it is available to the private credit bureaus. The SB is now using the data in this public credit registry to develop credit risk models to be used in the move to risk-based supervision.

18. **Data collected by the public sector are an important input to Colombia’s credit reporting system.** In terms of firm-level data, the information collected by the local Chambers of Commerce, which belong to the Confederation of Chambers (CONFECAMARAS) is very valuable and is now available in an on-line network of 57 Chambers nationwide. The collection of this data is mandated by government and covers approximately 70,000 private firms, many of which provide some limited financial disclosure on an annual basis. As with most commercial registries, the data also include basic firm information such as business line, contact information, ownership and management structure. Real estate registries also exist at the municipal level and collect data on title and ownership necessary for secured lending transactions. As of 2004, 76 out of 190 real estate registries in Colombia were partially automated and the rest were manually operated. Queries of information in these registries, which are local and are not connected through a network, must be performed in person in the corresponding municipal registry. Data from court proceedings is available via a private service known as the Boletín Judicial. This information is used by lenders but is not included as part of the private credit bureau reports. Table 3 below summarizes the primary institutions which provide credit information and other relevant data for financial and commercial transactions in Colombia.

Table 3. Credit and Loan Reporting Institutions and other Relevant Databases for Credit Activities

	Name	General Description
Private Credit Bureaus	CIFIN	Owned by the Bankers’ Association (Asobancaria). Is a not-for-profit organization. Traditionally focused in bank customers, although in recent years expanded to all sectors.
	Datacrédito	Traditionally focused in consumer data provided by non-regulated financial entities. In recent years expanded to all sectors, including banking institutions.
Public Credit Registries	CR-SB	Credit information database of the SB. This database does not function as a credit bureau, i.e., financial institutions do not obtain credit reports from CR-SB.
Business Credit Reporting Firms	Byington, Informa, Coface	These firms assemble reports on Colombian businesses on a one-off basis.
Other Databases		
Judicial System Databases	Boletín Judicial	A private firm that gathers public and some private information on judicial proceedings
Real Estate Registries	Municipal registries	There are 190 real estate public registries in the country.
Commerce Registries	Commerce registries	These are managed by Chambers of Commerce, which are private bodies for whom the government delegated this responsibility.

19. **Colombia does not have a separate microcredit credit bureau, but some microcredit data is collected by the main credit bureaus.** More than thirty microcredit institutions provide

data to Datacredito on the payment performance of their clients, including some of the largest microlenders. There are still many micro lenders, however, who do not share this information. In some cases, microfinance institutions lack the record keeping and technology to easily report on their clients' payment behavior. The microlending industry also has yet to include a consent clause for information sharing in lending contracts as a standard business practice, as is the case in the commercial banking industry. Other sources of data on microlending, such as information from firms that sell to microenterprises or utility data, remain undeveloped.

20. **Credit scoring tools, to make use of credit and other financial information, are available in Colombia and are used primarily for mass consumer markets such as credit cards.** Credit scoring tools were introduced to the Colombian market about ten years ago. Today both CIFIN and Datacredito offer credit scoring tools, including bureau scores. CIFIN has a relationship with Experian for some of their decision tools and Datacredito works with TransUnion for some of theirs. In addition, there are independent firms, such as LISIM (a Colombian firm) and Fair Isaac (an international firm), which offer credit scoring tools to lenders and firms in the market. Most credit scoring tools are focused on mass markets, such as credit cards. Smaller lenders and firms still make limited use of these tools. In some market segments, such as SME lending, credit scoring technologies are still only used by the largest lenders.

21. **Regarding the legal and regulatory framework, article 15 of the 1991 Colombian Constitution, commonly referred to as the *habeas data* provision, recognizes a right to know, update and correct information pertaining to oneself in both private and public sector databases.** It further states that the collection, analysis and distribution of data must respect the freedoms and other guarantees provided in the Constitution. These general principles have not been defined, however, in subsequent laws, leaving interpretation of data protection rules in Colombia to the Constitutional Courts. Between 1992 and 2003 there were more than 100 rulings of the Constitutional Courts involving *habeas data*. The jurisprudence on this topic created by the Courts provides some limited guidance to the private and public sector on how databases may be operated but does not provide clear and fast rules. As a result, there are frequent legal challenges, which have led the Courts to request that Government pass a data protection law. There have been numerous attempts at legislation since the Constitution was established but none has yet been successfully adopted.

22. **Due to the lack of a statutory law and the absence of a defined regulator, there is currently no proactive oversight or enforcement of credit reporting firms' activities.** Consumers who believe their rights have been violated by credit reporting agencies have only one official channel open to them, the *tutela* process. A *tutela* is a judicial process established in the 1991 Constitution, Article 86. The process is open to all consumers and does not require a lawyer. It has the advantage of being quick, as no more than 10 days may pass before a *tutela* is requested and resolved, and no more than 20 days for an appeal by either party. The process, however, is unpredictable. Judges are not obligated to have expertise on the subject matter, nor obliged to rule consistently with previous rulings. Datacrédito and CIFIN report that they are each obliged to participate in an average of eighty to one hundred *tutelas* each month, most of which they say are decided in their favor.

III. Assessment of Colombia's Credit Reporting System and Financial Information Infrastructure

Overview

23. **Colombia has developed many sources of financial and commercial data, in both the private and public sectors, however, the broader framework for the country's financial information infrastructure (FII) is still weak and threatens to slow or even reverse further development of information sharing.** We saw in the previous section that there is a competitive private credit reporting industry which provides millions of reports monthly to lenders and firms in the Colombian economy. This industry is unregulated, however, and lacks a legal framework to provide guidance on its operations and protection from superfluous lawsuits. The adoption of a law to govern sharing of credit and financial data and other related personal information is one key issue which will determine the extent and pace of further progress in credit reporting and FII but it is not the only one. In order for the credit reporting system to promote more widespread access to finance, and improved risk management, policies are needed to promote more complete coverage of lower income consumers and micro and small firms. This involves upgrading the data collected on borrowers and consumers as well as the tools, such as credit scoring, which are used to analyze this information. For progress to be made, the credit reporting system must also respond to consumer concerns and effectively balance economic incentives for access to data with individual privacy rights. Otherwise, negative public perceptions could derail an appropriate legal reform and reduce willing participation of lenders, retailers and service providers in the system.

Legal and Regulatory Framework

24. **The outcome of the pending legal reform for credit reporting will be a key determinant of the direction that credit reporting takes in Colombia.** If the new law unnecessarily limits access to information or otherwise increases the cost or complexity of information sharing, this could reduce the ability to use reliable credit data for risk assessments in a variety of transactions, both in the formal banking sector and in other lending and commercial relationships. The inability to again come to agreement on a law would also be a setback in that the industry would have to continue working in an uncertain and sometimes hostile legal framework and consumers would continue to lack basic protections. By comparison, a sound and well-balanced legal and regulatory framework would contribute to the continued development of the industry and would reassure consumers that their rights would be respected.

25. **In Colombia, much is at stake with the legal reform efforts since the system has been in place for more than 20 years, millions of dollars have been invested in developing reliable databases and tools to exploit them, and banks and other lenders depend on this information *daily* to support their risk assessments and lending decisions.** There is a risk that adoption of an overly restrictive law could erode the quality of the current system, reducing the value of the data for risk analysis. Credit bureaus, as well as banks and firms, have made significant investments in developing the credit reporting system and in developing lending technologies which require credit data. A poor legal framework would have immediate negative

economic consequences for these institutions. Moreover, a law which causes deterioration in the quality and availability of credit information would imply lost economic opportunities for many potential borrowers and consumers.

26. Tensions between consumer privacy concerns on the one hand, and the economy's need for timely and reliable credit data on the other, have frustrated adoption of a law for habeas data and credit reporting for years. Since the adoption of the 1991 Constitution, there has been a vigorous debate in Colombia related to what is the appropriate legal framework for the habeas data provisions and, by extension, what limits should exist on the operations of credit bureaus. These tensions are based on fundamental differences with respect to key issues such as what constitutes private information and what role information has in a modern credit economy. For example, privacy advocates have argued that payment data which is contained in a credit report is of a personal nature and should enjoy safeguards on distribution such as exist for medical information. There is no doubt that credit data are sensitive in nature, and few, if any, systems in the world make these data readily available to the general public. However, if access to credit data is overly restricted, and if borrowers, especially those in bad standing, are able to limit access to this information, how then can lenders hope to accurately assess and price risk? On the other side of the debate are those who view the circulation of one's payment data as a necessary part of participation in a modern credit economy. Without basic payment and financial data, lenders are unable to accurately assess and price risk, limiting access to credit and increasing the cost for those who are able to get loans. In countries without credit reporting, lenders are forced to rely on arguably more intrusive methods to assess credit risk such as visits to the borrower's home or business, detailed review of bills and tax documents, character references and co-signers on loans.

27. Several draft laws, representing different views on consumer protection and credit reporting, have been developed during the current Congressional session in Colombia. At this point in Colombia, the legal debate has moved beyond the basic tensions cited above, i.e. "privacy vs. transparency". The important role of credit reporting in the economy is accepted in all of the recent draft laws put before Congress and the focus is on how the bureaus operate including issues such as consumer notification and length of the historical archive. Since Congress entered into its current session, three separate draft bills related to credit reporting have been developed, but none has yet to be formally presented and discussed⁴. Two of these projects are broad data protection laws, with specific sections focused on financial information and credit reporting. A third project focuses narrowly on the amount of time that information may be maintained by credit reporting firms. At the time of this writing, sponsors of these separate bills have agreed to merge them into a single draft law, focused on financial and credit information databases.

28. The consolidated draft law, which has been produced in Colombia, negotiates many of the trade-offs between the previous bills relatively well, but there are still areas of

⁴ The Ministry of Finance (Hacienda) was the primary sponsor of one of the draft data protection laws. The draft law was developed by Hacienda and a group of interested legislators with input from the Superintendent of Banks, the Bank Association and private credit reporting firms. The other draft law on data protection was developed by the Office of Consumer Advocacy (Defensor del Pueblo). The third law was sponsored by an individual congressman and focuses solely on the amount of time data can be maintained.

concern, which are discussed in some detail below. The law addresses the rights and responsibilities of data providers and users, private credit reporting firms and data subjects. It also describes the regulatory framework for this industry and establishes dispute resolution mechanisms for consumers to protest data they consider to be inaccurate. In terms of consumer protections, there have been discussions about requiring consumer notification before negative information can be included in the report. This is a relatively costly and burdensome approach and is potentially less useful than other consumer protection mechanisms such as adverse action notification and requiring reports to include data on who has previously accessed a credit report to help detect fraud or misuse of the data.

29. **Obsolescence, or the period of time that data can be maintained in a credit report, is a key aspect of the current debate.** The consolidated draft law states that data can be maintained up to five years after the date when the loan was repaid or written off. International good practice suggests that data be deemed obsolescent and erased after five to seven years, with a few countries opting for longer periods of 10 years, so five years is a reasonable period. Shorter periods of time (such as a few months or one or two years) provide a relatively weak incentive for repayment. Periods of less than five years are also too short to include most business cycles and thus provide limited information for risk analysis when a crisis hits.

30. **Obsolescence provisions provide consumers with the possibility of a fresh start but if they are too short (fewer than 5 years) then they actually provide an advantage to “bad” borrowers who do not repay their obligations, at the expense of the “good” borrowers who are meeting theirs.** Obsolescence provisions are intended to give the customer an opportunity for a fresh start so that a period of financial difficulty does not follow the person forever. At the same time, by erasing data, two borrowers with very different payment histories may appear similar in terms of their credit report. If obsolescence provisions are for a reasonable period of time (5 years or more) then the impact of the erasure of data is likely to be limited, as more recent data has more predictive power. However, if data are erased after a short period of time (a few months or 1 or 2 years) then the result will be to effectively penalize good borrowers, who will be subsidizing the bad. Without data to distinguish those who have paid their obligations from those who have not, the terms and access to credit will not be able to reflect the different behavior, interest rates would likely rise and access to credit would be restricted.

31. **In the debate in Colombia, however, obsolescence or omitting data from a report, is only activated once the debt has been paid or otherwise settled. This is not the recommended practice for obsolescence provisions which should take effect even for outstanding debts.** The period of obsolescence on negative data should begin when the loan goes into some kind of irregular status. For example, if a consumer stops paying a loan in March of 2000, and it eventually goes into default and is eventually renegotiated and paid, the data should be removed from the consumer’s records as of March 2005, if obsolescence in the system was five years. Exceptions to the removal of data exist in some systems. In the U.S. for example, the obsolescence provision on negative data is applied to lower value credit applications but for large loans all historical data is made available. This enables the system to balance the needs of consumers for a fresh-start and for incentives to modify their behavior with the needs of the marketplace for complete data, especially where risks are greater. Note: The fact that data on past due obligations may be omitted from credit reports after some period of time does not mean

that the loan is no longer due. Court cases and collection efforts could proceed, the data would just not appear in the credit reporting system.

32. **Another key aspect of the debate relates to consumer consent and notification.** In the consolidated draft law, consumers do not have to provide authorization for their “credit and financial” data to be sent to a credit reporting firm, as they would for other types of personal data. This follows international good practice, as it may be difficult to obtain written consent in some types of transactions such as those done over the phone or via internet. By removing the consent requirement, it also becomes clear that consumers do not have a legal right to object to having their credit report pulled when they request a loan. For example, in some countries consumers have argued that consent requirements are “coerced” if they are required in order to be considered for a loan, and thus attempt to avoid participation in the credit reporting system. By removing the consent requirement, this type of side-stepping of the system is very difficult, and more complete reporting is likely. Even so, banks and many other lenders and service providers would probably keep a disclosure clause in their contracts, so that consumers would be aware that by applying for the credit or service their data would be consulted, and data provided, to the credit reporting system.

33. **There have also been suggestions to include a requirement that consumers be notified when negative data on them is sent to a credit bureau.** In one version of this proposal, negative information would not be able to be provided to a credit reporting firm until ten days after the letter (communication) to the borrower was *received* at the last address the reporting institution has for the borrower. The intent of this proposal is to provide borrowers with the opportunity to resolve the payment dispute or correct erroneous information before it is entered into the credit reporting database. However, this provision should be studied carefully, as it may result in an undue burden on the credit reporting industry and a loophole for unscrupulous borrowers to take advantage of the system which is not compensated by a significant increase in consumer protection. Related to this proposal, the following questions need to be answered. Do consumers have to be notified only when the first negative information relevant to a loan or service is reported or each time (each month) that the data is sent? Would this notification be duplicating notices already being sent by banks and other lenders and service providers notifying consumers they are late or delinquent and will be reported? How is the lender to know when the letter was received, and thus when the ten day window has been met? What types of communications will be considered adequate for meeting this notification burden? What is the likely impact this would have on microlenders, retailers and other service providers who deal with relatively small account balances? Would they be less likely to report negative information so as to avoid the notification requirements? How much additional time would likely lapse, on average, between a negative payment incident and including the information in bureau reports?⁵

⁵ Brazil provides a good example of the potential side effect of onerous notification procedures. A Brazilian judge ruled that in order to share positive information in Brazil, credit reporting companies would need to send consumers a certified letter advising them that such data were to be transmitted. The judge’s objective was to ensure that consumers were notified about the sharing of positive data which have not traditionally been available in Brazil. The high cost of certified letters – equivalent to several US dollars – was so high, however, that it made the positive data credit report commercially unviable.

34. **The draft law does not include adverse action notification, which is arguably a more effective and important notification rule than that related to negative information.** Under adverse action notification, consumers must be told when an adverse action occurs – such as not being approved for a credit or service – based at least in part on data contained in a credit report. This type of notification is important in that it makes the consumer aware of the data in their credit report, and the role of the report in the decision, when they encounter a problem. Adverse action notification focuses the consumer notification efforts on those individuals who are being affected by their credit report, so that they can take action to correct erroneous data or fulfill outstanding obligations. In keeping with decisions of the Constitutional Court that credit reports cannot be the only information used to approve or deny credit, the adverse action notification could state that the data in the report was only one of several factors used in the decision. Presumably other risk factors such as employment status, account balances, project risk, etc... are also being used. Adverse action notification helps to make sure that consumers become aware of how the data in their report is affecting them – this is often new information for the consumer as it arrives with the response to their pending credit application. In the case of negative data, most consumers are likely to already be aware of their late payments or delinquent loans so it does not represent truly new information for them. From the perspective of reporting burdens, many more individuals are likely to have negative information reported than those who face an adverse action so the adverse action notification rule can help to keep costs of reporting down and thus promote more widespread use of credit reporting data. The United States’ laws on credit reporting include adverse action notification, in section 615 of the Fair Credit Reporting Act (FCRA)⁶.

35. **Access to one’s own data is a fundamental part of data protection laws worldwide and is included in the consolidated draft law.** Article 8 (second paragraph) states that data subjects will have free access to their data. One free annual report, and free reports when adverse actions have been taken, are widely accepted international practices, but unlimited free reports could pose an undue burden on the credit reporting industry. Either the law or regulation should clarify this point so as to ensure that the cost to the industry for meeting this basic consumer right is not excessive.

36. **Another key aspect of credit reporting law concerns who has access to the data and under what circumstances – a point where the consolidated draft law is surprisingly vague.** Users are defined as institutions which have access to the data, but the law does not specify the conditions or circumstances where access is allowed. In an open system such as the Colombian one, where banks and other non-bank financial institutions provide data, as do retailers and service providers such as cellular telephone companies, rules on access should apply to the motivation for requesting the report, and not institutional type. In this sense, the law is good in that it does not single out one type of institution, such as banks, which have unique access to the credit and financial data. However, the law does not clearly establish the “permissible purposes”⁷ for obtaining credit reports or credit data from a credit bureau. Using motivation as a guideline, one could question, “Is the report being requested on behalf of the consumer for a financial or commercial transaction?” If the answer is “Yes” then this would constitute an appropriate or

⁶ The FCRA can be viewed at: <http://www.ftc.gov/os/statutes/fcradoc.pdf>

⁷ The concept of “permissible purpose” is part of the U.S. Fair Credit Reporting Act. The Act is available at www.FTC.GOV.

allowed data request. The private bureaus themselves can establish “rules of the game” to limit the ability of institutions to poach their competitors’ better customers through simple data queries. This is also an area where regulators have a role, to monitor how reports are being used in the economy so as to protect consumers’ rights.

Data Availability and Quality

37. **The quality of data and the tools to use the data need to be upgraded in order to promote both broadened access to finance and improved risk management.** The credit reporting system in Colombia has traditionally focused on bank clients and upper and middle income consumers, leaving a majority of the economically active population with no presence in either private or public credit registries. Even data on this privileged segment of the population has quality issues, for example, related to the identification of related firms and business conglomerates who should be evaluated as a group for risk assessments. Moreover, until recently many lenders, including major commercial banks, were slow to adopt automated lending technologies which are critical both to move toward more mass access to credit (as in the credit card industry) and to underpin advanced risk management strategies. Other non-bank lenders and businesses are still far from an optimal use of credit data to provide for extending their reach into new market segments while managing the risks this entails.

38. **In terms of data quality, the key issues are:**

- Limited coverage of low income consumers and micro and small enterprises in the system;
- Lack of socio-demographic data (birthdate, marital status, employment status, education, etc.) which is valuable for credit scoring and other risk assessment tools; and
- Quality of public source data including data distributed by the Chambers of Commerce, court data, collateral data, and data on unmet business obligations, as is reported to Protest Registries (Registros de Protestos) in other Latin American countries.

39. **In terms of availability of tools to use the data, the key issues are:**

- Limited penetration of decision tools, such as small business credit scoring and credit scoring for microfinance;
- Challenges related to a move to risk-based supervision, following Basel II principles.

40. **Table 4 below compares the overall scope and quality of financial information available in Colombia with experiences of other countries. In general, Colombia performs relatively well.** In particular, Colombia has good quality private credit bureau data. However, the country’s performance is average when looking at public sector data sources such as corporate or collateral registries. When rating these registries, one-half point was assigned if such a registry existed in the nation and another half-point if the data in the registry was available to the financial sector in electronic format. As can be seen, only Colombia’s corporate registry meets both these criteria and there isn’t a moveable collateral registry currently operating.

Table 4. Index of Financial Information Infrastructure for Selected Countries

Country	Public Information				Private Credit Bureau							Total
	Corp. Registry	Collateral Registry - fixed	Collateral Registry - moveable	Court Records	Both Negative & Positive Data	Both Real and Banking Sector	>5 Years of Data for Dist.	Both Firm & Individual	Credit Score	Legal Framework		
Argentina	0.5	0.5	0.5	1	1	1	0	1	1	1	7.5	
Colombia	1	0.5	0	0.5	1	1	0	1	1	0.5	6.5	
Czech Republic	1	1	0	0.5	0.5	0	0	0	0	0.5	3.5	
Thailand	1	0	0	0.5	1	1	0	1	0	1	5.5	
Turkey	1	0.5	0	0.5	0.5	1	0	0	1	0.5	5	
Uruguay	0.5	0.5	0.5	0.5	0	1	1	0	1	0.5	5.5	

Source: World Bank, Financial Sector Indicators (FSE-OPD)

Improving Data Quality in the Microfinance Sector

41. **To strengthen the quality of data available on microfinance clients, information is needed from a variety of payment sources.** In microfinance, borrowers may not have bank loans or credits. For this reason, one needs to look for other indicators of payment behavior, willingness to pay. These include past behavior with services (water, gas, electricity, phone – fixed lines and cellophanes, etc.), fulfilling government obligations (taxes, wage payments if applicable, etc.), socio-demographic information (age, marital status, etc.) and behaviors (property owner, number of years in job, owns car / phone / etc., has passport, etc.). Some of this data is available in Colombia, but there is significant room for improvement.

42. **Microfinance institutions should provide both positive and negative payment data to the credit reporting system.** Unlike the banking sector, where customer authorization for credit bureau checks is part of the standard loan contract, microfinance lenders are only recently including such clauses. As a result much of the payment history from microlenders is not captured in the credit reporting system. Other important sources of data, such as utilities providers, have also been reluctant to provide their data – which is of particular value for the non-banked and lower income consumers – because of the uncertainty regarding the legal basis for credit reporting. As a result, the extent of coverage of the population in the credit reporting system is relatively low in Colombia – between 20% and 25% - compared with levels of more than 50% in other Latin American countries such as Argentina and Uruguay.

Improving Data Quality in the Small Business Sector

43. **There are weaknesses in the corporate registry data administered by the Chamber of Commerce.** The Corporate Registry data available in Colombia is good in many respects. Nearly 70,000 firms, nearly all of them privately held, provide annual updates on their organization, business activities and structure. A smaller number – approximately 30,000 – provide annual financial data. This level of disclosure and transparency for firms which are not

publicly listed is unusual but the value of the information is degraded by persistent quality issues. For example, the worksheet which firms must complete provides one box for entering profits or losses and most firms do not include the negative sign before a loss so the data is difficult, if not impossible, to decipher. The data is also often left unchanged by firms from year to year, with little effort expended in obtaining more reliable or updated figures. Finally, access to this data is sometimes limited, which may be restricting its use and be in direct defiance of the government concession to collect and distribute the information. Policies on use and access should be reviewed so that this valuable source of data can be maximized in the economy.

44. **Colombia lags behind in the development of data on *firm financial behavior* such as information related to payment of non-bank obligations, trade line data and payment of other documents (invoices, etc.).** In Colombia, there is significant data available on firm financial statements, via the corporate registries managed by the Chambers of Commerce, but little data on the payment history of firms outside the banking system. Since many small firms receive little or no bank finance, this is a glaring hole in Colombia's FII related to SMEs. The development of information on firm-to-firm trade lines and other payments and the creation of a database on unmet obligations (known as protested document registries in other countries in Latin America) is however, largely absent.

45. **The United States has a very developed market for firm to firm payment data and D&B is the unrivaled leader in collecting and distributing this information.** There is a significant value to the D&B data, beyond the data in firm financial statements and other readily available sources of information on firm creditworthiness. In several papers, Kallberg and Udell empirically test the value of D&B reports – which include firm to firm payment data as a key input – and show that D&B information adds to the ability to predict bankruptcy.⁸ Other countries which share this type of trade data include Canada, the U.K., Australia and New Zealand. Similar practices are now spreading to emerging markets in Asia, South Asia and Eastern Europe but still lag far behind the U.S. experience.

46. **In Latin America, the availability of trade credit data varies by country.** In some cases, such as Colombia, there is very little information available on payment of trade credit. In other countries, such as Brazil, there are firms which have specialized in collecting trade credit information for many years.⁹ Yet other countries, such as Peru and Chile, have registries for protested documents where firms can file claims against unpaid invoices, providing valuable data on firm payment histories.

Improving Data Quality in the Public Sector

47. **Data in many public registries is a valuable input to the nation's credit reporting system and FII, but quality and availability of this data need to be improved.** Two of the

⁸ See Chapter 5, "Private Business Information Exchange in the United States" by Kallberg and Udell in *Credit Reporting Systems and the International Economy*, Margaret Miller, editor, MIT Press 2003. Also, see "The Value of Private Sector Business Credit Information Sharing: The US Case" Kallberg and Udell, *Journal of Banking and Finance* v27, n3 (March 2003): 449-69.

⁹ The Equifax Company in Brazil has a significant database of trade credit information.

most important changes which could be made include improvements in access to at least some court records and information related to collateral.

48. **Judicial information does not reliably identify the individual.** In Colombia, there is particular sensitivity to how data are used with relation to civil, and especially, criminal investigations as there have been numerous publicized cases of mistaken identity resulting in the arrest of innocent individuals. These cases have sensitized lawmakers to the importance of creating a way to readily identify individuals and thus avoid improper arrests. The expanded use of credit reports to detect identity theft and to accurately identify individuals could be part of the solution. At the same time, the cases of mistaken identity highlight the potential difficulties from expanding access to court and judicial data in a system where proper identification of individuals by law enforcement remains problematic. From a risk management / risk assessment point of view, however, there are reasons for seeking access to at least some types of judicial data, such as information on individuals involved in fraudulent business dealings or who have declared bankruptcy. Criminal data may also be valuable for determining risk.

49. **If appropriate protections are in place, at least some types of court and judicial data can responsibly be included in the credit reporting system.** This is the case in the U.S. where court data is considered public record and is available in comprehensive credit reports. Some U.S. jurisdictions make this information available in electronic format and there are many national firms providing online search services for public records, including court proceedings. Court data need to provide adequate information so as to identify the parties to the legal action – information such as the unique identification number, date of birth, address, etc.... If the data can be reliably linked to credit reporting files, then the issue becomes how to navigate between reasonable access and use of court data and the individual's right to a fresh start, especially once their "debt to society" has been paid through financial penalties, probation or time served in prison.

50. **Market participants claim that judicial information is difficult to access.** Even though its price is zero, the way the information is provided makes it extremely difficult to identify all the members of each party, plaintiff and defendant. A database that gathers information from all Colombian departments with judicial information, that allows remote on-line queries searching by the name or NIT of any of the parties involved, and that shows information of the state of the court proceeding, would be valuable. These changes would also help to improve identification of criminals or others wanted by law enforcement and contribute to reducing problems of mistaken identity by police and other authorities.

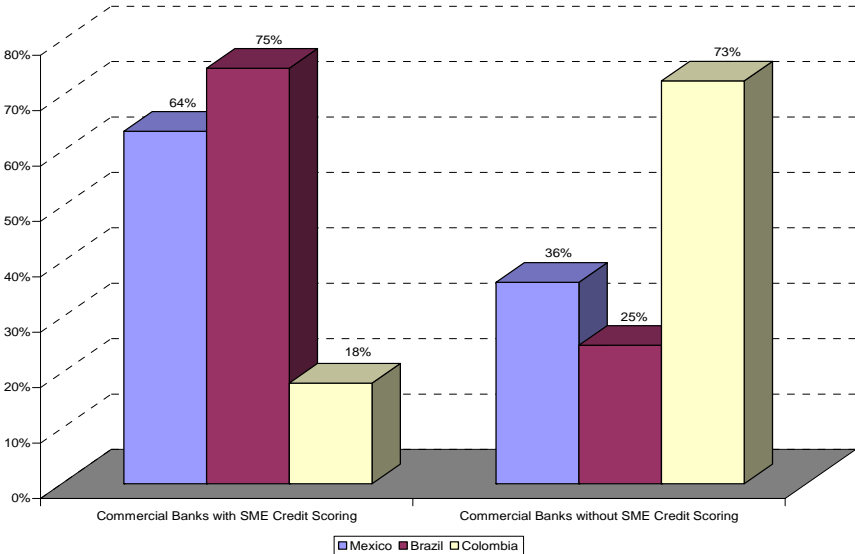
51. **Collateral registries for real estate should be modernized and linked via a network to promote both access to credit and risk assessments.** The functioning of public registries with information on real estate is not consistent across Colombia. For example, 76 out of 190 registries in Colombia are partially automated and the rest are manually operated. Queries of information in those registries, which are municipal and are not connected through a network, must be performed in person in the corresponding municipal registry. Therefore, the Superintendence of Notaries and Registries (*Superintendencia de Notariado y Registro*) should modernize these registries, automating and interconnecting them in an efficient network, with information updated on real-time basis and appropriately backed up (the SB informed the mission team that there is a project to modernize the registries under discussion that is likely to

be implemented in the near future). This should enable queries to be performed remotely, on-line, and yield information registered in every Colombian municipality. It should be possible to request certificates of individuals and firms searching by name or NIT. The degree of access and detail in the information should be decided taking into consideration personal security concerns.

Strengthening Credit Decision Tools

52. **Colombia lags behind other countries in the region in the adoption of small business credit scoring (SBCS) technologies.** As Graph 1 indicates, only a few Colombian banks have adopted these tools compared with a majority of financial institutions in other large Latin American countries like Mexico and Brazil. The limited penetration of SBCS indicates that lenders in Colombia are continuing to perform more traditional credit evaluations for their SME customers and losing out on opportunities to reduce the cost and time of extending credit and for expanding access. Recent World Bank research confirms this hypothesis. Colombian banks participating in a World Bank research project reported that it takes between five and 25 days to process a loan application. By comparison, Mexican financial institutions participating in the research reported a range of only two to four days.

Figure 1. Use of SBCS in Brazil, Colombia and Mexico, 2005



Source: World Bank Survey

53. **The World Bank sponsored a research project to determine the feasibility of developing pooled data SBCS models in Colombia and Mexico; the results from this research suggest such models, which are common in the U.S., could also be developed in Colombia.** Using data collected from financial institutions in Mexico and Colombia, the research project studied the possibility for developing a pooled data SBCS tool for these Latin American markets¹⁰. When speaking of credit scoring tools, custom models are those which are usually most familiar. Custom models are empirically derived, statistically based tools which are

¹⁰ The study was jointly developed by the World Bank and by the Fair Isaac Corporation.

developed for individual lenders using their proprietary data. Pooled data models are also empirically derived, but data is pooled from multiple lenders rather than being taken from a single institution.¹¹ In the case of both custom and pooled SBCS products, scores represent the odds that an applicant will pay as promised on a loan, permitting banks to rank order potential borrowers and estimate expected losses on a given portfolio¹². Although it is sometimes difficult to put together a consortium of lenders to contribute data to a pooled model, this approach has several advantages including a more robust dataset for model development which results in more powerful and accurate models, lower upfront costs for lenders and greater access to the SBCS tool since it is not the property of a single institution.

54. **Based on the data provided to the World Bank-sponsored research project, a pooled data SBCS model for small business in Colombia is feasible.** The empirical analysis identified several predictive characteristics across the participants indicating that a pooled model approach would yield favorable results. Colombian lenders also expressed interest in a pooled data model, and such a tool would be timely for that market as few custom or proprietary systems are now being employed¹³.

55. **New credit scoring tools for microfinance lenders are also an important step toward increasing efficiency of the sector.** Even in the absence of a specialized microfinance bureau, credit reporting firms have focused significant attention on this sector. In September 2005 Datacredito launched a new credit scoring tool for microfinance. Due to data limitations, the scorecard is focused on the upper echelon of the microfinance market, but they also have developed more limited analytical tools for the lower end of the market where data is scarce. LiSim, another local decision tool company, is also developing credit scoring tools for lower-income consumer markets, for both financial and non-financial institutions. Limitations in the underlying data, however, continue to limit the impact such technologies have in Colombia.

Public Perception of System

56. **The public perception of credit bureaus is generally negative.** Part of this poor image is due to a lack of understanding as to the operation of credit reporting firms and their role in a modern financial system. For example, many consumers do not realize that credit reports in Colombia include both positive and negative information – they believe they are “black-lists” containing only negative data. The much publicized sale of registry data on Colombian citizens to the U.S. government and the mortgage lending crisis of 1999-2000, during which many Colombians found themselves burdened with poor credit reports, are two factors which have recently contributed further to this negative image.

¹¹ Both custom and pooled data models also include data from credit bureaus if available.

¹² While the credit score provides the likelihood of a customer defaulting on the loan, other considerations affect the calculation of estimated losses, such as whether loans are secured, the industry of the firm receiving the loan and other information related to ability to collect on bad loans.

¹³ CIFIN launched a small business scorecard in October 2005 based on data in their database and financial information obtained from the Corporate Registries operated by the Chambers of Commerce. This tool, however, does not include more detailed information from the banks themselves on their small business customers.

57. **Borrowers have frequently challenged both public and private sector provision of credit information in the courts.** The absence of a clear legal framework has encouraged such litigation. Frequent court cases brought against the public credit registry (PCR) run by the Superintendent of Banks led the authority to cease the distribution of PCR data to the financial system. This is a very unusual step, since most PCRs make at least some data available to financial institutions for use in credit evaluation and risk analysis. In the private sector, legal challenges are also prevalent. While they have not resulted in suspension of private operations, and according to the firms are often settled in their favor, these legal battles do impose a significant cost on the industry.

58. **In the absence of a well-defined legal framework, both of the two major credit reporting firms operating in Colombia, CIFIN and Datacrédito, have struggled to develop a framework for operations that achieves a balance between protecting the rights of consumers and the needs of their users.** To balance these sometimes competing objectives and create a stable operating environment, each has developed an internal Code of Conduct that they and their users are subject to in order to avoid infringing upon consumers rights. However, despite the substantial efforts made by private bureaus to improve their image, consumer concern with the industry remains a significant problem, as evidenced by the tens of thousands of complaints recently received by a website focused on credit bureau activity and sponsored by a member of Congress.

System Oversight

59. **There are many disparate aspects of a national credit reporting system and no single public or private institution can cover them all. A system oversight function can provide a useful forum for addressing those issues that go beyond a single government regulator or private sector firm or industry.** The oversight function could potentially facilitate a more complete credit reporting system, with data from varied public and private sources, by increasing public confidence – and uniformity of treatment - in the way the information is being handled and used. Oversight would also encourage consistent public policies regarding access to information in the public sector, attention to special concerns such as the inclusion of data on low income individuals or microenterprises, and consistent enforcement of laws and regulations relating to private sector firms.

60. **There is no international “good practice” model for system oversight of credit reporting.** The oversight function might initially take the role of an inter-ministerial advisory committee headed by the Superintendent of Financial Institutions or Central Bank. Because of the importance of private firms in credit reporting, the private sector should also have a formal role in such a committee. For example, industry associations (banking association, credit reporting industry association, etc.) could have observer status. The goal of this committee would be to promote dialogue and to feed concerns into the primary regulators of the credit reporting industry¹⁴.

14 In this context, it is important to note that the role of system oversight in credit reporting is still being debated and even those countries with the most advanced credit information, such as the U.S., Canada, the U.K. and Germany, don't have one committee or institution with the mandate for system-wide oversight. However, these countries do tend to have well established channels for public-private dialogue on important issues facing credit reporting as well as protocols or formal relationships between key government departments with responsibility for regulating different aspects of the private credit reporting industry.

IV. Recommendations

Legal and Regulatory Reform

61. **The authorities should adopt a sound legal and regulatory framework for the credit reporting industry.** This framework should recognize the critical role played by credit reporting in the development of modern financial systems and the broader economy, while at the same time providing consumers with effective protections against abuse of the information.

62. **The key elements of the legal framework should include the following:**

- a. Maintaining data for a reasonable time period – at least five years;
- b. Creating an obsolescence provision which enables consumers to make a fresh-start;
- c. Developing an effective strategy for alerting data subjects to problems associated with their report – adverse action notification is recommended;
- d. Establishing who has access to the data and under what circumstances;
- e. Providing consumers with effective and actionable protections under the law including means to access their own data and dispute resolution mechanisms which are appropriate for consumers with varying levels of education and access to technology; and
- f. Developing a regulatory structure capable of system supervision. The law should specify the instruments and mechanisms which regulators will have for supervision of the credit reporting industry including issues such as the ability to bring court cases on behalf of a class of plaintiffs, to require external audits, to require reports and access to the database, and to specify penalties and sanctions.

63. **Beyond the more narrow need for effective regulation of the credit reporting industry, there is a need to take a proactive and strategic view for the credit reporting system development and oversight.** The complexity of the credit reporting system and FII, including the literally thousands of lenders and firms which provide and use the data, the importance of public data sources, the role of FII in bank supervision and the critically important consumer protection issues, suggests that a more comprehensive approach to policy making would be valuable. An Advisory Committee, as discussed in one of the draft data protection laws, could help with strategic planning and system design and development beyond the more narrow roles assigned to the regulator. While initially the institutional focus and resources should be on ensuring effective regulation of the industry, the establishment of this type of system oversight could be an important part of the strategic approach to the industry and broader FII development and reform agenda.

Data Quality and Data Tools

64. **Efforts to promote the development of microfinance credit data should be supported and strengthened.** For some time there has been recognition in Colombia of the importance of strengthening the quality of information available on the microfinance sector, so as to increase access to credit. The Ministry of Commerce, Industry and Tourism, together with the two main

private credit bureaus, leading microfinance institutions and other business and foundations in Colombia, initiated a project with this objective in 2003. The goal of this project is to create a dedicated microfinance / microenterprise credit bureau but unfortunately only limited progress has been made. Renewed attention to this initiative could yield substantial dividends.

65. Information related to firm financial performance, such as payment of non-bank obligations, trade line data and payment of other documents (invoices) should be improved. The establishment of a protested documents registry is one clear policy direction which government could take. For trade line data, and other firm-to-firm performance information, government could promote greater understanding of this type of credit reporting and possibly consider mechanisms and incentives to encourage such reporting.

66. Public data sources should be modernized especially corporate registry data, court record data and collateral registry data.

67. Small business credit scoring (SBCS) tools should be encouraged to develop, including possible pooled-data models as were the focus of the recent World Bank study. Already, CIFIN has introduced a type of expert SBCS tool. Other developments should also be encouraged. Securing the participation of government owned banks in such activities would provide an important initial data source for development of these tools. There may also be opportunities to build on the work on small business models being undertaken at the Superintendent of Banks as part of the move to risk-based supervision, so as to upgrade the SBCS tools available in the marketplace.

68. Outreach and education activities should be developed for smaller banks, non-bank financial institutions and other credit-granting firms to acquaint them with the appropriate use of automated lending technologies and decision tools such as credit scoring.

Improving Public Perception

69. The credit reporting industry in Colombia (credit reporting firms and creditors) should consider funding a joint public relations campaign to enhance the image of credit reporting in the country. The objective of the campaign should be to increase awareness among consumers of the value of establishing a positive credit history and the specific steps they can take to build a positive credit history and avoid or reduce the impact of negative information. It must be recognized, however, that no public outreach campaign will be successful until the system is truly transparent to consumers and their rights are fully enforced.

70. The credit reporting industry in Colombia should give special consideration to the needs for communicating to segments of the population with lower income. These segments of the population may be especially vulnerable because they often rely more on credit provided by non-regulated entities. This segment may also be more likely to include individuals with lower levels of literacy. Specific types of communications that would be expected to work well with this segment include public service announcements on television, using a popular format such as the soap opera to communicate key ideas; explaining the function of credit reporting systems and consumer rights on popular news or talk shows; using comic book formats to convey key concepts in public transportation and/or popular newspapers and magazines.

71. **Authorities and the industry should continuously create awareness on these issues among other key stakeholders who are in a position to influence the development of legislation or rules concerning consumer protections in credit reporting systems.** Seminars featuring international experts on credit reporting could be organized to raise awareness among public officials, judges, legislators, etc. Topics could include current laws and regulations, roles and obligations of authorities. The objective is to help them to avoid problems from developing within the system and to develop a knowledge base that will support thinking proactively about how the industry can and should be shaped in the future.

72. **Credit reporting firms should increase the transparency of the services they offer to protect consumer rights.** Web sites should give clear and easily accessible information about consumer rights with respect to accessing and disputing information in their credit reports, who may access their credit report and under what conditions, etc. Other communications mechanisms should be sought for segments of the population who do not have widespread access to the internet.

73. **The credit reporting industry should consider adopting common policies and procedures for their interaction with consumers to simplify consumer participation in the system.** At a minimum, adopting similar procedures for requesting copies of credit reports and disputing information should be considered. An example of even greater cooperation that could yield beneficial results would be the formation of a common call center to receive and route customer inquiries and disputes could be established and maintained by the credit reporting firms.

Role of the Public Authorities and Cooperation

74. **The SFC should coordinate efforts to develop credit reporting in Colombia with others in both the public and private sectors.** Initially, the SFC needs to focus their energies on establishing a basic regulatory capacity and working with the other legally identified regulators, if any exist, for credit reporting. Once the basic institutional capacity for regulating the industry is established, it would be advisable for the SBC to take a leadership role on the reform agenda for credit reporting by convening an advisory “oversight” committee for the system, even if this is not explicitly required by the law. The SFC could act as the Secretariat for this body, bringing in others with an important role to play. In particular, the SBC should engage those parts of the government with critical public data, coordinate with the Central Bank in regards to broad financial sector policies, work with the Defensoria de Pueblo and Superintendence of Industry and Commerce in relation with their consumer protection responsibilities and in the case of the Ministry of Industry and Commerce also in relation to small business and microenterprise development initiatives, and proactively engage the legislature in relation to debates on pending laws and regulations. Strong communication with key private sector actors, such as the private credit reporting firms, commercial banks and non-bank lenders including microfinance institutions is also vital to a successful reform effort.

APPENDIX 1. Principles for Credit Information Systems

A. Main Principles

Credit Information Systems

A modern credit-based economy requires access to complete, accurate and reliable information concerning borrowers' payment histories. Key features of a credit information system should address the following:

- B1.1 Legal framework.** The legal environment should not impede and, ideally should provide the framework for, the creation and operation of effective credit information systems. Libel and similar laws have the potential of chilling good faith reporting by credit information systems. While the accuracy of information reported is an important value, credit information systems should be afforded legal protection sufficient to encourage their activities without eliminating incentives to maintain high levels of accuracy.
- B1.2 Operations.** Permissible uses of information from credit information systems should be clearly circumscribed, especially regarding information about individuals. Measures should be employed to safeguard information contained in the credit information system. Incentives should exist to maintain the integrity of the database. The legal system should create incentives for credit information services to collect and maintain a broad range of information on a significant part of the population.
- B1.3 Public policy.** Legal controls on the type of information collected and distributed by credit information systems can be used to advance public policies. Legal controls on the type of information collected and distributed by credit information systems may be used to combat certain types of societal discrimination, such as discrimination based on race, gender, national origin, marital status, political affiliation, or union membership. There may be public policy reasons to restrict the ability of credit information services to report negative information beyond a certain period of time, e.g., five or seven years.
- B1.4 Privacy.** Subjects of information in credit information systems should be made aware of the existence of such systems and, in particular, should be notified when information from such systems is used to made adverse decisions about them. Subjects of information in credit information systems should be able to access information maintained in the credit information service about them. Subjects of information in credit information systems should be able to dispute inaccurate or incomplete information and mechanisms should exist to have such disputes investigated and have errors corrected.
- B1.5 Enforcement/Supervision.** One benefit of the establishment of a credit information system is to permit regulators to assess an institution's risk exposure, thus giving the institution the tools and incentives to do it itself. Enforcement systems should provide efficient, inexpensive, transparent and predictable methods for resolving disputes concerning the operation of credit information systems. Both non-judicial and judicial enforcement methods should be considered. Sanctions for violations of laws regulating credit information systems should be sufficiently stringent to encourage compliance but not so stringent as to discourage operations of such systems.

B. Detailed Assessment of the key features of a credit information system.

A modern credit-based economy requires access to complete, accurate and reliable information concerning borrowers' payment history. Key features of a credit information system should address the following. An effective credit information system can be integral to the operation of modern financial systems. Credit information systems can include a number of functions, including collecting, analyzing, and distributing information about how consumers and businesses, large and small, handle their credit obligations. This type of information has proven to be an effective tool for a variety of purposes, including assessing the risk faced by creditors, as past payment experience is a strong predictor of future performance. Credit information systems also make it possible to empirically assess, in the form of credit scoring tools, which factors are most predictive, permitting finely tuned credit decisions. As a result, creditors can more intelligently assess consumer and business lending decisions, thus promoting the extension of credit and economic development in the countries in which they operate. Also, creditors are in a better position to develop numerous credit offerings tailored to the risk presented by borrowers' unique credit histories. Credit information systems promote competition among lenders, thus reducing the cost of credit. In fact, such systems can also increase the ability to attract foreign investment capital by providing foreign creditors a rational basis on which to evaluate credit risk. This regionalization and globalization of credit granting is further enhanced if consistent or at least transparent information collection standards are employed.

i. Legal Framework

Basis for Operation of Credit Information Systems. The legal environment should not impede and, ideally should provide the framework for, the creation and operation of effective credit information systems. Establishment and operation of credit information systems may be impeded or prevented by legal prohibitions or uncertainties concerning the application of laws relating to the collection, disclosure and use of financial information. For instance, bank secrecy laws may be perceived to prohibit banks from sharing information about their customers' accounts and payment history with a credit information system. The existence of such laws can chill the creation or operation of credit information systems.

Enabling legislation is not required for the development of credit information systems. Many credit information systems have developed organically so long as laws did not prevent their operation. Nonetheless, concerns about fair use of information have led to passage of legislation authorizing and regulating the existence of credit information systems. Passage of such legislation removes doubt about the legal viability of such entities and, by creating greater regulatory certainty, may encourage entrants into the credit information systems marketplace.

Liability Protections. Libel and similar laws have the potential of chilling good faith reporting by credit information systems. While the accuracy of information reported is an important value, credit information systems should be afforded legal protection sufficient to encourage their activities without eliminating incentives to maintain high levels of accuracy. There are a number of potential legal impediments to the development of credit information systems. One of the most significant is the existence of libel laws, laws that permit legal actions based on false publications that damage a person's reputation. The information maintained in a credit

information system is of the type likely to damage a person's or company's reputation if publicly known. This may include failure to pay bills or filing bankruptcy. While credit information systems should be encouraged to maintain high standards of accuracy, potential exposure to libel actions -- even as a result of inadvertent mistakes -- could discourage their operation or make them unwilling to report information unless there was no question about its accuracy. Even with the best intentions, it can be difficult to develop certainty concerning the accuracy of information being reported. Accordingly, some protection from libel or similar actions can be critical to the existence of comprehensive credit information systems. Such protections should not relieve credit information systems from the responsibility to provide reasonably accurate information. Instead, standards more geared to the challenges of operating a credit information system should be substituted.

ii. Operations

Use Restrictions. Permissible uses of information from credit information systems should be clearly circumscribed, especially regarding information about individuals. Credit information systems collect a wealth of information about individuals and businesses. Much of that information could have a serious impact on reputations and financial standing. The information could be used in negative and potentially harmful ways, such as for purposes of blackmail or referrals to criminal authorities for tax evasion. On the other hand, if the information is used for legitimate, beneficial purposes, the existence of the credit information system is likely to receive public acceptance. Legally imposed use restrictions can address these concerns.

Data Security. Measures should be employed to safeguard information contained in the credit information system. To the extent information in credit information systems is sensitive, and to avoid undermining use restrictions, such systems should employ reasonable methods to protect the security of such information. As appropriate, these methods may include physical, electronic and procedural safeguards to protect against improper data access.

Credit information services can provide valuable information for assessing repayment risk, likely profitability of accounts, debt collection, marketing, employment screening, tenant screening, claims analysis, insurance underwriting, market research, and economic trends. A sound environment for managing credit and insolvency risk requires reasonable access to accurate, reliable and current credit information on borrowers that affords adequate protection and safeguards for the privacy of borrowers and that is governed by general rules of due process.

The legal environment should provide a transparent procedure that contains incentives for gathering and dispensing information. Access should be provided to firms engaged in credit activities and not limited to particular types of entities, e.g., banks. While there may be arguments to limit access to firms that furnish information to the credit information service, this could unduly limit potentially beneficial users, especially firms that are just starting up and may not yet have significant amounts of information to contribute.

Transparency and good corporate governance are the cornerstones of a strong lending system and corporate sector. Transparency exists when information is assembled and made readily available to other parties and, when combined with the good behavior of "corporate citizens," creates an informed and communicative environment conducive to greater cooperation among all

parties. Transparency and corporate governance are especially important in emerging markets, which are more sensitive to volatility from external factors. Without transparency, there is a greater likelihood that loan pricing will not reflect underlying risks, leading to higher interest rates and other charges.

Data Integrity. Incentives should exist to maintain the integrity of the database. Credit information systems can be used in a variety of ways. Some uses, such as evaluating credit risk, rely on a database containing historical data on as large a number of potential borrowers as possible. Other uses may not require that data be maintained for extended periods of time. One such use can be as a means of collecting past due obligations by encouraging repayment to have one's name removed from the list. In that context, it might make sense to remove a debtor's name from the database when the obligation has been satisfied. However, if the database is also to be used to make future risk assessments, removal of that information might encourage payment of the particular debt at issue, but it would undermine the ability to identify borrowers who have fallen behind in their payments in the past. If a database is to be used, even in part for credit risk assessment, there should be incentives in place to keep data in the system even after that particular creditor's loans have been repaid.

Scope of Data. The legal system should create incentives for credit information services to collect and maintain a broad range of information on a significant part of the population. Credit information systems are most effective and enhance risk prediction if they contain data on a large segment of the population. The more ubiquitous their coverage, the better they can serve financial institutions in evaluating applicants for credit. Many existing credit systems work effectively through voluntary contribution of data by creditors who recognize it is in their self-interest to contribute information on their customers. If voluntary contributions are ineffective in creating a robust credit information system, legal requirements to report information could be imposed on creditors. Such requirements could avoid the problem that large incumbent creditors may choose not to contribute information due to the concern that reporting will facilitate creditors' competing for their existing customers.

There is strong empirical evidence that systems that collect both positive and negative payment histories permit more accurate risk assessments. Those same systems present the potential of financial institutions identifying their best customers to competitors, thus discouraging participation in the system. Alternatives exist to reduce the risk of losing customers, such as not allowing credit information systems to be used to target specific financial institution's customers. However, it should be noted that these alternatives do potentially reduce some of the beneficial competition that results from increased access to credit information.

One means of increasing demand for credit information services would be if creditors, both consumer and commercial, were expected as part of due diligence on extending credit to consider the borrower's credit history. This would serve the dual purpose of improving those firm's risk controls and creating a necessary market for credit information systems.

iii. Public Policy

Collection and Use Restrictions. Legal controls on the type of information collected and distributed by credit information systems can be used to advance public policies. Control of the

use of information collected by credit information systems, or even controls over the type of information such systems are permitted to collect, can be used to advance public policy goals. These public policy goals may often be in tension with the risk assessment functions of credit information systems. In theory, those systems collect the maximum information they can efficiently collect and use it to predict risk. If they were not permitted to use certain types of information, due to public policy concerns, the ability to predict risk based on the available data could be diminished. There are often public policy judgments made to sacrifice the predictive value of the data in favor of advancing other social or economic goals.

Anti-discrimination. Legal controls on the type of information collected and distributed by credit information systems may be used to combat certain types of societal discrimination, such as discrimination based on race, gender, national origin, marital status, political affiliation, or union membership. There are often legitimate societal values that call for assessment of credit risk, either individual or business, based solely on prior credit experience, as a method of equalizing treatment of borrowers. In some cases, this could result in a prohibition on collecting certain types of information, such as demographic or other data about borrowers that goes beyond their prior loan payment experience, including gender, marital status, or race. The absence of such data collection and use restrictions might well enhance the ability to predict risk, such as by concluding that men pose a greater credit risk than women, or foreigners are more credit worthy than citizens of a country. However, there may be strongly held societal values calling for equal treatment regardless of certain characteristics. These values may be deemed worth the economic costs of reducing the ability to predict risk based on credit information system data. This may result in prohibitions on collecting or using certain information about borrowers, e.g., race, gender, etc.

Ironically, there is another approach to combating discrimination that is directly at odds with reducing the collection of information. Rather than excluding information concerning protected characteristics, in some cases, lenders may be required to collect such data. The data is collected not for its predictive value but instead to use as a basis for evaluating whether the financial institution is making decisions based on prohibited characteristics.

Obsolescence. There may be public policy reasons to restrict the ability of credit information services to report negative information beyond a certain period of time, e.g., five or seven years. Certain types of information in a credit file have the potential of seriously impeding a business' or individual's ability to get credit. One such example is the filing of a bankruptcy petition; another is a series of loan defaults. The knowledge that an individual or company was forced to resort to bankruptcy because their obligations exceeded their assets could lead future creditors to decline to extend them credit. While this is quite rational, the consequence can be the lifetime of economic destruction for an individual or company. In such cases, the government might find itself burdened with providing assistance.

Yet, in many cases, late payments or even bankruptcy filings are precipitated by causes beyond an individual's control, such as a natural disaster, unexpected medical costs, or loss of employment or a contract. It may not signify a permanent inability to manage financial affairs. As a result, there can be a desire to allow borrowers who have at one time failed to fulfill their financial obligations to rebuild their credit histories through subsequent good behavior. A credit information service could undermine this goal by continuing to report the existence of the

negative information indefinitely. As a result, there may be important policy reasons to prevent the reporting of certain types of negative information, e.g., late payments, court judgments, tax liens and bankruptcies, beyond a reasonable period of time, such as five to seven years. By contrast, there might be other types of negative information, e.g., convictions of serious crimes that are in society's interest to report for longer periods of time or even indefinitely. It is possible to craft regulation of reporting practices by credit information services to address and balance these policy concerns.

iv. Privacy

Notice. Subjects of information in credit information systems should be made aware of the existence of such systems and, in particular, should be notified when information from such systems is used to make adverse decisions about them. Citizens in a country are often troubled by the existence of secret, hidden databases that contain information about them, regardless of whether those databases are maintained by the government or private firms. The legitimacy of credit information systems will be enhanced, and public apprehension reduced, if there is transparency concerning their existence and operations.

Aside from a general awareness of the existence of such systems, it can be critical to inform data subjects that information from those systems was used to make adverse decisions about the subject. It is impossible for databases containing thousands, if not millions, of files from numerous sources, public and private, to maintain current accurate information about a population that may have similar or identical identifiers, who do not use their personal identifiers in a consistent manner in all their interactions, who change identifiers over time (e.g., by getting married), and who move frequently. If erroneous data from those systems is used to make adverse decisions about individuals or companies, and the subject is not notified of the source of the data that led to the adverse decision, the subject will have no opportunity to correct the misinformation. As a result, the subject will continue to face rejections based on incorrect credit information system data. Not only is that unfair to the subject, it casts doubts on the operation of the system. It also means that users of the system will continue to be provided inaccurate data that will lead to incorrect risk assessments.

Notifying subjects that adverse action was taken based on credit information service data can also be a tool in policing anti-discrimination laws. If data subjects are permitted access to their information (see below), they can assess whether there are legitimate, non-discriminatory grounds for the denial. For example, if they have comparable credit standing to other borrowers who were granted credit, and the only difference between the applicants is gender or race, they might be able to establish that discrimination has occurred.

It would also be possible to structure a credit information system to only collect or use information with the consent of the data subject. However, giving data subjects control over their inclusion in the database, as opposed to process rights over the use of their data, risks allowing individuals or businesses with poor credit to exclude themselves or limit access to their complete credit history. These are the very people or entities creditors most need risk information about.

Access. Subjects of information in credit information systems should be able to access information maintained in the credit information service about them. Access to data by subjects can serve a number of important purposes. First, greater transparency about how the database operates and the type of information maintained can enhance public confidence. Second, only with access can data subjects who have had adverse action taken against them based on data in the service, determine whether that data is erroneous. Third, in the case of distressed enterprises, it can be helpful to have clear laws and procedures that require disclosure of, or access to, timely and accurate financial information on the distressed enterprise. This can encourage lending to, investment in or recapitalization of viable distressed enterprises. It also helps support a broad range of restructuring activities, such as debt write-offs, re-schedulings, restructurings and debt-equity conversions; and provide favorable or neutral tax treatment for restructurings.

In addition, the Principles and Guidelines for Effective Insolvency and Creditor Rights Systems call for laws that require the provision of relevant information on the debtor that could be accomplished by a credit information service. In addition, those Principles state that corporate workouts and restructurings should be supported by an enabling environment that encourages participants to engage in consensual arrangements designed to restore an enterprise to financial viability. An enabling environment includes laws and procedures that require disclosure of, or ensure access to, timely, reliable and accurate financial information on the distressed enterprise; encourage lending to, investment in or recapitalization of viable financially distressed enterprises; support a broad range of restructuring activities, such as debt writeoffs, reschedulings, restructurings and debt- equity conversions; and provide favorable or neutral tax treatment for restructurings. A viable credit information service can advance these goals.

Dispute Rights. Subjects of information in credit information systems should be able to dispute inaccurate or incomplete information and mechanisms should exist to have such disputes investigated and have errors corrected. It is of limited value to simply make data subjects aware that erroneous information from a credit information service served as the basis for an adverse action concerning them. In order to make that information useful, there must be mechanisms in place, either voluntary or mandated, to have such disputes investigated and, if information turns out to be erroneous, have the information corrected.

There are often timeliness concerns about resolving information disputes, perhaps because a business needs a financial commitment in order to sign a lease or a consumer wishes to purchase a new home that will go to another potential buyer if funding cannot be arranged. Thus, some requirement of timely consideration of disputes may often be critical to making the dispute right meaningful.

Similarly, a cursory review of a dispute, with no real effort to investigate and learn the correct information, can serve to make dispute rights meaningless. In some cases, the error may be apparent on its face, such as a date of birth of an infant belonging to a senior citizen. In others, there may be a need to contact the furnisher of the information to verify its accuracy. Oftentimes the extent of the investigation will be determined by the nature of the dispute.

v. **Enforcement/Supervision**

Supervisory Function. One benefit of the establishment of a credit information system is to permit regulators to assess an institution's risk exposure, thus giving the institution the tools and incentives to do it itself. While the principle focus of credit information systems is to permit financial institutions to gauge the risk posed by borrowers, those systems provide valuable tools for regulatory agencies to supervise institutions under their jurisdiction. Credit information systems permit efficient systematic analysis of a financial institution's loan portfolio, including its size, diversity, and risk levels over time.

Effective Enforcement Systems. Enforcement systems should provide efficient, inexpensive, transparent and predictable methods for resolving disputes concerning the operation of credit information systems. Both non-judicial and judicial enforcement methods should be considered. In light of the important financial and privacy interests involved in reporting credit information, there is a need for a mechanism to resolve disputes relating to accuracy and proper disclosure. This mechanism can exist in the courts, through administrative processes, government oversight, or self-regulatory organizations.

Proportional Penalties. Sanctions for violations of laws regulating credit information systems should be sufficiently stringent to encourage compliance but not so stringent as to discourage operations of such systems. While compliance incentives serve a valuable role in maintaining the integrity of a credit information system, there is a risk of over-detering conduct by making the penalties for violations too costly. At the extreme, this could deter operations of such services.