

Analysis of Current Status of Credit Information System in Pakistan and Future Expectations

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Introduction

Financial sector development is one of the critical drivers of economic growth. Financial sector development improves access to finance for consumers and firms alike and facilitates the informal sector's inclusion in the formal economy. Especially for a country like Pakistan, financial sector development is critical to accelerating its growth further. But the question remains, how to achieve financial sector development? Credible financial information is needed for greater levels of financial development, but having access to it is also required. Since lenders, banks, and leasing businesses must base their judgments on adequate and complete information, they need to be equipped with relevant information. The ability to pay back the loan on time is a prerequisite for the lender to provide a loan. Proof of income, any other liabilities, and a track record of loan default are required. A borrower can use numerous banks to get a loan, then use undisclosed banking information to secure a new loan. Additionally, the borrower may be a new borrower who has never borrowed money before. All this information may not be readily available to the lender, and the lender may not be able to distinguish between a good and a bad borrower.

Significance of Credit Information System

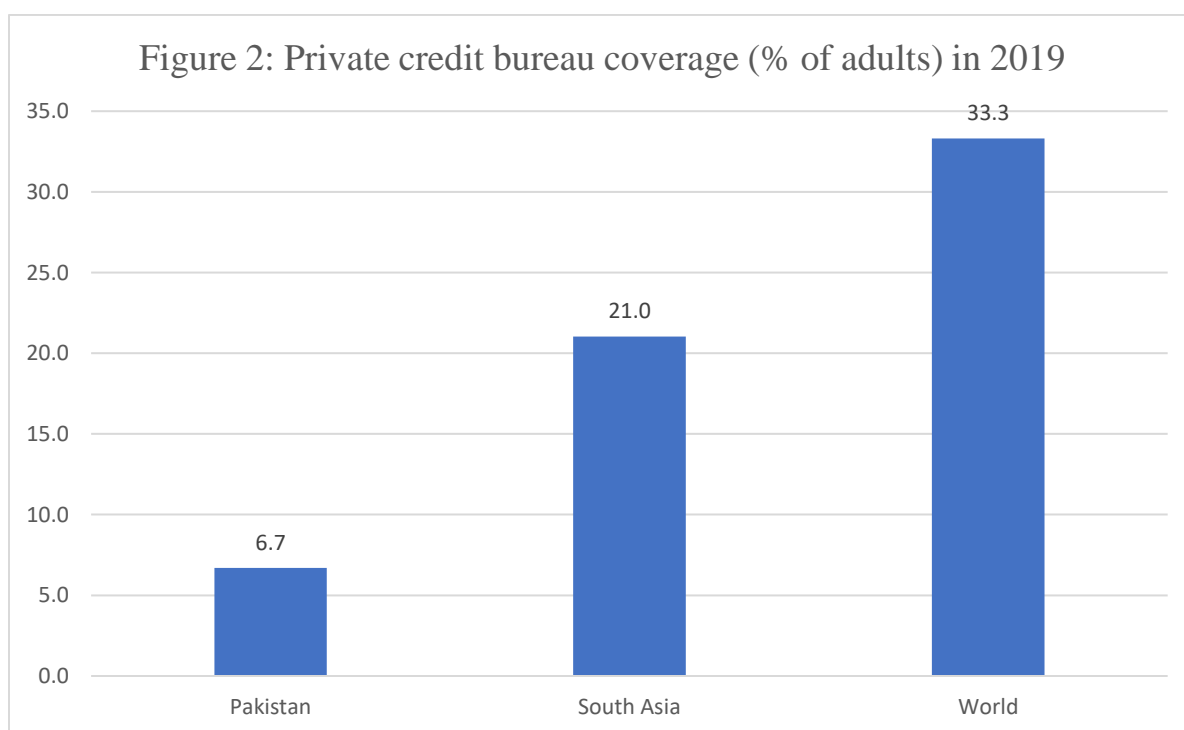
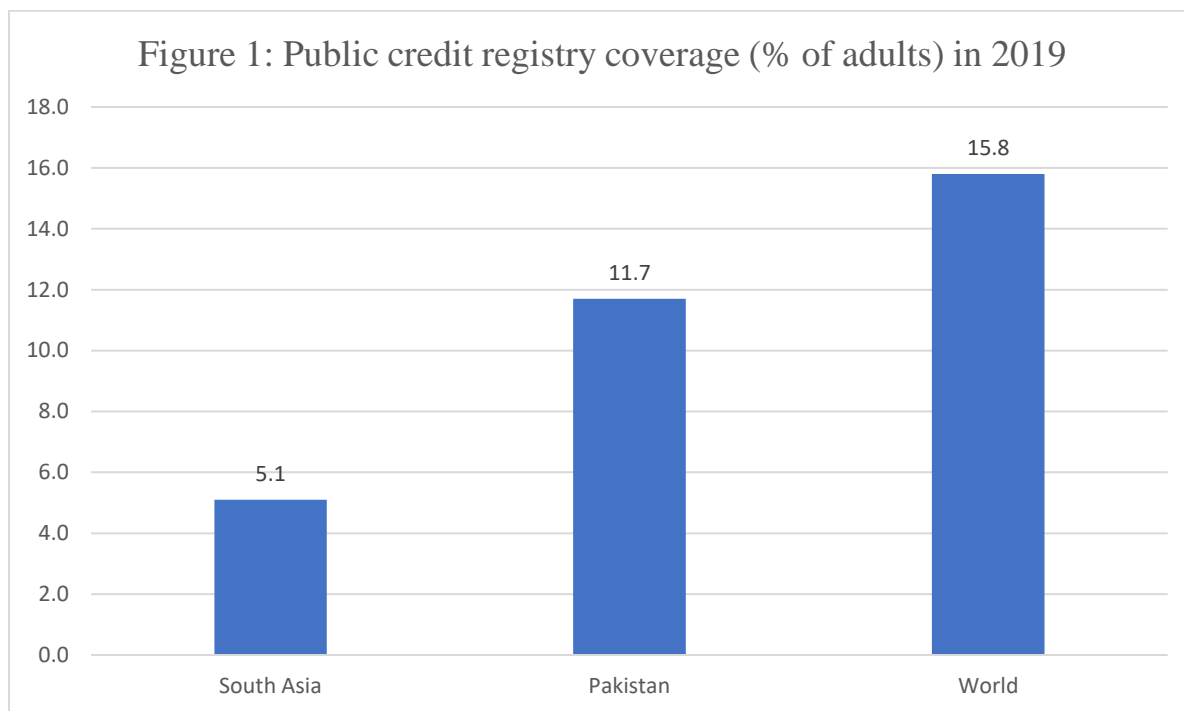
Therefore, lenders, banks, and leasing companies must have access to reliable financial information to make well-informed judgments when lending their money. The availability of such information will, in turn, spur business growth and hence economic growth. This is where credit information sharing institutions come in. These institutions keep a record of all loans and history of repayment and defaults of a borrower. There are two main types of institutions that provide such information: (i) a public credit registry, (ii) a private credit bureau. Both types of institutions have the same aim – they procure information on borrowers' credit histories (individuals and small businesses), including information on credit repayments, bankruptcies, and court judgments, from various sources and resell it to creditor's organizations. The sole distinction between the two types of organizations is that the government often manages a credit register, most commonly by the central bank of a country or region. In contrast, the private sector operates a credit bureau. In theory, they should be ideal replacements because it shouldn't matter whether the information is provided by a public or private institution.

Current Stage of Credit Information System Coverage in Pakistan

Despite the many benefits of credit bureaus, only a miserable percentage of the population is covered by them. Only 11.7% of the total adults were covered by credit registry in Pakistan according to the World Bank in the year 2019 (latest available) (see figure 1).¹ In contrast, the coverage by private credit bureaus is only 6.7% of the total adult population. Compared to Pakistan, its neighboring country India has 63.1% of the adult population covered by credit bureaus. Even

¹ <https://data.worldbank.org/indicator/IC.CRD.PUBL.ZS>

the number of people covered by credit bureaus in South Asia and the World stands at 21% and 33.3%, respectively, well above that of Pakistan (see figure 2).²

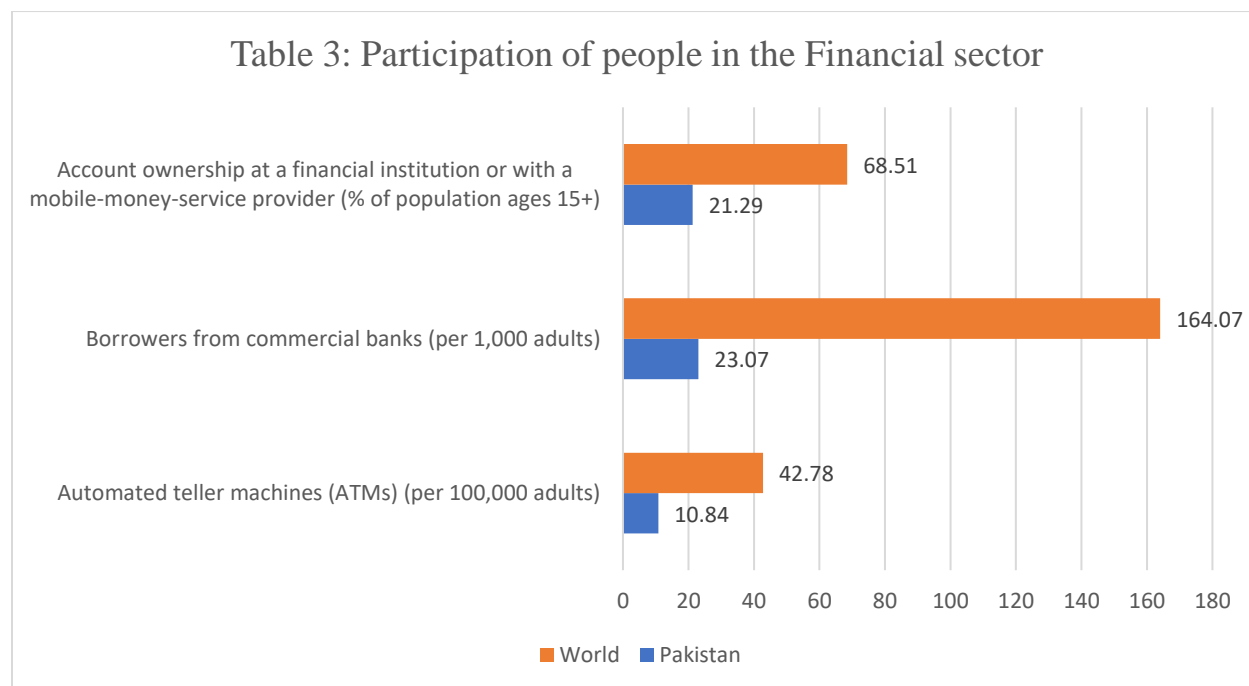


² <https://data.worldbank.org/indicator/IC.CRD.PRVT.ZS>

The State bank of Pakistan (SBP) made attempts to acquire information on the public's credit history. In this context, Credit Information Bureau (CIB) was created in 1992 by SBP to coordinate credit information sharing among different institutions. CIB collected credit information about defaults and overdue loans larger than rupees half a million in the beginning. However, from 2006 onwards, the threshold of half a million rupees was removed. The data on CIB is available to every institution that has access to CIB, which is updated every month. However, the CIB initiative was not very successful given the dismal coverage of the population.

Why Pakistan's Credit Information System remains relatively low?

There are a couple of reasons why in Pakistan credit information services have lower demand in the market. First and foremost, the participation of the people in the financial sector in Pakistan is very low. As shown in Figure 3 below, a very limited proportion of individuals actually use banking and financial services compared to the World average. In addition, the share of the informal economy is relatively large vis-à-vis the formal economy. Hence, most economic transactions happen outside the purview of the legal, financial system. This is highlighted by the fact that only around 1% of the total population in Pakistan pays income tax.³ Secondly, the cost of collecting information was relatively very high for the SBP, as it has limited resources at its disposal to collect financial data for such a vast population.



Note: Data on account ownership at a financial institution or with a mobile-money-service provider (% of population ages 15+) is from 2017. Also, the World average for borrowers from commercial banks (per 1,000 adults) is from 2017. The rest of the data is for 2019.

As a result, in an effort to increase access to financial information further, the Credit Bureaus Act was enacted in 2015, enabling the private sector to delve into the field of credit information

³ <https://www.thenews.com.pk/print/425729-only-one-percent-pakistanis-pay-taxes-fbr>

collection. Credit Bureaus registered under this act will be allowed to collect and transmit credit information data to both financial and non-financial entities, including but not limited to retail stores, insurance firms, utility suppliers, and landlords. The credit bureaus can prepare credit scoring, assemble various credit data, and so on. The act aims to enhance the breadth, extent, and accessibility of credit information so that lending institutions can make more informed choices. In addition, the act seeks to improve access to formal credit for the majority of Pakistan's population.

Credit Information System Alternatives for Pakistan

Another information sharing system that serves a similar purpose – i.e., increasing credit availability to the private sector, especially SMEs – is the collateral registry. Collateral of some form is typically required for loans obtained from financial institutions. However, generally speaking, lending institutions often require collateral in the form of land, property, or cars, while movable collateral (such as inventory, accounts receivables, crops, and equipment) cannot be used as collateral for loans, as these assets are not registered in anyone's name. For example, when a bank makes a loan to a business, there is no guarantee that the business owner owns the equipment in a factory and that the company will not sell this equipment after securing the loan by keeping it as collateral. This issue is easily solved if a country has a collateral registry – i.e., publicly available databases of interests that hold asset ownership records (both movable and immovable), allowing borrowers to demonstrate their creditworthiness and lenders to determine their relative value in claims.

Conclusion and Future Expectations

Expanded and thorough information on the borrower held by a credit bureau may significantly impact the country's financial development. Availability of information regarding the borrowers' credit histories can ease borrowing constraints, allowing consumers and SMEs to borrow smaller loans easily, which in turn can generate credit-fueled growth. As banks will have even more information to make lending decisions, this will, in turn, reduce risk premia and borrowing costs. In a nutshell, to improve Pakistan's productivity and economic growth, the financial sector has to develop swiftly. This can be achieved by making the credible financial information on the creditworthiness of the creditors readily available to creditors. By encouraging the collection of credit histories, borrower's income, and other relevant information through credit bureaus, Pakistan can solve the problem of sparse credit information availability. However, for credit bureaus to be beneficial and effective, they must cover the majority of the population.

In addition, collateral registries may also be used to preserve a record of assets, both mobile and immovable, of small and medium-sized businesses (SMEs and service businesses). This can assist these businesses in obtaining loans by boosting the value of their collateral. The use of collateral registries might lead to more significant funding for small and midsize enterprises (SMEs) and service companies. Banks will utilize office furniture, computers, and machines as collateral via the collateral registry. The borrower cannot sell the collateralized property without obtaining permission from the lender. The lender may take legal action to reclaim collateral property that the borrower has sold.