Credit information bureaus in India are finally gaining credence, as an increasing number of banks and lenders are vetting the names of applicants before giving the go-ahead, writes **Annamma Oommen.**

Credit Worthy

THE current turmoil that the global financial services sector – especially in the US and some European countries – finds itself in, can be attributed to lax lending practices, which resulted in delinquent loans.

The sub-prime mortgage crisis in the US housing finance business – which triggered off the financial sector meltdown in the developed world – saw lenders aggressively offering funds to borrowers, without carrying out even the basic checks, such as whether the person was employed, had a good credit standing, or would be capable of servicing the loan.

Ironically, the credit-rating business – both for corporates and individuals – is well developed in the western world. But many lenders, in their eagerness for a greater share of the business, gave the go-by to such sensible norms and went on a lending spree. The bursting of the housing bubble in the US led to the mortgage crisis, but many lenders are now worried about their exposure through credit cards and personal loans to millions of borrowers, many of who would turn delinquent.

India's financial services sector, however, is still evolving and has not attained the levels of those in the US and other western countries. Tough Reserve Bank of India (RBI) norms have also prevented over-exposure on the part of lenders to the retail market.

Delinquency rates in the consumer finance industry in India are negligible. Despite the rapid growth of the sector, leading players have been taking adequate steps to ensure that the loans – housing, auto, personal and educational – credit cards, etc do not turn sour.

While most banks have been cautious while lending, one handicap faced by them has been an absence of adequate and credible data on retail borrowers. While companies like Credit Rating Information Services of India Limited (CRISIL), now a Standard & Poor's company, provide credit ratings and risk assessment relating to corporate borrowers, there was a vacuum in the individual credit ratings business.

Consequently many potential borrowers would not know the answer to the question, 'What's your credit score?' A credit score is a quantitative measure that is used by potential lenders to evaluate

an individual's credit worthiness. When an individual applies for a loan, the bank may ask for his credit score. A good score would result in a lower rate of interest compared to a bad one. This is a fairly common and standardised process in countries like the US.

Says Harsh Roongta, ceo of apnaloan.com: "Banks charge customers variable rates depending on their credit profile. The credit bureau plays a major role as it draws up a complete borrower profile for each individual, making it almost impossible for a delinquent customer to access credit from other banks."

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Supporting the carrot-and-stick approach is Sachin Khandelwal, head (card group), ICICI Bank. "We have always rewarded our customers who have used their credit cards wisely and have paid their dues on time," he explains. "Over the past six months, a significant number of our customers have managed to get good credit scores and we are charging them lower interest rates. So it is not that every cardholder is charged the highest rates."

Although India's retail finance market is expected to cruise along at 20 per cent compound annual growth rate (CAGR) in the near future, banking sources say that delinquency rates could range between six to eight per cent.

Individual credit rating is yet to become the norm in India. The Indian Government enacted the Credit Information Companies (Regulation) Act in 2005 to regulate companies in the business of credit information and for facilitating efficient distribution of credit.

A start was made with the establishment of the Credit Information Bureau India Limited (CIBIL), in 2000. An initiative of the Reserve Bank of India, its objective is to fulfill "the need of credit granting institutions for comprehensive credit information by collecting, collating and disseminating credit information pertaining to both commercial and consumer borrowers.

It was originally promoted by the State Bank of India (SBI), Housing Development Finance Corporation Limited (HDFC), Dun & Bradstreet Information Services India Private Limited (D&B) and TransUnion International Inc. SBI and HDFC had a 40 per cent stake each in the venture and D&B and TransUnion held 10 per cent each.

Currently, the shareholding pattern has been diversified to include several leading Indian and international financial service sector players. Besides the four initial promoters – who now have a 10 per cent stake each in the venture – others include government banks like Central Bank of India, Union Bank, Punjab National Bank, Bank of Baroda and Bank of India, private banks and non-banking finance companies like ICICI Bank and Sundaram Finance and international players including Citicorp Finance, Standard Chartered Bank, HSBC and GE Strategic Investments, India.

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The fundamental objective of CIBIL is to provide its members with a service that allows them to take decisions on credit worthiness of credit seekers. CIBIL, in collaboration with TransUnion of USA, also launched a generic credit score in India in November 2007.

Says S. Santhanakrishnan, chairman and ceo, CIBIL: "Banks will now know ab initio the risk that borrowers have. Smaller banks that do not have elaborate risk management and credit appraisal systems will certainly benefit from this." Instruments used by CIBIL in the collation of accurate information include PAN (permanent account number) cards, passports and voter ID cards.

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'INDIA IS A DEBT-AVERSE NATION'

In a country that is not known much for it earn-and-burn habits, consumer lending was virtually unknown in India. The housing finance industry took shape about 30 years ago, with the establishment of Housing Development Finance Corporation Limited (HDFC).

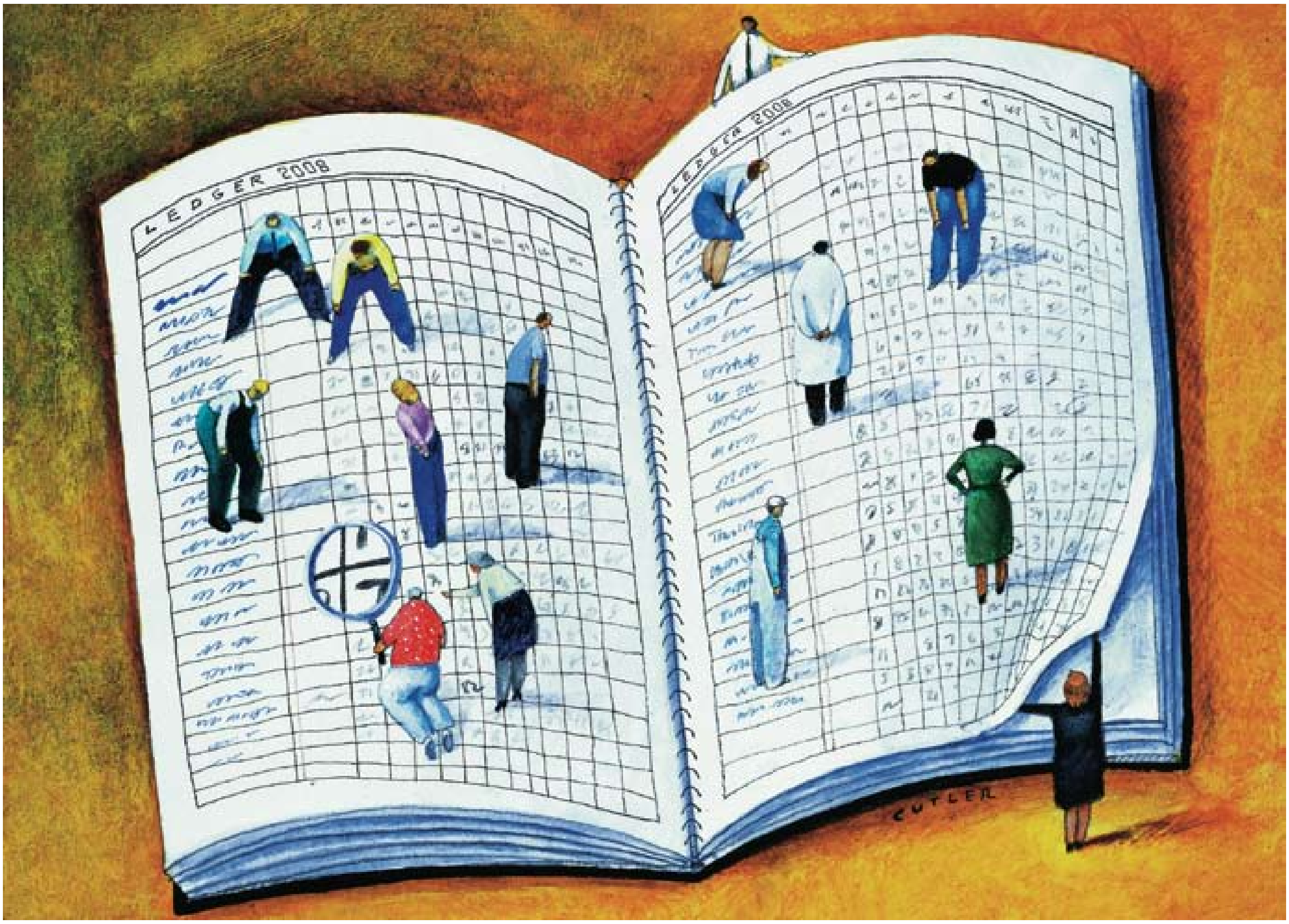
But over the last 10 to 15 years, other kinds of consumer lending have emerged including automobile loans, personal loans, education loans and credit cards. Despite the flourishing mortgage business – the industry has been growing at rates of above 30 per cent annually – the mortgage: GDP ratio in India is still six per cent, as against 80 per cent in the US. "In many western countries, the retail credit to GDP ratio is as high as 100 per cent," explains Keki Mistry, vice-chairman and managing director, HDFC. "In India, it is between 12 and 14 per cent. One out of every 23 Indians has a debit/credit card, whereas every American has at least two to three cards."

Mistry points out that most mortgage lenders in India offer plain vanilla, amortising home loans, not fancy products like sub-prime or Alt A categories. "All loans in India are repaid through EMIs (equated monthly installments), comprising both the principal and the interest amount.

Similarly, an Indian borrower has to bring in almost 35 per cent by way of equity, to avail of a debt of 65 per cent to fund a house. "India is a debt-averse nation and most Indians don't like to borrow," explains Mistry. "In fact, about eight to 10 per cent of our loans tend to get pre-paid." Non-performing assets are also negligible in the sector.

One of the major causes of the financial meltdown in the US was the securitisation of housing loans, with the primarily lender selling off the debt to other entities. In India, securitisation is still at a nascent stage and the National Housing Bank, the regulator, has ensured that it does not get out of hand.

There are 130 million payment cards in use in India, including 30 million credit cards, through which consumers spent nearly $15 billion last year. Celent, a consultancy, projects payment cards will touch 210 million in about two years. Hopefully, the growing numbers will not end up in blemishing the fine record of timely repayments.



the borrower is good or bad. It merely compares his creditworthiness and gives details about his credit history. It is up to the lending companies to decide whether the customer is likely to default or not."

The organisation sends out over two million credit reports every month to its over 140 members, which include banks, housing finance companies, non-banking finance companies, credit card firms, financial institutions and state finance corporations. Although individuals currently are not allowed access to their credit reports, the RBI is soon expected to release guidelines allowing this.

Action is now building up in this industry, with others planning to float similar ventures in tie-ups. Fair Issac Corporation, a US-based pioneer in the business and developer of the FICO score – a measure of credit risk and one of the most widely used credit scores - and High Mark Credit Information Services, an Indian firm, are setting up a venture.

CRISIL is also joining hands with Equifax of the US and Tata Capital to set up the Credit Information Company (CIC).

Prime mover CIBIL, however, claims to already have close to 100 million credit records documented and ready for reference for its members. In the past the records only included information on institutional defaulters that was shared between banks. With the incorporation of CIBIL, however, information shared expanded from not just on institutional defaulters but on individual consumers too.

Also, once records will be made available to individuals and consumers, they would be able to adhere to their repayment obligations, thus helping them reap benefits of their fiscally responsible behaviour, through better terms on loans.

So how is a credit score arrived at or computed? The score is actually a reflection of a statistical model that includes parameters like numbers and amounts of loans taken in the past, repayment history, number and amounts of defaults, balance outstanding on each of these loans, filings for bankruptcy and delays in credit card or EMI payments.

So does this mean that once you have defaulted on a payment, you will always have a poor credit score? Not quite. With the implementation of a proper planned approach it is possible to repair the damage and achieve a good credit score over a period of time.

While many of the American practices might take a while to find their way into India, there is no denying the fact that more than a start has already been made towards creating an accurate database of individual borrowers. How this evolves only time will tell, but the Indian financial sector will only benefit from such best practices, and emerge as a more robust and fortified system in times such as the ongoing global financial services sector crisis.