



## COVID 19 Emergency Policy Responses: Why Credit Reporting Matters in the Stabilization and Recovery Phases?<sup>1</sup>

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*Firms and individual borrowers are experiencing a sharp decrease in income due to COVID-19, making them unable to meet their credit obligations. Governments, Central Banks and financial sector regulators across the globe have proactively intervened to support the credit markets and avert a possible credit freeze by introducing unprecedented measures such as regulatory forbearance (includes moratoria on repayments, extension of past-due days). Given the interplay between fiscal, monetary and prudential policies, there is need for a coordinated and holistic approach to policy formulation and implementation to increase the likelihood of success of these measures in the longer term. For example, it is important that measures be carefully implemented, mindful of the implications on the credit information cycle because inaccurate and untimely data may delay recovery from the crisis. Properly functioning credit reporting systems can assist in the stabilization and recovery phases through supporting private sector credit granting, minimizing cost of public intervention, data driven policy formulation, credit classifications and IFRS 9 ECL computations.*

### 1. Implications of COVID 19 on borrowers and credit reporting systems

**Supply and demand side shocks caused by COVID 19 will result in traditionally responsible individual and business borrowers failing to meet their loan obligations as they fall due.** Majority of individuals borrowers who live paycheck to paycheck<sup>2</sup> have lost their jobs<sup>3</sup> while others have been furloughed impacting on their income. Businesses have been affected by lockdown rules which have impacted on their operations and declining aggregate demand because of the pandemic. Access to credit for individuals working in certain industries<sup>4</sup> will be severely constrained as lenders consider the impact of the pandemic during the recovery stage.

**Missed payments due to the pandemic will affect creditworthiness on individuals and businesses.** In the absence of safeguards such as technical reporting solutions (for example special reporting codes and identifiers), delinquencies arising from the crisis will affect traditionally good borrowers' credit histories and scores. Crises tend to result in lower credit scores<sup>5</sup> of affected borrower's post the stabilization phases thus impacting the cost of credit during the recovery phases. Unfavorable credit costs can slow the pace of recovery and increase the likelihood of default.

**Inadequate guidance on the treatment of credit data will impact on the integrity of the credit reporting systems.** Suppression directives<sup>6</sup> and incomplete instructions on treatment of forbearance/

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<sup>2</sup> McKinsey estimates that 74% of US workers live paycheck to paycheck.

<sup>3</sup> As at 30 April 2020, 30 million workers had lost their jobs due to corona virus induced disruptions.

<sup>4</sup> Some lenders in the UK and US have started restricting or excluded self-employed, tourism and frontline staff. <https://financialit.net/news/covid-19/impact-covid-19-personal-loan-market>

<sup>5</sup> A study on the impact of natural disasters on financial health of US residents affected by natural disasters found that credit scores declined by as much as 22 points.

<sup>6</sup> A few countries have issued suppression directives ordering the suspension of submission of negative data during the crisis.



moratoria<sup>7</sup> affects the integrity of the data in credit reporting systems reduces the reliance placed by credit providers on the credit reporting system as it leads to false positives. In addition, it also reduces the usefulness of the data for micro and macroprudential purposes.

**Faced with information asymmetry lenders tend to restrict customer acquisition, increase the cost of credit and in extreme cases ration the allocation of credit.** In the stabilization phase, public interventions are less focused on segregating between viable and non-viable firms.<sup>8</sup> As we move to the recovery stage, the role of private sector lenders increase. As the crisis deepens, lenders are looking for additional ways of assessing creditworthiness for existing and new clients.<sup>9</sup> Inadequate and untimely data will constraint the ability of credit providers to conduct creditworthiness assessments thus resulting in exclusion of new customers and credit rationing<sup>10</sup>.

This note is designed to demonstrate the role of credit reporting during the stabilization and recovery phase of the crisis, outline the interplay between prudential measures and credit reporting systems and proffer some credit information sharing recommendations across the phases. The measures are aimed at minimizing the friction and cost of implementing the COVID 19 financial sector policies.

## 2. Financial Sector Policy Responses to COVID 19

**Most governments have implemented a gamut of financial sector policy measures targeted at supporting financial and non-financial firms from the effects the COVID 19.**<sup>11</sup> The measures include injecting liquidity, reducing policy rates, increasing concessionary and non-concessionary credit lines, expanding the use of guarantees schemes and reviewing insolvency policies. Regulatory authorities have also implemented prudential measures aimed at complementing the fiscal and monetary policy measures including releasing capital buffers; relaxing portfolio classifications and provisioning, regulatory limits such as credit exposure, days past due, liquidity, and definition of capital.

**Private sector players such as financial institutions have also been creating additional lending headroom through securitization structures mostly with Central Banks.** Further, financial institutions are accessing credit lines from international finance institutions<sup>12</sup> most of which are being accessed at favorable terms, with the expectation that lenders continue adhering to prudent credit risk management which include the need for credit checks.

**The measures implemented are aimed at enhancing financial sector resilience so that they can support the smooth functioning of credit markets through ensuring availability of affordable credit.** This will in turn guarantee the survival of firms and reduce job losses and ultimately limit the negative effects of the crisis on economies.

**In normal times, credit market activity relies on the availability of reliable, accurate and up-to-date information on borrowers, which enable credit granters to take informed risks and grant effective credit.** In a pandemic, where risks are amplified for all the reasons mentioned in section 1 above, therefore, the importance of credit reporting systems cannot be emphasized enough. Lenders need objective guidance on how to allocate the additional liquidity that they now have access to, which a credit reporting system is

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<sup>7</sup> Several prudential directives including forbearance and moratoria directives have not be accompanied by details instructions of how that data should be treated in the credit reporting systems.

<sup>8</sup> A lot of the public sector initiatives have little or no regard of the probability of survival of the firms being supported

<sup>9</sup> See McKinsey Global “Leadership in the time of the coronavirus: COVID-19 response and implications for banks” March 2020

<sup>10</sup> Personal lending in Louisiana and Mississippi declined by 39% post Katrina.

<sup>11</sup> FCI GP COVID-19 Financial Policy Response Compendium

<sup>12</sup> The recently launched \$6 billion IFC FIGE facility is an example of IFIs support to financial institutions.



well positioned to provide. The rollout of financial, liquidity and prudential measures, therefore, should be formulated and implemented keeping in mind the underlying impact on credit reporting systems. Any measure that is taken should minimize disruptions to the credit reporting system, while at the same time affording protection to borrowers that are impacted by the crisis. If credit reporting systems can effectively continue to operate without disruption and protect vulnerable borrowers, then they will enhance the effectiveness of financial sector policy measures during the current stabilization phase of the pandemic response as well as in the subsequent recovery phase.

### 3. Role of Credit Reporting in Supporting Financial Sector Policy Responses for the Pandemic

**Access to reliable credit information, which is the cornerstone of most lending decisions globally, can help address both liquidity and risk aversion issues.** Globally, as financial markets grapple with the effects of the pandemic, financial institutions are generally facing liquidity issues and reduced risk appetite. During and in the aftermath of a crisis, lenders using their own funds will tend to adopt cautious lending approaches based on prudent credit risk management which include credit referencing (bureau checks). As a result, lenders usually look for past credit histories but also seek an understanding of how different sectors are going to be affected by the crisis and the likelihood of non-performance going forward. Faced with uncertain economic conditions and even more uncertainty regarding a recovery, lenders will hesitate to disburse available funding, thus reducing the likelihood that most private sector led liquidity measures will achieve their intended objectives in the immediate term.

**Adequate credit information can reduce the cost of government interventions to taxpayers.** In instances where lenders are extending public sector facilities, these funds usually come with less onerous conditions and in most instances do not include the need for credit referencing. As a result, these funds might be disbursed without due consideration, resulting in loan delinquencies, financial instability and ultimately the potential cost to the taxpayers of resolving the crisis might end up being high and unbearable for some developing and emerging economies without fiscal space. There is also evidence that in the absence of adequate information on certain borrower segments, lenders tend to target existing clients<sup>13</sup> thus negatively impacting on non-customers particularly MSMEs and minority owned businesses, most of which are usually excluded.

**While credit reporting information is critical in credit granting, the bureaus host information that can also help in informing data driven policy formulation<sup>14</sup>.** This is important in the context of minimizing the costs of the crisis on the taxpayers. As governments and development partners launch relief packages, it is important to guarantee that support is directed to more deserving firms and sectors (based on need, contribution to GDP, employment, viability, etc.), and also ensure that such interventions are timed to address the needs of different sectors as and when they are affected.

**Credit bureau data can assist in credit classifications and IFRS 9 expected credit loss computations.** The measures implemented by governments in response to COVID-19 introduce additional complexities in complying with IFRS 9<sup>15</sup> when assessing whether there is a significant increase in credit risk and computing expected credit loss (ECL). Credit reporting systems can provide accurate and timely historical, current and forward-looking information without imposing undue cost or effort to reporting entities.

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<sup>13</sup> Banks in the US administering the Small Business Loans Program have been criticized for excluding new clients.

<sup>14</sup> WBG Zimbabwe CO is supporting the government with aggregate data analytics to support evidence driven policies. The initiative will analyze mobile phone data including GPS and mobile data.

<sup>15</sup> IFRS issued a guidance on IFRS 9 and COVID-19 on 27 March 2020.



**Effective implementation of credit reporting measures can potentially contribute to the success of some of the fiscal, monetary and prudential measures.** For example, the success of a recovery loan program can be positively impacted by availability of full file credit information in credit reporting system. Studies have shown that faced with potential “blind spots due to credit data suppression” lenders tend to tighten their underwriting policies or increase the cost of credit<sup>16</sup> thus militating against the objectives of a recovery loan program. **Annex 1: Interplay of prudential and credit reporting measures** provides examples on the importance of credit information sharing to supporting other financial policy measures.

## 4. Credit Reporting Intervention

Given the implications that the various prudential and other measures taken can have on credit reporting and how critical credit information systems are to enabling these regulatory and prudential measures in reaching their respective objectives, we outline below a series of phased interventions to be considered by regulators and policymakers, credit reporting service providers, and lenders/data providers in responding to the COVID crisis.

In this section, we outline credit reporting interventions across the COVID response phases indicating measures<sup>17</sup> that should be considered by policymakers and industry participants to uphold the credit information sharing market and ensure that it supports the other initiatives that regulators have put forth.

### 4.1 Phase 1 Interventions: Stabilization/ Containment Phase (3 to 6 months)

Phase 1 responses are aimed at addressing the immediate needs of the credit markets (over the next three to six-month period). This will ensure that credit flows from financial institutions to borrowers and enhance the financial stability and economic objectives of the prudential, fiscal and monetary measures.

#### **Regulators and Policymakers:**

1. Implement and enforce policy to report **full file credit information** to credit reporting service providers during COVID-19, **using technical reporting solutions** (such as flags or codes for loans under agreed forbearance or deferred payment status window) that ensures minimal or no effect on borrowers’ credit histories and scores. This will enhance the flow of credit and safeguard the integrity of the financial systems.
2. Provide guidance to bureaus and/or lenders on the **use of technical reporting solutions** to ensure uniformity and consistency in application of policies.
3. Build/strengthen **capacity of regulatory authorities and policy makers to utilize the credit reporting information and ratings products from credit bureaus and registries to support data driven policy interventions** such as targeted allocation of credit to critical industries and sectors and firms with higher probability of survival.
4. Targeted **financial literacy programs to raise awareness of borrowers** on the following:
  - advising borrowers experiencing payment difficulties due to the crisis to approach credit providers to negotiate payment deferrals, restructuring of facilities.
  - publicizing how credit providers and credit reporting service providers will report and process payment delays, deferral and restructuring arrangements in a way that minimizes the impact on credit scores.
  - publicizing government intervention including existing policies and facilities.

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<sup>16</sup> Experian issued an article titled Data Reporting Under Guidelines Is Better for Consumers Than Data Deletion on 20 April 2020

<sup>17</sup> The recommendations are based on the ICCR Policy Recommendations on Treatment of Credit Data in Credit Information Systems in the context of the COVID-19 pandemic



- the need for borrowers to conduct more frequent review of their own credit reports.
5. Promote **access to alternative data sources and public databases** (for instance for employment and salary verification) to credit reporting services providers so that they can develop alternate means of analysis for borrowers' particularly those that are considered as thin file (such as MSMEs).

#### **Credit Reporting Service Providers:**

6. Provide **training to ensure consistent interpretation and application of the data reporting requirements** by all credit providers and participants in the credit reporting system.
7. **Activate business continuity measures** to offer (i) flexibility in reporting for lenders (where needed); (ii) continued access to credit reporting services by lenders in a timely manner; (iii) ability to handle consumer complaints, disputes and self-inquiries.
8. **Ensure data subjects are provided digital access to free credit reports & scores** during the crisis, where possible.
9. Develop **COVID 19 rating for MSMEs** that can be used to assess firms' probability of survival. The rating can be used by governments and private sector credit providers to identify the firm that have a higher likelihood of survival.

#### **Credit Providers:**

10. Ensure clear communication to borrowers regarding the potential impact of adjustment to payment agreement (based on forbearance or any other relief) on their credit report.
11. In cases where data submissions timelines are changed, the financial institutions should continue collecting and recording data in anticipation of making submissions as per the new timelines.
12. Coordinate with CRSPs and other lenders to ensure consistent interpretation and usage of data reporting requirements during and after the crisis.

### **4.2 Phase 2: Recovery Phase (6 to 24 months post Phase 1)**

Phase 2 talks about measures to be taken once the health crisis subsides, the lockdowns end, and businesses reopen.

#### **Regulators and Policymakers:**

13. Implement **measures to monitor that the negative payment information reported during the crisis has minimal or no effect on credit histories and risk scores of data subjects**. The measures may include following periodic random reviews of data supplied to CRSPs.
14. Support the **review of scoring algorithms** to reflect the impact of the crisis.
15. Enhance **complaints and dispute handling capacity of regulatory authorities w.r.t credit information**, which are likely to increase as the crisis evolves.
16. **Utilize granular data housed in credit reporting system and analytic tools** about credit portfolios for recalibrating policies throughout the recovery phases and beyond the COVID 19 crisis.
17. Enhance **regulatory authorities' consumer and financial literacy programs** through publication of recommended plan of actions and availing additional useful resources to the borrowers

#### **Credit Reporting Service Providers:**

18. Ramp up and/or **automate their complaints and dispute handling processes** to ensure that any impact of the crisis on call centers handling complaints and disputes is minimized.
19. **Review and revise credit scoring models and algorithms** based on performance data from initial phase of the crisis.



20. **Provide training to credit providers and other data providers on revised data inputs (if any) and scoring models.**

**Financial Institutions/Lenders:**

21. **Utilize sectoral data** from CRSPs to cater the segments which were not considered during the COVID Phase I for lending.
22. **Recalibrate internal scoring models.**



**Annexure 1: Interplay between Prudential Measures and Credit Reporting**

Measures	Impact on Financial Sector	Credit Reporting Solution
Launch of individual/ business loans programs	<ul style="list-style-type: none"> <li>Unhinged credit granting can result in over indebtedness, NPLs</li> </ul>	<ul style="list-style-type: none"> <li>Full file credit reporting with safeguards that minimize impact on credit history and scores of customers</li> </ul>
Suppression of negative credit data	<ul style="list-style-type: none"> <li>Credit rationing – the continued submission of positive and reporting information will inadvertently reveal to credit providers the customers with missed payments</li> </ul>	<ul style="list-style-type: none"> <li>Full file credit reporting with reporting codes for delayed payments</li> <li>Implementation of technical reporting codes</li> </ul>
Moratoria	<ul style="list-style-type: none"> <li>If no accompanying guidance is provided, there will be negative consequences for credit reporting such as inconsistencies in interpreting DPD and reporting it</li> </ul>	<ul style="list-style-type: none"> <li>Issue of credit reporting guidance</li> <li>Full file reporting with loans under moratoria being reporting as current and flagged?</li> <li>Implementation of technical reporting codes</li> </ul>
Ease of days past due (DPD)	<ul style="list-style-type: none"> <li>Impacts compliance with international accords such as Basel and Accounting Standards</li> <li>Introduces several practical considerations for bureaus including recalibration of systems, review of scores – all of which will be for a short time</li> </ul>	<ul style="list-style-type: none"> <li>Issue of guidance on treatment of data during and post crisis</li> </ul>