

**WESTERN HEMISPHERE CREDIT AND LOAN
REPORTING INITIATIVE**

**INICIATIVA DE SISTEMAS DE REPORTE DE PRÉSTAMOS
BANCARIOS Y CRÉDITOS DEL HEMISFERIO OCCIDENTAL**



**ASSESSMENT AND OBSERVATIONS ON THE CREDIT AND
LOAN REPORTING SYSTEMS OF BRAZIL**

**DRAFT
(March 2005)**

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EXECUTIVE SUMMARY

INTRODUCTION AND OVERVIEW

The World Bank and the Centro de Estudios Monetarios Latinoamericanos (CEMLA) lead the Western Hemisphere Credit Reporting and Loan Initiative (WHCRI). The objective of the Initiative is to describe and assess the credit and loan reporting systems of the Western Hemisphere with a view to identifying possible improvement measures in their quality, efficiency and integrity. This document is the result of work developed by an international team, in coordination with a local team. The international team visited Brazil from January 17-28, 2005. Members of the international team were: Ms. Lucinda Brickler (FIRST Consultant), Mr. Federico Castro (FIRST Consultant), Mr. Massimo Cirasino (World Bank), Mr. José Antonio García (CEMLA), Mr. Mario Guadamillas (World Bank), Mr. Matías Gutierrez Girault (FIRST Consultant), and Ms. Margaret Miller (World Bank). The local team was coordinated by officials from the Central Bank of Brazil (*Banco Central do Brasil*, BCB), and included Mr. Cornelio Pimentel (Head, Off-site Supervision Department) and Mr. Carlos Urata (Senior Advisor, Off-site Supervision Department).

The team held several meetings with the objective of understanding various aspects of the credit reporting system in Brazil and the status of ongoing and planned reforms. In addition to meetings with several departments of the BCB, the team attended meetings with the Ministry of Finance, the Ministry of Justice, the three major credit bureaus, Fair Isaac, the Sao Paulo Consumer Protection Agency (PROCON), a private consumer protection entity (IDEC), the Association of Public Notaries (ANOREG), commercial banks, the banker's association (FEBRABAN), the Association of Financial Market Institutions (ANDIMA), SEBRAE, and associations of non-bank financial institutions, of cooperatives, of leasing institutions, of factoring institutions and of home loans and savings institutions and the Real Estate Registration Institute (IRIB). The team had an opportunity for open discussions with these institutions and believes that it has been able to obtain representative views of the financial community in the country with regard to current credit reporting arrangements and ongoing and planned reforms. The team wants to express its appreciation to the management and staff of the BCB and to all the representatives of the institutions visited for their full and enthusiastic support of the mission's activities and objectives.

This Executive Summary presents the results of the assessment of credit and loan reporting based on international best practices and includes several observations for the improvement and future development of the credit reporting system in Brazil. The document also provides suggestions on how to move forward reforms in the credit reporting system. In preparing this document, the international team has taken into account the fact that the authorities are already planning and/or taking appropriate actions on several of the issues discussed. In many aspects, this document should be viewed therefore as a checklist for use by the local team in undertaking the already initiated current and future actions. In other cases, some additional elements might have been identified and those are brought to the attention of local authorities. The rest of the document is organized as follows: first, presentation of a brief overview of the current credit reporting system; second, comments on the overall management of the reform agenda; third, discussion of key issues for reform of the credit reporting system from a variety of viewpoints (legal and regulatory reform, issues related to consumer outreach and protection, private credit information providers, reforms with respect to the BCB-run *Sistema de Informações de Crédito* (SCR) and other public databases, credit reporting systems and competition in the credit market, linkages between payment systems and credit reporting and the oversight function and cooperation in credit reporting systems); and, finally, suggestions on next steps. This is a detailed Report, for a final revision and feedback. The BCB and CEMLA will work together to finalize the Descriptive Report "Credit and Loan Reporting Systems in Brazil" (so called "Orange Book"), based on the draft being developed by the mission.

For some years now, negative credit information has been available and shared through the credit reporting system in Brazil. Recently, some positive credit information is also becoming available for regulated financial institutions through the BCB-operated *Sistema de Informações de Crédito* (SCR). This database was originally called *Central de Risco de Crédito* (CRC) and functioned mainly as a centralized system of credit information for banking supervisory purposes. Initially only loans of amounts \geq R\$50,000 were reported. In 2001, the former system was reformed to include additional positive and negative information on all loans with amounts \geq R\$5,000, and the information collected was made available through more efficient means to financial institutions. Nevertheless, the SCR's basic purpose is still to support banking supervision activities and the credit bureau function it provides is considered by the BCB only as a secondary role of the system. Regulated financial institutions feed the SCR monthly and only these institutions may access the database for consultation purposes. At present, approximately 2.5 million consultations to the SCR are made by authorized financial institutions every month.

The BCB also operates other databases, some of which are relevant for credit granting purposes. These include the *Registro Comum de Operações Rurais* (RECOR), *Microcrédito*, *Sistema de Registro de Operações de Crédito com o Setor Público* (CADIP), and the *Cadastro Informativo de Créditos não Quitados do Setor Público Federal* (CADIN). The BCB is also closely involved with the *Cadastro de Emitentes de Cheques sem Fundos* (CCF), whose daily operation is carried out by the state-owned Banco do Brasil. While the first three are used by the BCB basically to monitor the compliance of regulated financial institutions with laws and regulations as well as for statistical purposes, the CADIN and the CCF are relevant for credit decisions and the information they contain may be accessed by credit providers either directly or through private credit reporting firms.

SERASA is the largest privately-owned credit bureau in Brazil and is owned by a group of private commercial banks, although it also provides services to many other financial and non-financial credit providers. SERASA was created almost 37 years ago, but it began to function as a credit reporting firm only in 1995. Traditionally, SERASA's focus has been on consumer credit data. Approximately 25,000 institutions feed data to SERASA (20,000 negative information and 5,000 negative and positive) and its database contains information on approximately 70 million individuals (only 42 million with credit information) and more than 7 million firms. On average there are 2.5 million consultations per day. Besides negative and some (few) positive credit information reported by credit providers, SERASA also has and provides information on delinquent taxes (CADIN), dishonored cheques (CCF), and judicial actions and proceedings, among others. Finally, SERASA also provides a variety of value added products and services for credit grantors, including analytical and decision tools such as bureau credit scoring models.

Other relevant credit reporting firms include *Serviço Central de Proteção ao Crédito* (SCPC) and Equifax. SCPC is a not-for-profit venture of the Sao Paulo Chamber of Commerce, which has developed a nationwide network by linking similar registries in other cities. Its information sources were traditionally retail merchants, although at present banks comprise a substantial share of information provided to SCPC. After SERASA, SCPC is the most commonly used database of consumer credit information and is used by both non-financial and financial creditors. Its database contains approximately 40 million individuals. On the other hand, Equifax focuses on commercial credit. Until 1998 when Equifax acquired it, the firm used to be a local credit bureau focusing on the manufacturing industry. Currently, its database contains records on 5 million enterprises. It also reported having data on 7.5 million individuals. Besides its credit bureau services, Equifax is working intensively on the development of credit scoring models.

Regarding other useful data for credit decisions such as public commerce acts or property information on real estate and other major goods (i.e. vehicles) and their related liens, in most

cases there is no public centralized registry system from which this information can be obtained. In general, information of these types is handled by public notaries and private registries (*cartórios*), each of them with a monopoly over a particular geographical area where such information is recorded. Through authorized distributors, some information is then sold to credit providers and private credit registries. One exception is the *Sistema Nacional de Gravámenes* (SNG), which was developed to register liens on motor vehicles.

There is a lack of an adequate legal and regulatory framework. Laws like the *Lei 8.078* (Consumer Protection Law) and *Lei Complementaria 105/01* contain some of the concepts and dispositions that are relevant to credit reporting, including the conditions under which positive and negative credit information may be shared without violating banking secrecy provisions and the time limit for negative data to remain in any given database. Also, there are some Resolutions issued by the *Conselho Monetário Nacional* that deal with specific issues related to credit reporting. However, information sharing and credit reporting activities remain unregulated for the most part. To this end, there is currently a draft law to be presented shortly to Congress whose basic purpose will be to provide a sound legal basis for exchanges of positive credit information.

CREDIT REPORTING SYSTEM REFORM

For some years now, negative credit information has been available and shared through the credit reporting system in Brazil. Recently, some positive credit information is also becoming available for regulated financial institutions through the BCB-operated *Sistema de Informações de Crédito* (SCR). This database was originally called *Central de Risco de Crédito* (CRC) and functioned mainly as a centralized system of credit information for banking supervisory purposes. Initially only loans of amounts \geq R\$50,000 were reported. In 2001, the former system was reformed to include additional positive and negative information on all loans with amounts \geq R\$5,000, and the information collected was made available through more efficient means to financial institutions. Nevertheless, the SCR's basic purpose is still to support banking supervision activities and the credit bureau function it provides is considered by the BCB only as a secondary role of the system. Regulated financial institutions feed the SCR monthly and only these institutions may access the database for consultation purposes. At present, approximately 2.5 million consultations to the SCR are made by authorized financial institutions every month.

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LEGAL AND REGULATORY ISSUES

Context:

The legal and regulatory environment for sharing credit information and other related data is a key determinant of how credit reporting develops. In some countries specific laws on credit reporting exist, in others more general laws related to data protection and/or bank secrecy govern the industry and in yet others, little legal or regulatory guidance exists. While there are many ways to construct an adequate legal and regulatory framework for credit reporting, there are also some common principles that most of the countries with good practice in this area follow. These common principles include:

- i. Recognition of the legality of credit information sharing by lenders, retailers and service providers in the economy, including both positive and negative data;
- ii. An effective consumer protection framework which balances the lenders' need for data with the individual's rights regarding the collection and distribution of his/her own financial data;
- iii. Institutions and mechanisms to enable authorities to supervise and enforce compliance with the legal and regulatory framework.

The World Bank has developed good practice guidelines for the development of laws and regulations for credit reporting. These guidelines will be used for country compliance reviews undertaken by the World Bank, IMF and other multilateral organizations and are attached as an Appendix to this document. These guidelines also provide a point of reference for the review of credit reporting laws and regulations in Brazil.

The current legal situation in Brazil:

Brazil does not have a specific law focused on credit reporting. The legal foundations for credit reporting come from several laws including the Constitution (Art. 5, incisos XII, XIV, XXXIII), the Consumer Protection Law (No. 8.078, Article 43), Financial sector Law (No. 4.595, Article 38 regarding bank secrecy), the law for Habeas Data (No. 9.507) and the Civil Code (No. 397 – mora). Additional laws govern specific aspects of information sharing, such as the laws for Cartórios (Nos. 8.935/94, 9.492 and 9.841 – Art. 40) and Central Bank laws and regulations related to the public credit registry (including notably Complementary Law 105). In some cases, state laws and regulations also affect this activity, as well as judicial decisions. There is also an important new draft law being developed to provide a strong legal foundation for the operation of positive information credit bureaus. The most important of these laws, regulations and judicial decisions, including the new draft law for positive bureaus, will be briefly described and analyzed in this section in terms of its current impact on credit reporting. Recommendations follow relating to the most important issues for reform and development of the legal and regulatory framework for credit reporting in Brazil.

The Brazilian Constitution

The Brazilian Constitution of 1988 includes the fundamental right of access to information, from both the public and private sectors, but also recognizes certain conditions or limits on this access. Article 5, item XIV states that citizens, in general, have a right to access information but also states that the source of the information may be protected if necessary for exercising a profession. For example, Article 5, item XII of the Constitution recognizes the private or secret nature of correspondence and communications including telegraph and telephone. This “telephone secrecy” may discourage telecommunications providers from reporting on delinquent customers as their dealings with the phone company are seen to be protected in the Constitution. Item XXXIII of the same Article guarantees citizens their right to access data held by the government, with exceptions for information which requires confidential treatment to protect the security of society at large or the state.

The Consumer Protection Law, No. 8.078, Article 43

Articles 43 and 44 of the Consumer Protection Law, No. 8.078 (passed into law on September 11, 1990) provides general guidance on the operation of databases in Brazil. Although databases for credit reporting are not mentioned specifically, this law is considered to cover their operation, as they are not excluded. Article 44 relates to a registry of consumer complaints about Brazilian businesses to be maintained by the consumer protection authorities and made available to the public. The relevant guidance on credit reporting thus comes in Article 43, items 1 through 5 which include the following principles:

- i. Data should be objective, clear and accurate;
- ii. Negative information should be maintained for no more than five years;
- iii. Consumers must be notified in writing about the creation of a file on them if they did not request its creation;

- iv. Consumers can request changes of incorrect data to the database operator. These changes are to be effected in 5 working days and communicated to institutions which received the erroneous data;
- v. Databases on consumers, credit protection services and other related databases have a public character; and
- vi. Once a debt is repaid negative information related to it should be erased.

Although specific regulatory guidance on the implementation of the Consumer Protection Law with respect to databases was never passed, the law is observed by the credit reporting industry and is the basis for judicial decisions. The Law, however, is written in fairly general terms as more detailed guidance was expected to be provided by the Ministry of Justice. The uncertainty resulting from this situation gives judges significant latitude in interpreting the law, with consequences far from what may have been originally intended by lawmakers.

One of the most important of these judicial rulings for the credit reporting industry concerns the interpretation of what is required when informing customers of the creation of positive databases. On May 8, 2003, a Federal Judge in Sao Paulo upheld an earlier ruling and found that in order to duly inform consumers of their inclusion in a positive information database SERASA would have to use registered letters with proof of receipt. This type of mail is much more costly than the standard letter used for other consumer communication, such as when negative information is added to a file. The difference in price (about R\$ 7 compared with less than R\$ 1 for a standard letter) makes positive credit reporting economically unviable and has effectively suspended the development of positive credit reporting in Brazil (i.e. development of a database containing information on a person's complete payment history, including on-time payments). Although this decision is being appealed, due to the case backlog it could still be years in normal circumstances before it is resolved.

The Financial Sector Law, No. 4.595, Article 38 (bank secrecy)

The Financial Sector Law, No. 4.595, from 1964, governs the financial system in Brazil including the operation of the Central Bank, National Monetary Council, public banks and privately owned financial institutions. Article 38 of this Law describes bank secrecy and states that it relates to both assets and liabilities. Item 7 of the Article specifies criminal penalties of up to four years in prison for violation of bank secrecy. It does not mention credit information sharing by financial institutions nor does it provide any guidance as to how credit reporting would be viewed under bank secrecy.

Bank secrecy is often cited as a primary reason for the lack of sharing of positive payment history data by banks in Brazil. The law applies to bank assets (loans) as well as deposits and, as stated previously, provides no exception for credit reporting. Subsequent laws, such as Complementary Law No. 105, and even the draft law "cadastro positivo" (both described in greater detail below) do not specifically state that bank secrecy does not apply to private credit reporting initiatives and the exchange of positive payment history data. The lack of clarity with respect to the status of credit reporting has been an impediment to the development of this activity, even if it does not represent an outright prohibition on information sharing.

The Law for Habeas Data, No. 9.507

The Law governing Habeas Data (No. 9.507, passed on November 12, 1997) further specifies the rights of data subjects with respect to access to their information contained in registries and databases and their legal recourse to correct and amend this information. The Law begins by stating that registries and databases which have information that is distributed to third parties have a public

character. Data subjects can request access to their information and can request changes to information they consider erroneous. Once information has been shown to be inaccurate, the database operator has 10 days to change the data. If the database operator believes the data to be accurate even after the challenge, the data subject still has the right to add a comment to his/her file with regard to the data. If data subjects are denied access to their information or do not receive communication from the database operator for more than ten days after seeking access or if the database operator refuses to amend inaccurate data or does not communicate with the data subject within 15 days of being notified of the data error, these are grounds for seeking judicial remedy under habeas data.

Draft Law on Positive Credit Reporting (Cadastro Positivo)

The Secretary of Economic Policy in the Ministry of Finance (Fazenda) is leading work on the development of a new law for credit reporting which would provide a legal foundation for the creation of positive information databases as well as address other aspects related to the operation of credit reporting firms in Brazil. Fazenda organized an interministerial team to develop this draft law, including both the Ministry of Justice and the Central Bank. The work on this law was inspired by a desire to promote greater access to credit in Brazil and lower transaction costs through more transparency and better risk analysis. The Ministry of Justice, which oversees the state-level PROCONs (Consumer Protection Advocates) brought consumer protection concerns to the debate and the Central Bank brought insights regarding the importance of this data for the financial sector. In addition, the team sought input from the major credit reporting firms in Brazil. As a result, this draft law enjoys the support of the involved government institutions, the private credit reporting industry, bank associations and consumer advocates – no small feat.

The draft law, which was provided to the mission, provides very useful guidance on the legal basis for sharing credit information in Brazil and thus helps to overcome some of the legal vacuum which currently exists. Among the most important aspects of the draft law are the following:

- i. Establishment of a clear legal framework specifically for credit reporting activities;
- ii. Establishment of the legal foundation for sharing positive payment histories, including detailed guidance as to the required mechanisms for notifying customers of the creation of a positive data file;
- iii. Creation of the legal basis for negative information to be provided directly to credit reporting firms with no prior requirement of passing through the cartório system;
- iv. Creation of the legal basis for maintaining information on debts which have been regularized in credit reports (so that negative data is not simply erased once the debt is repaid);
- v. Clarification that credit reporting firms may not restrict data providers from sharing information with other competing credit reporting firms;
- vi. Clarification of some consumer rights and grievance procedures related to the operation of credit registries; and
- vii. Establishment of the legal foundation for the development of decision tools such as credit scoring and other analytical risk tools.

Recommendations:

1. **Work to approve the credit reporting “cadastro positivo” legislation.**
2. **Strengthen the credit reporting “cadastro positivo” legislation in some key aspects, either before presentation to Congress or in the future via amendments.**

The mission supports the passage of the draft law for “cadastro positivo” which would represent an important step forward in creating a more complete legal framework for credit reporting in Brazil. The mission recognizes that this draft law was developed carefully over many months with significant input from key market participants and that additional modifications to the draft could slow its passage into law. Notwithstanding our support of the law in its current form, and our desire to see it approved into law as soon as possible, the mission also has identified some weaknesses in the current draft which should be addressed in the future. These include the following issues:

- i. ***Additional rules or restrictions on access to credit reporting data are needed to protect consumers from unwarranted consultations and abusive customer practices.*** Current Brazilian law, as well as the “cadastro positivo” draft law, focuses attention on a person’s inclusion in a database but places few restrictions on access to data by data furnishers. The draft law states that in order to access the data the lender or firm need only maintain, or intend to maintain, a commercial relationship with the data subject. This broad access would not seem to restrict uncompetitive policies, such as obtaining reports on potential clients or suppliers so as to gain an advantage in commercial negotiations. Restricting access in some way is advisable. The concept of permissible purpose is one way to accomplish this; only firms or lenders with a permissible purpose under the law, such as responding to a request for credit or by specific authorization of a client, are able to obtain a credit report.
- ii. ***The law does not specifically mention that it overrules bank secrecy as described in Law 4.595, Article 38, thus providing a legal basis or exception from bank secrecy for credit reporting.*** As such, it may be interpreted as only relating to credit information provided by retailers and other businesses and not for data from regulated financial institutions. If banks do not feel that they are protected legally when sharing data with credit reporting firms then the law may fall short of its intended objective – to create complete credit histories on Brazilian consumers. There is also no good economic rationale for treating data from regulated and non-regulated financial institutions differently – the goal should be a comprehensive credit reporting system, not one where bank data must be segregated due to different legal treatment. There in fact seem to be different interpretations of the draft law regarding its relevance for bank data and bank secrecy between the credit reporting firms and government officials.
- iii. ***A regulatory framework is absent in the draft law.*** Strengthening supervision and non-judicial means of customer recourse is necessary to make customer protections effective and increase confidence in the industry. The lack of a discussion on the regulatory framework suggests that PROCONs and the judicial system would be the continuing main avenues for consumer complaints. The effectiveness of the PROCONs in this respect should be addressed as they receive only a handful of complaints per year on the credit reporting system– an extremely surprising figure given the size and scope of the industry and the number of judicial complaints related to credit reporting. The central bank should likely assume at least a limited role related to supervision of credit reporting as related to regulated financial

institutions. For broader regulatory oversight, in addition to PROCONs, there may be a role for other government institutions (perhaps related to commerce and economic development) to provide policy inputs and support for oversight of the industry.

- iv. ***Additional attention should be placed on effective mechanisms for consumer protection, especially for more marginal, less educated borrowers.*** These issues are discussed in greater detail in the section on consumer protection. One of the most important of them is to include adverse action notification so that consumers are aware when a negative action has been taken based on their credit report, such as denial of credit.
3. ***Approve the specific guidance (“regulamentar”) required to fully explain and implement Complementary Law No.105, related to bank secrecy, and make it clearly include participation in both private and public credit reporting activities.*** Complementary Law No. 105 was passed into law in January 2001 and four years later banks are still not sharing positive data on their customers via the private credit reporting industry. Law No. 105, specifically states in Article 3 that it is not a violation of bank secrecy for banks to share information with other financial institutions, including via “centrais de risco” as long as the regulations stipulated by the National Monetary Council and Central Bank are observed. The Law provided the legal protection required by the Central Bank to pursue their “central de risco” but without “regulamentação” it does not provide the kind of iron-clad protection which banks seek from charges that sharing positive data with private credit reporting firms violates bank secrecy.
4. ***Allow private credit reporting firms access again to CPF and CNPJ data for identification purposes.*** Tax identification numbers for individuals (CPF) and firms (CNPJ) are publicly available today on a one-by-one consultation basis. Batch processing of this information, however, used to be done between at least one credit reporting firm (SERASA) and Receita Federal in the government. This service was suspended in the wake of controversy several years ago, but the essentially public nature of the data was not changed. Moreover, some financial institutions and regulators beyond Receita Federal are still receiving access to this database in aggregate form, including the Bank of Brazil and Central Bank. If the CPF and CNPJ data are essentially public in nature, then access to this data solely for identification purposes should be reinstated for all recognized, duly operating credit reporting firms. This could be done against a list of CPF & CNPJ numbers provided by the firms to the government on a periodic basis, with inconsistencies or suspended numbers highlighted. This would help to reduce fraud, strengthen incentives for complying with fiscal obligations, reduce the computing demands on Receita Federal systems as direct inquiries are made instead of using the credit reporting infrastructure and reduce processing costs for the credit reporting industry.
5. ***To increase focus on competition and corporate governance aspects of the credit reporting industry via appropriate regulations, laws and supervision.*** The credit reporting industry in a country is part of the financial sector infrastructure. If it has weaknesses, this can affect the soundness and performance of the system. In the case of Brazil, credit reporting developed on a voluntary basis with segmentation by type of lender – a situation which today results in limited competition. The leading Brazilian banks created SERASA more than 35 years ago and it continues to be the dominant credit reporting firm, with data on both individuals and firms. Most banks provide information only to SERASA, and while SERASA now gets a majority of its data from non-banks (60% according to firm officials) its competitive advantage still derives from its unique access to bank data. Equifax

purchased the Brazilian firm SCI five years ago and their database continues to focus on business data (SCI's market), especially from the industry and manufacturing sectors, although they are making inroads into consumer data – but still with very little information from banks. SCPC and other databases formed by Chambers of Commerce focus on data from smaller retailers, and in some cases data from banks on their lower income customers.

The industry structure described above is one of segmentation rather than competition. This suggests less dynamism in the market in terms of introduction of new products and services and less downward pressure on prices than if the market were competitive. In addition, the fact that banks (major banks have the largest ownership share, smaller institutions have smaller shares) are in control of the dominant credit bureau raises the concern that policies followed by the bureau provide them with an unfair advantage vis-à-vis other regulated and non-regulated lenders, stifling competition not only in the market for credit reporting, but also more broadly in the market for credit and financial services. While it is beyond the scope or ability of this mission to document whether such policies exist, the mission did hear concerns from different market participants regarding the close relationship between SERASA and its bank owners and the implication of this relationship for the independence of the firm. Because SERASA is a privately held firm, it also is free to choose its Board of Directors, which is formed exclusively of representatives of the banks which own it. Together with the lack of any real supervisory or regulatory oversight, this situation at the least creates a problem of perception where the firm's independence in setting prices and policies can be questioned. This perceived lack of independence may also be a factor in the reluctance of at least some lenders to provide their positive information to the firm.

In many respects SERASA has been an exemplary market leader for the credit reporting industry in Brazil. It has very effectively extended its reach into non-bank credit data, has developed sophisticated decision tools and sought for years to develop positive credit reporting in spite of reluctance by lenders and obstacles created by judicial decisions. SERASA has won numerous quality and marketing awards in Brazil and is active in regional and international credit reporting forums. As the largest private credit reporting firm in the developing world, much of its success derives from its own solid management and vision. The many positive attributes of this firm do not, however, distract from the fact that Brazil would be better served if there was real competition in the provision of credit reporting data and services.

While in the longer term the government may want to give further consideration to the corporate governance and ownership issues for credit reporting firms, the mission has a short term recommendation for strengthening competition. Government owned banks, such as Banco do Brasil, Caixa Econômica Federal, BRB and Banco Nordeste should begin sharing their data – at least their negative data – with all responsible private credit reporting firms and not maintain exclusive relationships with only one credit bureau. Because of the significant market share still in the public banks, this one simple step would immediately make the market for credit information much more competitive.

CONSUMER PROTECTION, EDUCATION AND OUTREACH

Context

Databases containing information relevant to making credit decisions, such as credit histories, personal data and other information, represent a great concentration of power. For this reason, the impact of misuse, mishandling or errors is potentially damaging to individuals. At the same time, it should be recognized that the existence of such databases offers consumers who honor their obligations with the opportunity to distinguish themselves from those who do not, i.e., to establish

“reputation collateral.” As a result, these consumers should enjoy greater access to credit at more favorable rates. The ability to build “reputation collateral” is especially important to consumers with lower incomes who may not own property that could serve as physical collateral for borrowing.

To achieve the optimal balance between protecting consumers while allowing information that will benefit them in their borrowing activities to be collected and distributed requires a combination of adequate legal and regulatory protections, enforcement and properly aligned incentives for all participants in the system.

- i. Consumers should understand what information is being collected about them and how and by whom it is being used.
- ii. Consumers should feel confident that information about them contained in a credit information system is accurate, complete and up-to-date.
- iii. Consumers should feel confident that information about them is secure and not being misused. Extra care should be given to the collection and distribution of data deemed to be sensitive.
- iv. Policies with respect to credit information systems should protect the rights of consumers with good payment histories. Some of these elements include achieving sufficient coverage of the population, requiring reporting of positive payment behavior as well as negative data, maintaining data for an adequate period of time, and avoiding so-called amnesty periods that allow negative information to be erased.
- v. The existence and operations of credit information systems should be as transparent as possible in order to develop public confidence.
- vi. Adequate enforcement and procedures for dealing with violations of consumers’ rights should be provided.

The legal section of this report deals with additional elements of the credit reporting legal framework that are essential to consumers. This section of the report focuses on specific tools that are often afforded to consumers to allow them to assert their rights. Examples of the kinds of provisions found in highly functional credit reporting environments to protect the interests of consumers include:

- i. **Consumers have free or low cost access to information about themselves.** It is widely recognized that consumers are in the best position and have the greatest incentive to ensure that data contained in their credit reports is accurate, complete and up-to-date.
- ii. **Consumers have the right to dispute information that they perceive to be inaccurate, incomplete or out-of-date in a timely and low cost manner.** When potential problems are detected, the source of the information in question should be obligated to investigate thoroughly and make any needed corrections in timely manner. Other measures that are often employed to protect consumers’ rights with respect to disputing information contained in their credit report include flagging of data that is in dispute and allowing consumers to include explanatory text in the body of their credit report in order to explain a dispute or the circumstances related to information contained in their report.
- iii. **Requiring authorization of the data subject before data may be distributed for any permissible purpose.** This measure is used to prevent misuse of data. Consumers are empowered to detect abuse by being able to examine who has accessed their report.

- iv. **Notification of consumers when they are denied credit or some other adverse decision is made based upon the information in their credit report.** This gives the data subject the opportunity to correct any erroneous information contained in their record. It also promotes the development of a credit culture by providing consumers with direct and timely feedback about why their profile may be considered too risky by creditors, giving them the opportunity to take corrective action.

Status in Brazil

Legal and Regulatory Environment

The rights of Brazilian consumers are protected by the Consumer Defense Code, Law 8078 of 1990. Specifically, Article 43 guarantees free access to consumers of data contained in any database and that data must be objective, clear, true and comprehensive. Negative data may not be maintained for a period exceeding five years. It also states that consumers shall be notified in writing prior to their inclusion in any database. Consumers are entitled to request prompt correction of incorrect information and that all who received the incorrect information will be notified within a period of five working days. Once a debt has been extinguished, data that would make it difficult for the consumer to receive future credit must be removed.

Infractions against consumer defense rules are subject to fines, suspension of service (temporary or permanent) and/or administrative intervention depending on the severity and precedents of the violation. Fines shall be a minimum of two hundred times the *Unidade Fiscal de Referencia* (UFIR or reference fiscal unit) and will not exceed three million times this amount.

In addition, the law authorizes education and information, the provision of free legal assistance for low-income consumers and the easy defense of consumer rights.

While the Consumer Protection Law states that Brazilian consumers have the right to view and to dispute any information contained about them in any public or private database, no laws or rules specific to credit reporting systems currently exist. Statistics on the number of requests consumers made to view their own information were not made available to the project team. Comprehensive national statistics on the number of disputes registered by consumers were not available either, in part, due to the fact the disputes can be handled in a variety of manners—directly with the credit bureaus, directly with creditors, through one of the Procon offices, through private consumer protection organizations or through the judicial system. The number of disputes filed, however, is probably quite low. Procon Sao Paulo, for example, logged just 104 complaints in 2003 involving 58 firms with respect to information managed by credit reporting firms. Of these, 46 (44 percent) remained unresolved by Procon's assessment. The 58 firms consisted of 31 financial institutions and 27 non-financial businesses. The 30 financial institutions, however accounted for more than two-thirds of the complaints filed. Financial institutions seemed had better performance with respect to resolving complaints. Procon reported that 48 of the 73 disputes filed with respect to financial institutions were resolved. Non-financial businesses on resolved 15 of the 32 disputes filed with Procon Sao Paulo.

It is current industry practice among the private credit reporting firms to only report negative credit information and to not report the information after the debt has been resolved. This is due to concerns about violating Brazil's banking secrecy laws and concerns about competition among the largest authorizers of credit. The Consumer Defense Code requires that consumers be notified in writing before negative information about them be sent to one of the credit reporting firms. This obligation may be handled either by the creditor or by the credit reporting firm. There is no requirement of consumer authorization before information may be distributed. The credit reporting

firms operating in Brazil do not currently show consumers who has accessed their information in the past.

The Ministry of Finance has proposed a law specific to commercial credit information with the objective of increasing access to credit for lower income Brazilians who may not be in the banking system. It provides a basic framework for the data that should be included in credit reporting systems operating in the country as well as consumer protection provisions.

Consumer protection provisions include defining a permissible purpose as a “commercial relationship” with the consumer, allowing consumers free access to their own credit report every six months and the ability to see who has accessed their report over the past six months. Reports must be accompanied by a copy of their rights with respect to the data and corrections. Requests for corrections submitted to the credit reporting firms must be answered within five days or the data must be removed. If data is changed, the changes must be reported to users of the information within five working days. It reinforces the idea that data subjects must be notified before their data may be submitted to a credit reporting system. It states that data may be shared between databases, but that requires that the consumer is notified in each case. Finally it assigns responsibility to credit reporting firms, information sources and users for damages caused to users for failure to maintain the integrity of the data, for providing false data and failing to observe confidentiality and appropriate use of the data, respectively.

Enforcement

Credit reporting firms operating in Brazil are not required to receive authorization from any government agency in order to operate and are not supervised by any regulatory agency. Problems must be resolved through legal actions after they are discovered.

The defense of consumer rights may be exercised individually or collectively by governmental entities and agencies specifically designed for the defense and interests of the consumer or by associations that have been legally constituted for at least one year whose institutional purposes include the defense of the interests and rights of consumers.

Specifically the Department for Consumer Protection and Defense (*Departamento de Proteção e Defesa do Consumidor*) branch of the National Economic Law Office (*Secretaria de Direito Econômico*) of the Ministry of Justice or Procon is the body coordinating the national system of consumer defense.

Box XX Procon’s Responsibilities

- i. To plan, elaborate, propose, coordinate, and perform the national policy for consumer protection;
- ii. To receive, analyze, evaluate and forward queries, charges or suggestions submitted by representative entities or public/private legal entities;
- iii. To provide consumers with a permanent guidance regarding their rights and guarantees;
- iv. To offer information, awareness, and motivation to consumers through the different means of communication;
- v. To request that the judiciary police hold inquiries to verify infractions against consumers;
- vi. To submit infractions to the appropriate branch of the Attorney General’s office to initiate

- procedural measures within its sphere of authority;
- vii. To advise the appropriate bodies about administrative infractions that violate consumers' diffuse, collective or individual interests;
 - viii. To request cooperation from bodies and entities in the Federal Government, States, Federal District and municipalities as well as to provide assistance as to the monitoring of prices, supply, quantities and safety of goods and services;
 - ix. To incentive the formation of entities of consumer protection by the community, as well as by the States and local government, including granting financial resources and other special programs;
 - x. To develop other activities that are compatible with its purposes.

Procon offers advice and legal assistance to consumers who have issues with creditors who have submitted inaccurate information to credit reporting firms, but does not handle directly complaints about credit reporting firms themselves. They also conduct consumer education activities, but are limited by budgetary constraints to submitting articles or experts for inclusion in newspaper or television news programs. Procon does not have any direct supervisory authority over the procedures and policies of credit reporting firms.

In addition to Procon, there are several non-governmental consumer protection agencies operating at the local and national levels in Brazil. Two of the most important are the *Instituto de Defesa do Consumidor* (InDec) and *Associação Brasileira de Defesa do Consumidor* (Protestes). Like Procon, InDec provides education, legal advice for consumers, tracks the status of legislation that impacts consumers and initiates collective legal actions on behalf of consumers. Protestes performs similar functions.

Self-Enforcement

Consumers are inhibited from ensuring that information reported about them in credit reporting registries is accurate by a general lack of awareness of their rights and by the varying policies and procedures for viewing and disputing data at the numerous firms that handle credit information in Brazil. In addition, there are no specific rules, monitoring or other enforcement on how the firms assist consumers in exercising their rights.

SERASA and SCPC, the two primary credit reporting firms handling consumer information, allow consumers to query their own data free of charge in customer service offices. SERASA maintains more than 50 sites across Brazil for this purpose and also offers free citizen guidance service used by more than 1 million people annually. They also maintain a customer call center, although it is not toll free. The SERASA web site provides tips for rectification for credit information on their website, but the burden of proof falls mainly on the consumer.

SCPC maintains two customer service centers in Sao Paulo. They also maintain a program to aid consumers, the *Serviço Central de Proteção ao Crédito Movimento de Apoio de Consumidor* (MAC). This program has produced various brochures on tips for cleaning up credit information, managing domestic finances and how to use cheques.

Consumers may inquire into their information in SCR's database online (SISBACEN) or at a central bank-run service center. In addition, consumers may inquire on information about them with respect to government debts recording in CADIN through SISBACEN. There is no consumer information

available on the Equifax website.

Codes of conduct which define the responsibilities of credit information providers with respect to accuracy, completeness and timely and thorough resolution of consumer disputes are not published by any of the credit reporting firms operating in Brazil.

Recommendations:

6. ***To expand opportunities for credit for Brazilian consumers, the authorities and the credit information industry should work to minimize the negative effects that other laws, regulations or industry practices have over the culture of fulfillment of obligations in the country.*** Examples include restrictions on the reporting and distribution of positive data due to perceived limitations posed by bank secrecy laws and erasing of data once a loan has been repaid. These features of the current situation deny consumers with good payment behavior the opportunity to benefit from their past behavior by establishing a good payment history in the form of increased access to credit at lower interest rates.
7. ***There is currently a draft law and no regulation protecting the rights of Brazilian consumers with respect to data held in credit information systems.*** The current draft law proposed by the Ministry of Finance makes specific some key consumer defense provisions. The Ministry of Finance could consider extending the scope of the law to covering data provided by the financial sector and to give consumers additional tools to actively manage their participation in the credit reporting system.

It is recommended that the following items be explicitly addressed in the legal framework in Brazil to help consumers exercise their rights:

- i. The law should specify the manner in which the identity of consumers will be verified when requesting their reports and the mechanisms by which credit reports may be requested or delivered (i.e., in person at a customer service office, internet, e-mail, telephone, fax, mail, messenger service, etc.).
 - ii. Consumers should be notified when adverse action (e.g., credit, service or employment) has been taken based on information contained in their credit report. Notification should include specific instructions on how to obtain their credit report (free of charge) and consumers' rights with respect to disputing information they believe to be inaccurate or complete. This gives consumers the opportunity to identify and correct any erroneous information that may have led to their being denied credit or to determine whether they have been discriminated against inappropriately. In the case that the denial was warranted, it is a good opportunity to reinforce the development of the "credit culture" by linking behavior to specific outcomes.
 - iii. Consumers should be allowed to place explanatory text in the body of their credit report. Consumers may use this space, typically limited to 100 words, to explain why they disagree with the contents of their report or to explain circumstances which may have contributed to the behavior documented in their report.
 - iv. Rather than notifying consumers before inclusion in a credit reporting database or when negative information is provided, many credit reporting systems require consumer authorization before data may be accessed. This is especially important when the credit history contains positive data that could potentially be misused. Alternatively, the legal framework could be more specific about the permissible use of data. Under the proposed law, users with any type of commercial relationship may request the data.
8. ***Enforcement mechanisms for consumer protections that rely on administrative rather than legal processes should be established.***

9. *Administrative processes should be overseen by a designated authority and include proactive monitoring of data quality, supervising the dispute resolution process, receiving and tracking consumer complaints to identify systemic problems, and supervising procedures to ensure compliance with consumer protection provisions. The scope of the enforcement should extend beyond providers and users of credit information whether they are financial or non-financial entities to the credit report firms themselves.*
10. *The credit reporting industry in Brazil (credit reporting firms and creditors) should consider funding a joint public relations campaign to enhance the image of credit reporting in the country and awareness of consumer rights. 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.*
11. *The credit reporting industry in Brazil 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.*
12. *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.*
13. *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, pricing, etc. Other communications mechanisms should be sought for segments of the population who do not have widespread access to the internet.*
14. *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.*

PRIVATE CREDIT REPORTING ACTIVITIES

Context

A modern credit-based economy requires access to complete, accurate and reliable information concerning borrowers' payment history. Credit reporting addresses a fundamental problem of credit markets: asymmetric information between borrowers and lenders that leads to adverse selection and moral hazard. The heart of a credit report is the record it provides of a consumer or firm's payment history. Since one of the best predictors of future behavior is past behavior, data on how a potential borrower has met obligations in the past enable lenders to more accurately evaluate credit risk, erasing adverse selection problems.

An effective credit information system can be integral to the operation of modern financial systems, improving the efficiency of financial institutions by reducing loan processing costs as well as the time required to process loan applications; it could also eliminate the need to make physical inspections. Lenders may also use credit data to monitor their existing portfolios, identify potential problems, and develop and sell new products, thus contributing to their profitability to more accurate pricing and targeting.

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.

A well-functioning credit reporting system may 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.

The reputation of credit reporting firms is a crucial factor to gain trust and confidence from the consumers and creditors. Key elements to consider in this regard are: quality of the information; extensive coverage (e.g. financial institutions, retail sector, public registries, utilities, positive and negative data) to present a complete picture of the person or firm's debt situation; consumer protection and rights; clear circumscription of permissible uses of information; and, permanent measures to safeguard information contained in the credit information system.

Lastly but equally important, competition between credit reporting firms promotes and encourages many positive aspects, such as quantity and quality of information, services, products, price reduction, etc. Nevertheless, negative aspects can also arise if there no appropriate regulations are in place.

Status in Brazil

There are several positive elements of the credit reporting system in Brazil. These include:

- i. Several players in the market which in the long term should bring downward pressure on prices, and more and better services.
- ii. Because of this competition all of the credit registries have generated new tools for credit

decision support.

- iii. These three firms are financially solid because of their owners.
- iv. The negative information is properly understood, managed and widely spread in the market.
- v. Good service levels for creditors, which means that they have enough infrastructure to comply with creditors' requirements.
- vi. There is a single identification number for persons and firms nationwide avoiding problems with merged data or incomplete records.
- vii. There is a new law in development which seeks to encourage the market to share positive information and to clarify what can and can not be done with credit information.
- viii. There are basic consumer protections in place.
- ix. The BCB shares returned cheque information with the private credit reporting firms.

Recommendations:

- 15. ***Data sources do not provide positive payment information to the credit reporting firms.*** *This limits the predictive ability of the data contained in the databases and prevents consumers who honor their obligations from benefiting from the reputation collateral (ability to benefit from past good payment behavior) they have built. The proposed legislation should encourage both commercial and financial sector sources of credit information to submit positive as well as negative payment information to the credit reporting firms. A complete credit history would also allow creditors to develop credit products with interest rates that more closely reflect the actual risk posed by an individual consumer.*
- 16. ***The absence of a credit bureau law creates uncertainty and inconsistency in the operation of Brazilian credit reporting firms harming both creditors and consumers.*** *For example, credit reporting firms may be reluctant to invest in introducing new credit decision support tools or other innovations to the market due to uncertainty in the current legal environment which relies primarily on case law. They cannot be certain on what information can be collected, maintained and used. It also leads to inconsistent policies employed by data sources and users regarding consumer authorization to share and use data. Regulations should include procedures to verify that the information that creditors provide is complete.*
- 17. ***In addition to the lack of legislation, the credit reporting firms operating in Brazil do not maintain internal Codes of Conduct that would allow them to appear more accountable to the eyes of consumers, as well as data sources and data users. However, the existence of these codes do not replace the need for an adequate supervisory framework.***
- 18. ***The positive impact of competition in the credit reporting industry is limited by segmentation in the market.*** *The various market players have staked out niches requiring users of data to establish relationships with multiple service providers increasing the overall cost of administering credit in the Brazilian market. The authorities may consider ways to motivate credit reporting firms to share and regularly update at least the negative information they get from their shareholders. In any case, it should be done in such a way*

that it does not reduce the incentive of credit bureaus to pursue new data gathering. For this purpose, it is important that fair prices are established.

19. ***Credit decision-making could be enhanced by the availability of additional information within the credit information databases.*** For example, information on vehicle registration and ownership, real estate, and the ability to verify government-issued identification numbers like the CPF. Utility information would also be useful.
20. ***The ability to build “reputation collateral” is especially important to consumers with lower incomes who may not own property that could serve as physical collateral for borrowing.*** The BCB should consider reducing the amount of the information collected to be able to help low income people to build their “reputation collateral”. This recommendation will be discussed in greater detail in the Public Credit Registry section.
21. ***Regulation should also consider keeping low costs for credit reporting firms.*** Regulation has to take into consideration a lot of aspects but also an equilibrium with credit reporting firms’ costs. There are several aspects in the current regulations that increase the costs. Examples include letters to let the consumers know that their information has been included in a database, registered letters with proof of receipt. There could be other kinds of temptations like: free access for consumers to their credit report, registered letters to let the consumer know when a creditor has reported negative information. To be able to reduce prices and as a consequence make it easier for small creditors to take advantage of the information, authorities should take this into consideration.
22. ***Finally, in order to further reduce costs and speed-up the credit granting process, financial institutions together with credit reporting firms must take advantage of the modern technologies, particularly of credit scoring techniques.*** The three major credit reporting firms provide credit scores and many financial institutions calculate their own scores. However, only a few sophisticated lenders are using credit scores to automate the credit granting process. Most still have a manual credit granting process. To improve their marketing and to reduce costs, it is advisable that credit reporting firms and other information providers promote a series of seminars to demonstrate the different ways to use these credit scores available in the market.

PUBLIC CREDIT REGISTRY AND OTHER PUBLIC DATABASES

Context

Public credit bureaus are a frequent element of credit and loan reporting systems, sharing a basic framework regarding their institutional arrangements, the type of data they collect and their policies regarding distribution of credit data.

Usually these bureaus are operated either by the central bank or the superintendence of financial institutions. While they are major credit and loan information collectors, as a result of their banking nature they limit themselves to requesting information from the financial sector intermediaries they regulate, who are compelled to report by means of law or resolution. Therefore, they have typically more limited data sources and resources (human, financial and technological) than private credit bureaus: reporting financial institutions usually furnish borrower’s identification, outstanding debt, type of credits, risk rating, collateral and guarantees, and business sector.

The information stored in these databases is used to aid prudential regulation and banking

supervision, perform economic analysis and research (measures of credit by sector, by credit quality, compute portfolio credit risk models, etc.) and sometimes also to produce credit reports or share the information through queries. In fact, these potential uses entitle the operator (central bank or banking superintendence) to compel banks report all the information considered relevant, both positive and negative, and can therefore assemble a more complete picture of credit in the regulated financial sector and even operate where the legal environment is inhospitable for private ventures.

As mentioned above, public credit bureaus usually face severe budget restrictions that impact the completeness of their credit reports, the fact that they seldom provide supplementary products and services (i.e., credit scores) and the process in place to handle consumer complaints and challenged reports. On the other side, not always the private sector participates in the credit reporting system or provides the most convenient service. Given that the sharing of sufficient credit information can be regarded as a desirable institution in any market economy, both the costs and benefits of operating a public credit bureau should be balanced. While the costs of doing so are clear, the benefits of the sharing of positive and negative information and thus of a complete credit reporting system are supported by profuse empirical evidence¹: attenuation of moral hazard and adverse selection problems, reduced default rates and increased availability of credit. In fact, the empirical evidence also shows that public credit bureaus are more likely to be present where private-sharing arrangements have not risen.

While the public sector is not to replace the private sector in this regard, it does have to play a subsidiary role and correct eventual inefficiencies in the credit reporting system such as insufficient competition², not enough sharing of positive and negative information, inappropriate treatment of customer complains and lack of regulation regarding the propriety of the databases. Therefore, both the need to enjoy the benefits of sharing and disclosing credit information and the lack of a reasonable solution provided by the private sector may motivate the need for a more active public credit bureau, at least temporal and subsidiary.

Regarding the use of their information with prudential regulation purposes, their information is a useful input of portfolio credit risk models that yield economic measures of capital and provisions. In fact, a public credit bureau's data can be used to compute provisioning and capital requirements following the guidelines issued by the Basel Committee on Banking Supervision (enforceable as from end 2006): *International Convergence of Capital Measurement and Capital Standards: a Revised Framework*, which introduces different approaches to compute capital requirements for credit risk. The Standardized Approach, which is an updated version of the existing one (issued in 1988) is based on external ratings (provided by rating firms or export credit agencies), and the Internal Ratings Based (IRB) Approach, which can be implemented either in its Foundation or Advanced variant. Despite the fact that only international active banks of Basle's Committee member countries will have to comply with the new accord, in many other countries banking sector supervisors are considering to adopt it or use them to compute "shadow" economic capital requirements against which to benchmark their ad-hoc capital requirements.

The IRB approach is a simple portfolio credit risk model that provides economic-based capital requirements and provisioning levels. Both of its variants rely on PD (probability of default), LGD

¹ See Jappelli, T. and M. Pagano, "Information Sharing in Credit Markets: International Evidence", Inter-American Development Bank, Working Paper R-371, June 1999. Further statistical evidence for Brazil and Argentina has been found in Majnoni, G., M. Miller, N. Mylenko and A. Powell, "Improving Credit Information, Bank Regulation and Supervision: On the Role and Design of Public Credit Registries", World Bank, June 2004. See also Barron J. and M. Staten, "The Value of Comprehensive Credit Reports: Lessons from the U.S. Experience", Purdue University and Georgetown University, 2003.

² See Negrin J. L., "Mecanismos para compartir información crediticia. Evidencia internacional y la experiencia mexicana", *El Trimestre Económico*, Vol. LXVIII (3), N°271, July – September, 2001.

(loss given default), EAD (exposure at default) and M (effective maturity) estimates; once these are plugged into the IRB formulae the results are economic measures of what the appropriate provisioning and capital levels should be. While in the Advanced Approach the bank internally estimates all the variables (PD, LGD, EAD and M), in the Foundation the supervisor must provide each bank with an appropriate estimate of them, with the exception of the PD. In addition to this, in both cases the supervisor must validate all those estimates computed internally, by each bank. Therefore, should a regulator decide to implement a Foundation IRB, he should provide the regulated institutions with estimates of LGD, EAD and M and validate their rating systems; in the Advanced IRB, where banks must internally estimate all the parameters, the supervisor should validate their internal estimates³.

All the abovementioned uses of the borrower's information stored in public credit bureaus motivate that efforts are made to guarantee its reliability; this is critical both for an efficient supervision and to provide accurate credit reports.

Status in Brazil

Central de Risco de Crédito (CRC) was created in June 1997 to aid the supervision of the regulated financial institutions performed by the Central Bank of Brazil (CBB) by helping to monitor the counterparty risk of their portfolios; this was its stated foremost purpose. However, another (secondary) purpose was to operate as a (public) credit bureau within the financial system: as from August 17th of 1998 its information has been increasingly used by the financial institutions to improve their knowledge of their clients and prospective ones, and thus their credit risk management process.

To enhance the usefulness of its database, the CBB launched in June 2004 a substitute of CRC named *Sistema de Informações de Crédito do Banco Central* (SCR), which collects a broader set of information of credits in order to increase the usefulness of SCR as a supervisory tool and as a public credit bureau. The fact that it is equipped with more (positive and negative) information fills an existing vacuum in the private credit bureau market where only negative information is shared. Nevertheless, there is still a considerable fraction of borrowers who are not individualized in SCR, and thus can't demonstrate their good paying behavior. While there is negative information in the private credit bureaus, the only source of positive information and "reputation collateral" (i.e., being a good borrower) is only available at SCR for clients above R\$5,000. This, in turn, limits the capacity of lower income individuals who may be good clients of the financial system to demonstrate this and thus benefit from more and cheaper credit.

Database Operation and Quality

Coverage and Access

Every month the CBB receives end-of-month information of the financings of those borrowers with total liabilities with the reporting institution above R\$5,000. This information includes data on performing and non-performing credits, and off-balance sheet or contingent financing such as guarantees and credit limits. SCR receives approximately 14.000.000 records of borrowers with total liability above R\$5,000 every month, and should the floor be further reduced the size of SCR would increase dramatically. CBB's estimates of the impact of additional reductions of the floor are included in **Table I**.

Table I. *Sensitivity of SCR's size to changes in the floor to reporting*

³ See Trucharte Artigas, C., "A Review of Credit Registers and their Use for Basel II", FSI Award 2004 Winning Paper, September 2004.

Clients above...	Number of records received each month	As % of total credit	Increase in database
R\$ 5,000	14 million	85,5%	-
R\$ 1,000	52 million	94,7%	4 times
R\$ 500	82 million	97,2%	6 times
R\$ 100	160 million	99,6%	11 times
all borrowers	242 million	100 %	17 times

Source: Central Bank of Brazil.

However, SCR doesn't actually give information of all the borrowers whose liability is above the existing floor since in many cases credits' and even borrowers' information is not disclosed through SCR due to judicial injunctions or flaws at the origination of the financing. In other cases the credits are shown but identified as "sub judice".

Furnishing the information is mandatory, and reporting institutions include: *Bancos Múltiplos; Bancos Comerciais; Caixa Econômica Federal; Bancos de Investimento; Bancos de Desenvolvimento; Sociedades de Crédito Imobiliário; Sociedades de Crédito, Financiamento e Investimento; Companhias Hipotecárias; Agências de Fomento ou de Desenvolvimento; Associações de Poupança e Empréstimo; Sociedades de Arrendamento Mercantil* and some *Cooperativas de Crédito*.

There are various ways to access the information in SCR. Borrowers can get their own information from any of the 10 CBB's *Centrais de Atendimento ao Público (CAP)*. To get the credit report individuals must show their identification and CPF, and moral people must take their social contract, *Junta Comercial* certificate and statement regarding the authenticity of the documents presented. Also a borrower may get a copy of the report by postal mail, or register at a CAP and access his information through the Internet.

With previous written authorization financial institutions can see their clients' or prospective clients' information, although with a lower degree of detail than the information a borrower can see of himself. Not complying with the authorization carries legal sanctions. Financial institutions have three channels to request this information:

- i. **Web Service:** is a real time, host-to-host connection.
- ii. **Internet:** the financial institution can perform queries of specific clients.
- iii. **Batch file:** allows to request information from many clients (as long as they gave their consent). However, through this channel the information is only about the borrowers' stance with the financial system as a whole. With this procedure the bank can request credit information of selected clients (up to 50,000 borrowers 7 times a month) or of his entire portfolio (up to three times a month). That is, the financial institution can get aggregate credit information from specific requested borrowers (detailing them in document 3081) or from its portfolio (making the request at SCR's website), and receive it through document 3082.

While borrowers and reporting financial institutions can query on SCR, from outside the CBB no other person or firm can do so (there is legal impediment for the CBB to give access to non-financial sector institutions) with the exception of a borrower's legal representative and judges. Within the financial institutions only some individuals have access to the borrower's information. At the CBB some officials have access to the information in SCR but with different levels of detail: it depends on

the needs and responsibilities of each person. Nevertheless, every time somebody accesses the information, this is registered.

Data Collected and Distributed, Credit Scoring and Other Decision Tools, Pricing

The CBB receives information following the guidelines set in documents 3020 (*Dados Individualizados de Risco de Crédito*), 3026 (*Dados Individualizados Complementares de Risco de Crédito*) and 3030 (*Dados Agregados de Risco de Crédito*) and the rules set in Circular 3098 of 2002. Also financial institutions furnish document 3081 with the identification of those borrowers that gave their written authorization to the bank to request their information from SCR. In the first case, institutions must furnish before the 20th information of those borrowers with total outstanding liabilities above R\$5,000 at the end of the previous month. By the same date, and as a result of the request set in document 3030, financial institutions must also report aggregate data of all their portfolio of credits.

The individual information furnished in document 3020 varies according to the amount of each credit. For those credits larger than R\$5,000 they send more individualized data, credit by credit, such as: identification of the contract, date when the credit was contracted, nature and type of credit, source of funds (i.e. if it is directed credit), indexation clause, exchange rate adjustment, annualized effective interest rate, breakdown by maturity, credits written-off in each of the previous 12 (twelve) months, the existence of any credit written-off in the last 5 (five) years, date the most recent installment matured, existence of guarantors (identified by CPF or CNPJ), location (CEP), type of collateral or guarantee, special features of the credit (in general associated to restructurings) and risk classification⁴.

The credit's risk classification may be any of the following: AA (0% provision), A (0.5%), B (1%), C (3%), D (10%), E (30%), F (50%), G (70%), H (100%). These classifications depend not only on the credit's days past due but also on the type of credit, the guarantees, etc. For example, a restructured credit that is not past due may not be rated AA. Every credit has a risk rating, and the same borrower in the same financial institution may have many risk ratings if has many credits. This risk classification is not shared through SCR, to avoid banks relying on other banks' risk assessment.

The credits below R\$5,000 of those borrowers are aggregated for each client by criteria such as nature of operation, type of operation, risk rating, etc. And regardless of the amount borrowed, for all borrowers banks inform their identification (CNPJ/CPF, internal code for foreign borrowers or for borrowers without CNPJ or CPF), type of client and the date when the relationship with the borrower began.

The records required through document 3026 must be furnished every six months; those corresponding to December must be sent by April the 20th and those of June by October the 20th. This information is of those borrowers with at least one operation larger than R\$5,000,000, and includes data of the business conglomerate the borrower belongs to (if the borrower does belong to a business conglomerate), borrower's balance sheet data (and of its business conglomerate) and any risk rating the borrower may have received from a rating agency, amount collateralized and date of its last

⁴ This is performed following the rules set by the National Monetary Council in Resolution 2682, issued in December 1999. These state that to classify credits of moral people (firms), the banks must take into consideration the following aspects: nature and end of the transaction; characteristics of the collateral and guarantees given by the client; amount; economic and financial situation; indebtedness; ability to generate profits; cash-flow; quality of the management; days past due; contingencies; business sector and credit limit. Regarding individuals, the creditor must consider nature and end of the transaction; characteristics of the collateral and guarantees given by the client; amount; equity of the borrower; indebtedness; days past due and credit limit.

valuation and amount provisioned. This information, though, may also have to be furnished upon the sole request of the CBB.

Regarding the information distributed, in the case of financial institutions that query on SCR the information they get varies with the channel used. While **batch files** provide information for many borrowers but only of their stance in the financial system, they don't include information of the credits that those borrowers have with the bank that requests the information. On the other side, both aggregate and individual data can be obtained from **Web Service** and from the **Internet**. Those two sets of information have the same structure (the same variables) with the exception that the aggregate "report" does not show who the other creditors of the borrower are.

A bank that request a borrower's individual information will first get a summary of the information in each of the last 13 (thirteen) furnished databases, which includes a distribution of credits by payment status (outstanding, past due or written-off), the borrower's total liabilities (credits plus contingent financing) and approved limits (*crédito a liberar*), number of credits with the institution, debts in foreign currency, number and amount involved of credits *sub judice* (disputed in courts), largest exposure in the last 13 months and date when the borrower's relationship with the financial institution began. This information is contained in the first screen (*tela*) named *Síntese de uma data-base* (Summary of a Database) which has links to further screens with more detailed information. These screens are:

- i. *Fluxo de Vencimentos Consolidados* (Flow of Aggregate Maturities): gives a breakdown of the borrower's total credits by maturity, indicating the amounts and fractions of the borrower's total credits that fall due in different time horizons, with a further breakdown by currency of denomination. It also shows the amounts written-off in the last year and in the last 5 years.
- ii. *Fluxo de Vencimentos Consolidados por Níveis de Risco* (Flow of Aggregate Maturities by Risk Classification): this screen is similar to the previous one, and combines the breakdown of the borrower's total credits by maturity (the amounts and fractions of the borrower's total credits that fall due in different time horizons) with a distribution by risk classification. Here contingent financing's risk classification is shown too.
- iii. *Histórico das 13 Datas-Base* (Historic of Last 13 Databases): gives an overview of the information contained in each of the last 13 databases furnished to the CBB, with a breakdown of total liabilities by type of financing.
- iv. *Modalidade x Data-Base* (Breakdown by Type of Credit in Each Database), *Modalidade x Nível de Risco* (Breakdown by Type of Credit and Risk Classification) and *Modalidade x Situação de Vencimento* (Breakdown by Type of Credit and Payment Behavior) give a breakdown of the information in the last databases by type of financing, and in the last database by type of financing and risk classification, and by type of financing and payment status.

On the other hand, borrowers can consult their information of the last 13 (thirteen) months. They can view the same information that financial institutions view about their stance with the financial system, plus the identification of the creditors and, in the case of a specific request to CBB, all their information.

Empirical Tests and Exercises to Assess the Quality of Credit Data

There is a methodical procedure in place, performed by DEFIN, to verify the quality of the information received and detect inaccuracies. This procedure is automated and composed by the

following three steps:

- i. **Stage 0 – Pre-validation:** initial tests are run, for example, to check that the date of the document is right.
- ii. **Stage 1 - Syntactic Validation:** analyzes the structure and format of the document. Checks that in those fields where numbers are expected the bank included numbers, that the size of the field is correct, etc. There are in place more than 600 syntactic controls.
- iii. **Stage 2 - Semantic Validation:** analyzes the consistency of the information. More than 50 additional checks are computed, for example, to compare the individual information against the balance sheet information. However, only slightly more than 10 of these are specific to document 3020 (the individual information in SCR) and they include cross checks with the aggregate information from document 3030 (the aggregate information in SCR), internal validations, comparisons with information of the previous month and seeking for duplicate registers.

Depending on the sort of mistake found there are automatic rejections or the information is revised. In spite of this process, though, data is not flawless and there is a tolerance level for mistakes given that SCR has not completely replaced CRC and still doesn't operate at full capacity. Nevertheless, mistakes are few and are reducing. Institutions may correct the mistakes or send the document with the correct information again. The rules used to detect mistakes in the syntactic and semantic validation are public and can be obtained from the CBB's website (*validador sintático* and *críticas semânticas*) and with SCR financial institutions can even correct or exclude their information on-line. This may happen because of a mistake or as a result of a judicial injunction.

There is a scheme of sanctions to deal with situations when data is furnished with problems, such as late reporting or reporting data of bad quality. However, and as explained in the previous paragraph, so far they are not using fines since the migration from CRC to SCR has not ended yet (although in the former CRC they rarely used fines). In the future, charging fines due to these wrongdoings will be automated, although now these have been temporarily suspended by the Board of Directors until the new system consolidates. Nevertheless, CBB officials claim that some small institutions such as cooperatives wouldn't be able to face the fines, and that in the case of big institutions the quality of the information received is good.

According to CBB's officials, the quality of the information of individual credits is in general very good, with the exception of some variables such as interest rates, indexing clause, *prejuízos* and guarantees. The balance sheet data received through document 3026 hasn't got the best quality given that usually is hard to validate. Besides, only a few firms are obliged to have audited balance sheets (*Sociedades Anónimas*), for the others (*Sociedades de Responsabilidad Limitada* and of closed capital) this information is not audited and sometimes even inexistent, and so the creditor must "create" a proxy of the balance sheet and this is the information that furnishes in document 3026.

Technological Infrastructure & Efficiency

While with CRC the information was sent in a fixed .txt format, SCR uses the flexible XML (eXtended Markup Language), which allows handling the much larger volume of information received: every month they get from 1800 institutions information on 10.000.000 borrowers and 18.000.000 credits. This amounts to between 15 and 17 Gigabytes of data every month, and has stored so far 2 Terabytes (1 for each year of information received). The information is furnished using a system developed by the central bank: PStaw10, although some (big) banks still use their own and compatible systems. Besides, the fact that financial institutions concentrate the furnishing of

the information between the 17th and 20th of every month makes the task of receiving the data more demanding.

SCR's information is stored in the Data Warehouse for 5 years (with additional information elaborated from the data received) and there is also an Operational Database with up to one year and a half of raw data aimed at satisfying ordinary requests and needs. Regarding the effect on the Data Warehouse's size of lowering the R\$5,000 floor exemplified at the beginning of the section, they would probably have some resource limitations and eventually may need new hardware; otherwise the system would lose responsiveness.

DEINF has a *Business Disaster Recovery Plan*: they have another system operating at 4/5 kilometers distance which can replace the main system in less than one hour. The information is backed up in real time and that more than 5 years old is stored in physical devices.

Credit Information and Banking Supervision

The information contained in SCR, received through documents 3025, 3026 and 3030, is adequate and sufficient for banking supervision: supervisors are comfortable with the R\$5,000 floor as it is and don't see the need to reduce it further. Today, both on and off-site supervisors use the information in SCR to monitor clients and conglomerates and can make queries on the Data Warehouse.

Supervision (on-site and off-site)

The off-site supervision is performed by DESIN, while the on-site is carried out by DESUP. DESIN has an internal platform named *Siscred*, with many different functions (*aplicativos*) and products sometimes shared with the on-site supervisors. All of them are confidential and for the internal use within the CBB. The reports in *Siscred* are descriptive, without judgment. 70% of the information used corresponds to CRC and the remaining 30% corresponds to SCR. In the near future, though, all the information will be from SCR. With these tools DESIN identifies the banks that deems riskier or in (potential) trouble, and then together with DESUP they both decide for the coming months which are those banks that will be supervised more deeply.

Besides having access to *Siscred* and using the *Perfil de Risco de Crédito*, DESUP uses the information in SCR and registers its opinions regarding the financial institutions supervised in a system named *Sisup*. Also they use a software named *Riskcred*, that allows to compute a bank's credit portfolio distribution by amount (*faixa de valor*), identify credits past due, compare the institution's provisioning level against the average in the financial system, etc. It also allows to perform queries or extract samples from SCR with various criteria, such as the "largest risks" (worse rated borrowers and largest borrowers), borrowers with signs of being "frozen" (if the outstanding debt of a borrower is always the same, probably is having problems and the bank is hiding them), exclusive clients, etc. With the information in the Data Warehouse (SCR) also they can compute other static and dynamic reports.

Use in analyzing capital an provisioning levels, relation to Basel II

The CBB, through *Comunicado 12.746* of December 2004, announced a schedule of steps to converge to capital requirements for financial institutions inspired in the guidelines of Basel II.

While most banks will have to adopt the Simplified Standardized Approach (the version of the Standardized Approach in which no rating agencies' assessments are used), the bigger and internationally active banks will have the option to adopt firstly the Foundation IRB (FIRB) and later

on the Advanced IRB (AIRB). Therefore, the CBB (who is the National Supervisor) will have to provide these banks with estimates of LGD (Loss Given Default), EAD (Exposure at Default) and M (Maturity) and validate their internal rating systems while they use the FIRB, and assess both their internal rating systems and their internal estimates of LGD, EAD and M once they move on to the AIRB. In all these cases, the information kept in SCR will play a crucial role, either in the validation of the estimates or perhaps in developing an internal rating system to be used as a benchmark of those used and developed by the banks themselves.

However, and besides some isolated research, SCR's information is not used on a regular basis to compute portfolio credit risk models and then obtain sound measures of provisions and capital.

Use for economic analysis and research

Besides being used in the supervision process and prospectively be used to aid the implementation of Basel II's requirements, it is also used for some economic analysis and research. After a formal requirement furnished to DEFIN, departments such as DEPEC⁵ and DEPEP⁶ may use that information. For example, SCR's information was used by DEPEP, DESIN and DESUP in *Credit Risk Measurement and the Regulation of Bank Capital and Provision Requirements in Brazil – A Corporate Analysis*, where they compute a credit scoring model and obtain capital requirements and provisioning levels using portfolio credit risk models, such as *CreditRisk+* and the IRB approach.

Recommendations:

23. ***The authorities should consider the public credit bureau, Sistema de Informações de Crédito (SCR), as a strategic institution of the Credit Reporting System of Brazil. In the case of credit reporting systems, the empirical evidence shows that public credit bureaus' main purpose is being a tool in prudential supervision, but they are also created when there is a lack of any credit sharing institution in the market, such as private credit bureaus. In particular, in Brazil some banks that are not owners of private bureaus are reluctant to share most of their data because they fear that competitors owning the bureaus might use their information inappropriately.***
24. ***If one of the authorities' objectives is to expand access to credit, changes in the structure, functionalities and technological infrastructure of the SCR should be taken into consideration. Including more information in the credit reports, especially positive data, or lowering the floor for reporting, would also reinforce SCR's role as a tool to foster credit and lower its cost. As a first step, without breaching any ruling on borrowers' right to privacy and if an agreement is reached with ALL banks regarding the concerns expressed in the previous paragraph, the SCR may collect and share as much positive information as possible. This would have the following desirable effects: i) foster further access to credit; ii) induce the sharing of positive information with private credit bureaus by banks, if it is allowed that more detailed positive data of their clients is shared and disclosed through SCR; iii) creating incentives for public banks to furnish their information to the credit bureaus owned by private banks, provided that an appropriate regulatory framework prevents from the misuse of the database. In addition, the BCB may consider lowering even more the floor for reporting individual credits to allow more citizens to demonstrate their good payment behavior. Lowering the floor will not impact the supervisory process but will, on the other hand, contribute to foster credit. However, it should be taken into account that small loans should be preferably reported – both positive***

⁵ Economics Department (*Departamento Econômico*).

⁶ Research and Studies Department (*Departamento de Estudos e Pesquisas*).

and negative data – directly to the private credit bureaus.

25. ***The following upgrades are recommended, provided that additional measures to support the operation of much larger databases are feasible.*** For example, the mission team understands that lowering the threshold will have an important impact on system operations (reorganization of internal processes and strengthening of technological equipment) and comprehends the concerns of the BCB in taking this step. If a feasibility study is conducted and concludes that further implementation is possible, the measures to be implemented might include:

Report that displays information about the borrower's situation with the bank

- i. ***Information regarding type of credits (less aggregation):*** the report should give a breakdown of the outstanding debt with more detail, by product (car loans, mortgage loans, consumer loans, project financing, overdrafts, etc.).
- ii. ***Detailed historical information:*** the report should give additional information about the history of the client with the institution and not only the date when their relationship began, i) original debt of outstanding credits, ii) previous credits contracted by the client, indicating if they were paid in full, restructured or written-off; iii) some measure of its past performance such as historical average and worst risk classification or a summary of any previous late payment (number of occasions the borrower was past due, length of the delinquency and amounts involved).

Report that displays information about the borrower's situation with the financial system as a whole

- i. ***Information on current risk ratings assigned by financial institutions, type of credits and days past due:*** the BCB could include more information regarding the situation of a bank's borrower with the financial system. The additional information could include an aggregate measure of the risk rating that all creditors have given to that borrower, as well as more detailed information regarding the financial products the borrower has contracted with the financial system and information on days past due. Regarding the former, the credit report could include the average and worst risk classification the borrower had in the financial system. The information regarding type of credit would only imply a breakdown of the information currently provided by type of credit (car loan, revolving credit, project financing, etc.). This would give a clear picture of the borrowers' (or applicant's) creditworthiness.
 - ii. ***Detailed historical information:*** following the guidelines mentioned above, the SCR should provide more information of the past performance of the borrower with the financial system. The report should include some historical information on products contracted, risk ratings and events of default (days past due, restructures, etc.). Also it is critical that this information is reported even if the individual is no longer a borrower of the financial system, and that is shown for more than just 13 months. Otherwise, an individual that in the last two years took no financing from the banks is reported as equal as a new prospective client.
26. ***The BCB should aim at allowing non-financial institutions some access to credit reports from SCR, although subject to the borrower's previous consent.*** Given the absence of any positive and negative private credit bureau, BCB's objectives regarding access to credit and the fact that a considerable fraction of credit in the Brazilian economy is granted by

non-financial institutions, SCR should consider providing the latter with credit reports of the borrowers of the financial system. Although there would not be any reciprocity, since SCR would not collect information from the non-financial institutions, allowing them to request reports would have a significant positive impact on the availability of credit. Non-financial institutions would also have to demonstrate the client's consent, and they should only see information regarding the clients behavior with the financial system as a whole.

27. ***Given the information contained in SCR and the existing expertise at the BCB, there is an unexploited possibility to implement portfolio credit risk models to compute capital and provisioning needs. Also, given that the SCR will probably be used to supervise banks adopting Basel II's IRB, the BCB must ensure that it has all the required data for that purpose. The role of the Supervisor varies with the approach adopted regarding Basel II. Should some banks adopt the Foundation IRB, not only their internal rating systems will have to be validated, but also the Supervisor will have to provide them with estimations of the Exposure at Default (EAD), Loss Given Default (LGD) and Maturity (M). On the other hand, should (some) banks adopt the Advanced IRB, the BCB will have to validate their rating systems as well as their estimations of EAD, LGD and M. While there is no doubt that the information at the SCR will play a key role in this process, it should be kept in mind that Basel II requires at least 7 years of data for estimations associated to corporate, bank and sovereign borrowers, and at least 5 years of data for estimations associated to retail borrowers, besides covering a complete economic cycle in the two cases (i.e. there is data from a recession). Moreover, obtaining observations for those variables also takes time, i.e., computing one observed LGD following the Workout approach (registering the present value of all the expenses incurred in recovering a defaulted credit and of the amount recovered) may imply gathering data for two or three years, so this increases the length of time that the database should cover. In the current design of the SCR, the Data Warehouse is expected to store information for the last 5 years, while the rest of the data would be stored in physical devices. The BCB must ensure that sufficient data is stored to comply with its supervisory duties regarding Basel II, as well studying what is the most efficient and advisable way of storing the required data, balancing technological restrictions with the need to have complete data in perhaps a readily manner. Also, the BCB could use the existing resources to start computing portfolio credit risk models and credit scoring models on a regular basis, for example quarterly, and use the resulting estimates to assess the current prudential (capital and provisioning) regulation.***
28. ***Upon its reception, the information is controlled with various checks and validations. However, by its nature some variables are more difficult to control, especially interest rates and balance sheet data. The mission team suggests that the BCB continues working to enhance the quality of such variable. For example, interest rate information may go through empirical exercises to check the accuracy, such as identification of outliers, comparison with market interest rates for the same product or with the information furnished by the same institution in previous months. Balance sheet data, particularly when not obtained from audited balance sheets, has limited quality. Therefore, further consistency checks must be applied to that information, such as checking that financial and economic ratios computed with the information received are within reason, not only because of its usefulness in supervisory tasks, but also because it can be used to comply with the supervisory role regarding Basel II, for example, to validate rating systems for corporate borrowers.***

Public Databases

Context

Credit reporting systems require comprehensive and quality credit information, which is instrumental in credit risk assessments and decisions. While the information usually stored in credit bureaus and provided in credit reports refers to bank loans, credits granted by stores, etc., there is additional useful information in other databases as well.

As a result of their responsibilities, some public sector entities operate databases with information on debts and collateral. Examples of these may include databases with unpaid taxes (including unpaid tax information in credit reports may prove beneficial for the tax collection agency, who may find that by this token can align the delinquent tax payer's objectives with those of the public sector) and traffic fines (perhaps with detailed information of traffic accidents, that in the case of car loans or insurance firms may be useful), databases with economic and financial information of firms (usually associated to commercial registries), rejected checks and collateral registries.

Collateral registries have information on vehicles and real estate, necessary at the origination of a credit and to assess a bankrupted's capacity to repay. For example, real estates that are not connected in a modern national network obstruct a creditor's ability to assess an applicant's wealth, and while it doesn't make that task an impossible one, creates inefficiencies that increase legal costs, giving a comparative advantage to those creditors that operate on a larger scale.

Status in Brazil

Cadastro Informativo de Créditos não Quitados do Setor Público Federal (CADIN)

CADIN is a database operated by the CBB that has information of debts with the federal public sector by all motives, but doesn't receive information from debts with states and municipalities. It registers the name and CPF/CNPJ of the individuals and firms with commitments with the Federal Public Administration, direct and indirect, 90 days past due. Also the creditor and date of registration in CADIN are identified. Debts may have originated on unpaid taxes, fines owed to the CBB, debts with the postal service, *Receita Federal*, with Social Security (INSS) and even some traffic fines, as long as they are above \$R1000. If they are above R\$10,000 the creditor is obliged to register the debtor, otherwise it is at its discretion. However, the amount of the debt is not included.

CADIN's debtors are removed only when their debt is cancelled. In this case, the creditor has up to 5 days to remove the former debtor. Being registered in CADIN has negative effects and there is no limit for the time that a debtor may be included in CADIN. On the other side, it has helped to increase the recovery of these debts. In fact, it is more difficult to have ones information in CADIN removed by the justice than in SCR. Individuals can query their information in CADIN at any CAP.

Cadastro de Emitentes de Cheques sem Fundos (CCF)

CCF is a registry that gathers information on returned checks, created with the objective of giving more reliability to the use of the check, by means of registering and disclosing information of issuers of checks without funds, therefore strengthening that payment instrument. Currently CCF has 100,000,000 records with a turnover of 100,000 a month.

The issuer of a check can figure not more than 5 years in CCF, and the information disclosed includes: name of the issuer, CPF/CNPJ, number of rejected checks, number of the current account, of the rejected checks and amount involved, reason for the rejection (closed current account, insufficient funds, etc.), date of rejection and of inclusion in CCF.

While the CBB is in charge of its regulation, it is operated by *Banco do Brasil S.A.* The information is furnished and received in electronic files on a daily basis (although smaller institutions send it with

less frequency) and upon its reception the information is subject to some consistency checks. However, only the furnishing institutions are responsible for the accuracy of the information in CCF. Then the information received from all banks is consolidated and sent back in one file to the financial institutions. Institutions that furnish information don't have to pay to receive the complete database; those that don't participate do have to pay (to get a version of CCF with less information) such as SERASA or SPC.

Collateral Databases

The information regarding real estate in Brazil is spread in *cartórios*. There is not in Brazil such a thing as a centralized real estate or property registry run by the Public Administration, the National State has delegated this function, as well as others such as those of the civil registry, in privately run offices, the *cartórios* (who are not synonymous of notary).

The information in the *Registro de Imóveis*, the *cartório* that registers all the facts related to real estate, is not interconnected in Brazil, neither between states nor within them. Therefore, to find out about an individual's property the interested party will have to make inquiries in each of all the *cartórios* in Brazil, either in person or through a postal service offered by ANOREG (*Associação dos Notários e Registradores do Brasil*), *Cartório 24 Horas* (www.cartorio24horas.com.br). In addition to this lack of an interconnected system with on-line access and updated information in real time, sometimes liens on real estate are not registered in the corresponding *cartório*. Therefore, the certificates issued by these registries (*matrículas*) may not give a complete description of a given property.

Nevertheless, there are projects to interconnect all the *cartórios*, developed by ANOREG and IRIBI (*Instituto do Registro Imobiliário do Brasil*). That of IRIBI actually aims at interconnecting those *cartórios* that register real estate.

Regarding vehicle registration, with the RENAVAL (*Registro Nacional de Veículos Automotores*) code the information of every automobile, including if there is a real right on the vehicle, can be queried through the webpage of each state DETRAN (*Departamento Estadual de Trânsito*). Also it is possible to query by person, although the authorization of a judge is required. Banks are authorized to do so. However, the information stored in the different DETRANs is not interconnected either.

Recommendations:

29. ***CADIN's effectiveness could be broadened by including information of debts with lower levels of the public sector, at least with states. While the disciplinary effect of CADIN is acknowledged, on the other hand it is limited, since it does not include debts with lower levels of the government. The institution that will eventually oversee the credit reporting system in Brazil should devote efforts to include in CADIN at least debts with the states, while ensuring that the quality of the data continues being outstanding.***
30. ***The information regarding collateral should be modernized. This implies interconnecting the information in existing databases, and facilitating electronic access to it. The institution in charge of overseeing the credit reporting system should regard this as an urgent matter. The system of public registries, the cartórios, does not seem to be working efficiently. The information about real estate, which is kept in the cartórios that operate as Registros de Imóveis, is spread and unconnected in the Brazilian states (and even within them). This, in turn, makes querying on its information a cumbersome activity whose cost is transferred to the borrower. The information regarding vehicles is dispersed in local Departments of Transit, which register the vehicles and have information of liens***

on them. While banks can access each of these Departments and query the vehicles a borrower has, the databases are not interconnected. The Team is aware of the existence of projects (developed by ANOREG, IRIB) to modernize the real estate registries, and considers that special attention should be given to these initiatives.

Cross-Border Sharing of Information

Context

As a result of cross-border businesses and other activities, individuals and firms may need to receive credit or some other financing from non-residents. Examples of these may include opening a current account in a foreign branch of a non-resident bank, requesting credit from a store or applying for a mortgage to buy real estate in a foreign country. This may be particularly relevant in those countries that belong to free trade areas or customs unions, where the exchange of goods and services, and production factors across the board is more frequent.

In addition to this, financial institution's supervisors often monitor the behavior of the largest borrowers (firms) of the financial system to anticipate problems with those borrowers that account for a large fraction of the banks' portfolios. Therefore, agreements to exchange information on credits between superintendencies with supervisory purposes would be instrumental in a comprehensive monitoring of those borrowers.

Status in Brazil

There is some sharing of credit information across the board within the private sector. SERASA offers the service *Relatórios Internacionais Serasa* as a result of agreements between SERASA and other foreign private credit bureaus, which makes it possible to get a credit report from a foreign firm and the other way round. However, this service only gives information for firms, not for individuals.

Within the public sector there are no agreements between CBB and other supervisors to share information in their public credit bureaus, to reinforce the supervision of firms with activity across the board, especially those that are the largest borrowers of the financial system.

Recommendations:

31. ***As a result of Brazil's commercial integration with other nations and at least regarding private credits bureaus, the regulation should explicitly authorize cross-border sharing of information. The fact that some Brazilian individuals and firms may want to do business with foreign counterparts motivates the need that local credit bureaus be able to provide credit reports to foreign clients.***
32. ***For the same reason stated above and to reinforce the financial supervision, the BCB should help financial supervisors to get cross-border information on credits regarding the largest clients of the financial system. The fact that Brazil participates in MERCOSUL, for example, implies that some of the largest borrowers of the financial system may be obtaining cross-border financing from foreign banks. In order to perform a better risk assessment domestic supervisors need information of the credits that banks' largest borrowers have obtained from foreign financial systems, while foreign supervisors may need to receive some information stored at SCR as well. Therefore, the BCB should consider signing agreements with foreign supervisors to exchange information in their corresponding public credit bureaus.***

CREDIT REPORTING AND COMPETITION IN THE CREDIT MARKET

Context

The degree of concentration of credit grantors and the quality of the infrastructure (i.e. “public good”) that is necessary for running a credit business, are two key determinants of the degree and type of competition in the marketplace: in those cases in which concentration is high and infrastructure quality is low and participants’ access to this infrastructure is uneven and unfair, players will tend to compete more on the basis of the partial infrastructure each of them has deployed rather than through price and quality.

From this perspective, a well-functioning credit reporting system can help in providing a more level playing field for smaller banks and other credit providers by reducing the information advantage some institutions have over their existing clients and by giving quick, reliable and affordable access to credit histories. Reliable information in these registries lowers costs and improves the efficiency of the system as a whole. Furthermore, when credit reporting systems include information from a wide variety of lenders (both commercial banks and other types of lenders such as leasing firms, finance companies, retailers) further competitive pressures are brought to bear as consumers can effectively seek finance from a variety of outlets and providers. The availability of bureau scores (credit scores based exclusively upon credit bureau data) can also provide another element of increased competition in financial service markets – if the scores have sufficient predictive power to enable small and less sophisticated lenders who would not otherwise have been able to develop such tools to use them as a key part of their credit evaluation procedures.

In order for these benefits to materialize, however, several other conditions must be fulfilled as well. These include fair access to credit reporting services, appropriate governance structure for the private credit reporting firm(s), appropriate regulation, and an oversight function that aims at improving the overall information infrastructure (i.e. not only the services provided by credit reporting firms) that facilitates credit decisions.

Status in Brazil

Real interest rates for all types of loans in Brazil are among the highest in the world, despite the significant reduction of inflation in the last ten years.

Banks are the major players both in the consumer and commercial lending markets in Brazil. The Brazilian banking sector is characterized by still a relatively large presence of government-owned banks and some directed-lending practices. At the end of 2003 government-owned banks held 37.2 percent of total banking sector assets. Directed credits, in which banks’ sole decision is the debtor since all other variables (e.g. loan purpose, interest rates, collateral and other guarantees, etc.) are pre-determined by some government policy, represent 36 percent of total loans. While short-term credit from commercial banks is common for business finance, in many cases longer term loans are only available to the segments of the economy targeted by these policies, such as the promotion of exports.

Other financial institutions (e.g. leasing, factoring) are increasingly serving the financing needs of small and medium enterprises (SMEs). Lower-income consumers typically recur to some government-owned banks (e.g. Caixa Econômica Federal, Banco do Nordeste do Brasil, etc.) or to microfinance firms such as credit unions and savings & loans firms for financing purposes. In most cases, these customers can also access credit from some commercial firms that sell electronic appliances, furniture, etc. (e.g. Casas Bahia, Ponto Frio, Electro). In fact, at present non-bank credit providers are the most intensive users of consumer credit data the major credit bureau, SERASA, representing more than 60 percent of SERASA’s revenues.

Information available at SERASA and other private credit registries has proved helpful in some aspects to increase competition in the credit market. However, two major problems that hamper further progress in this regard are that positive credit information is generally not shared and thus is not available at private credit registries, and also that credit providers currently do not share their (negative) data with all credit registries, not even the three major ones. One of the major elements that prevents banks and others from sharing positive information appears to be, according to several market participants, the ownership and governance structure of some of the major bureaus, particularly that of SERASA which is the dominant player in the market. In particular, some banks that are not owners of SERASA are reluctant to share most of their data because they fear that competitors that do hold SERASA shares might use this information inappropriately.

Therefore, credit providers seeking to have reliable credit histories, which are built with both negative and positive credit data, must build such histories themselves with the data they have access to, which is only data on their own customers and not of the market in general. Thus, larger institutions retain a clear advantage over smaller and less sophisticated lenders who do not have the necessary resources to develop such histories and other related decision tools.

Large credit providers like the bigger banks also have specialized departments to gather the necessary information from databases other than credit registries and which contain data that are also useful in credit decisions, like legal, commercial, property and real state registries, among others. Large institutions, thus, also use this other infrastructure as a competitive advantage (e.g., banks with comprehensive specialized departments of this kind would authorize loans faster than their competitors).

Recommendations:

33. *A significant increase in the amount and types of information that is shared by banks and other credit providers in Brazil, including in particular positive information to allow for the creation of reliable credit histories, will greatly help in fostering competition, lowering costs, and improving the efficiency of the system as a whole, thereby setting the basis for a reduction in financial margins (i.e. spreads). A measure that will immediately strengthen competition in the credit market is for all banks share their data – at least their negative data – with all credit reporting firms and not maintain exclusive relationships with only one credit bureau.*
34. *The creation of modern centralized databases containing other types of information (e.g. property registries and their corresponding liens) useful for credit decisions is also key, as this would allow for further cost reductions in the market that may have a favorable impact on spreads, thereby benefiting credit users. As an institution's own ability to extract information from these sources can no longer be used as a competitive advantage, the reform would also induce players to compete more on the basis of price and quality, which eventually would translate into real benefits for customers. In this regard, the BCB, as the overseer of the national credit reporting system (see below), has a role to play to raise awareness in this respect as a matter of urgency and then, in coordination with other relevant authorities, work on the agreements that are necessary to create and/or modernize real state and other property registries.*
35. *In order to create adequate conditions for increasing competition, an appropriate governance structure for the private credit reporting firm(s), appropriate regulation, and an oversight function must be implemented. In this regard, the current ownership structure at SERASA, the dominant player in the credit reporting market, in which only the private banks are the shareholders and decision-makers, might not be adequate to foster increased information sharing, particularly by some banks (e.g. government-owned and small banks). This*

governance structure creates at the very least doubt in the marketplace regarding conflicts of interest and/or that relevant decisions favor the dominant players. While in principle in the case of Brazil the existence of other relevant credit information providers might give an incentive to SERASA to give greater importance to the needs of non-represented minorities, it should be noted that SERASA remains a quasi-monopoly in bank-generated data.

Context

Credit and loan reporting systems and payment systems are key components of the financial infrastructure in every country. Economic and financial literature have analyzed the clear positive correlation between the stage of development of these two pieces of infrastructure on one hand and financial stability and economic development on the other hand. It might not be coincidental that the attention to both issues has increased exponentially in recent years at both the national and international levels.

As already discussed throughout the report, in many countries, credit reporting systems have been crucial in facilitating faster credit decisions based on more reliable credit histories. The knowledge of the credit granted and especially of the failure to fulfill obligations by customers is essential for creditors in deciding either in opening a new credit facility or in evaluating whether to maintain or revoke an already existing one.

The payments system is the infrastructure (comprised of institutions, instruments, rules, procedures, standards, and technical means) established to effect the transfer of monetary value between parties discharging mutual obligations. Its technical efficiency determines the efficiency with which transaction money is used in the economy, and the risks associated with its use. An efficient payments system reduces the cost of exchanging goods and services, and is indispensable to the functioning of the interbank, money, and capital markets. A weak payments system may severely drag on the stability and developmental capacity of an economy; its failures can result in inefficient use of financial resources, inequitable risk-sharing among agents, actual losses for participants, and loss of confidence in the financial system and in the very use of money.

There are clear interrelations between credit reporting and payment systems, in particular with regard to payment instruments. In some countries credit reporting systems also maintain data which allow an effective monitoring of the use of cheques and cards. In other countries, these databases are not managed by credit reporting agencies but still are important sources to establish the creditworthiness of individuals and corporations and provide credit reporting agencies with relevant information to expand their databases. In many cases, ineffective ways to collect data on the use of the different payment instruments has not allowed the country to increase the efficiency of its payments system by moving towards less costly and more reliable payment instruments (e.g. card payments). In some countries, automated clearinghouses (ACHs) and card operators keep more efficient databases on customer behaviors than those maintained by the individual financial institutions, but the former are not used efficiently by credit reporting systems (e.g. the number and nature of frauds on cheques and cards).

Therefore, effective interrelations between payment systems and credit reporting operators are both instrumental to enhance the reliability of payment instruments, and consequently on the efficient circulation of money, and improve the quality of the information managed by the credit bureaus.

Other relevant issues refer to the fact that 1) In some cases for some individuals the first step towards obtaining credit (e.g. a credit card, a car loan) is demonstrating a good and orderly management of a bank current account (e.g. no attempts to overdraw the checking account, etc.); 2) In most cases the structure of the retail payments system (typically owned by banks) becomes a de facto entry barrier

for non-bank credit providers (e.g. credit cards issued by department stores and others can only be used at their locations and not as general purpose payment instruments).

In addition, an interesting common element for all components of the financial infrastructure is the dynamics of their reform process. As in the case of any payment system reform, the implementation of efficient credit reporting systems depends on the establishment of specific legal and technical rules, an adequate infrastructure, as well as a competent managing body. The domestic banking sector, including the authorities (central bank and banking supervisors), needs to define all the characteristics of the Credit Bureau, such as the categories of operations, the limit of exposures, the characteristics of the information that credit reporting systems must provide to the banks. While every solution is country specific, on many occasions recognition of the operational arrangements of similar systems in other countries is useful before implementing the project. Since many countries are engaging themselves in the reform of their National Payments System (NPS) some economies of scale can be derived in exploiting possible forms of integration of the reform processes and organizational arrangements for the two efforts.

Authorities can take advantage of the model being developed in many countries to carry out the function of payment system oversight to shape their regulatory and supervisory framework for credit reporting systems.

Effective cooperation among market participants, between regulators and market participants and among regulators is essential for the development of sound and efficient credit reporting systems. On the one hand, 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, within the credit reporting systems, 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 as to the system's reliability and efficiency. The credit reporting systems overseers are therefore entrusted with making up for a specific type of failure in the market for information sharing, i.e. the coordination failures.

With regard to the cooperation among regulators, the safety and efficiency objectives of credit reporting systems may be pursued by a variety of public sector authorities, in addition to the central bank and the banking supervisors. Examples of these regulators include: legislative authorities, ministries of finance, competition and consumer protection authorities. Appropriate cooperation among authorities can be achieved in a variety of ways, for example, exchanges of views and information between relevant authorities may be conducted by holding regular or ad hoc meetings. Agreements on the sharing of information may be useful for such exchanges.

Status in Brazil

Brazil has been traditionally characterized by the heavy use of cheques, which are cleared efficiently, normally in T+1.⁷ Other instruments exist in the market (Credit and debit cards, DOCs,⁸ Cobranças,⁹ etc.)¹⁰. Several developments are under way in the Brazilian retail market, in part as a result of the recent reform of the large value payments systems, which culminated with the launch of a central bank

⁷ At the COMPE, operated by the Banco do Brasil.

⁸ Credit transfers.

⁹ Bloquetos de cobrança are documents used to pay bills. A customer receiving a bloqueto de cobrança takes it to a bank and pays in cash or writes a check to authorize payment through his account. Alternatively, the customer can input the bar-coded numbers at a home-banking station. Banks charge the payee an interbank fee to use them. They are cleared and settled electronically and when it is the case the physical item is truncated at the collecting bank.

¹⁰ DOCs and Bloquetos de cobrança are also cleared and settled at the COMPE.

owned and operated RTGS system (*Sistema de Transferência de Reservas, STR*).

Although more comprehensive data be needed, at first sight it appears that Brazil might not have achieved as yet a use of payment instruments which is optimal from an efficiency point of view. In many cases, payment instrument choices by customers may be optimal from the individual agent's point of view (due to cross-subsidization of payment instruments) but not from the point of view of the society in a welfare economics environment. Commercial banks report their desire to reduce the dependency on cheques, whose processing is quite correctly perceived as costly, but they have concerns relating to cultural resistances from their clientele. Furthermore, taxation and fiscal legislation do not seem to be neutral towards the use of instruments and might penalize the use of the less costly instruments. Credit and debit cards have increased dramatically over the past few years of macro-economic stability. In particular, credit cards are characterized by very high interest rates due, among other things, to the difficulty to recover the credit in case of insolvency of the cardholder by the banks. On the other hand, debit cards seem to be a very efficient instrument with the capability to reduce the costs of the banking sector to the satisfaction of both the merchants and the customers. There is a strong belief that the base of more than 70 million cards can be expanded along with the intensity of the instrument's use. In the case of credit and debit cards, two main players operate as acquirers and process transactions (REDECARD-CREDICARD and VISANET). Together they process over 93 percent of the market transactions. POS terminals are given free of charge to the merchants, who also receive maintenance from the suppliers. ATM operations are supported by several networks and are not interoperable. A company, owned by several banks, TECBAN, and traditionally operating in the ATM industry, has launched a new clearing for retail payments which connects the systems on line and in real time. Settlement of TECBAN operations occurs on the STR system. Despite some forms of consolidation both POS and ATMs do not have full interoperability in Brazil.

A new instrument, *Transferência Eletrônica Disponível TED*, became available as part of the overall Brazilian payment system modernization process. The TED is an express electronic funds transfer operation that can be settled through the STR, in real-time, or through the SITRAF, a hybrid settlement system operated by CIP, in same-day funds. In both cases the funds must be available at the beneficiary's current account no later than the end of the same day the credit order is issued. The usage of the TED has soared since its implementation. Considering only those TEDs processed through the STR, monthly transactions on behalf of banks' customers increased from 1,383,924 in January 2003 to 2,343,604 by the end of that same year, i.e. a 69 percent growth.

The largest private commercial bank, BRADESCO, won the concession to offer banking services in partnership with the Postal Administration. The new entity has been denominated *Banco Postal*. The service was launched in March 2002 and completed, in a period of 2 years, with the opening of branches in all the 5400 post office locations, present in all municipalities in Brazil. BRADESCO estimates that more than 3.5 million accounts will be opened, the vast majority of them by customers who do not hold bank accounts. A project to expand the services and the penetration to the less affluent population and in the inner country is also being implemented by the *Caixa Econômica Federal* through the *Casas Lotéricas*.

Some traditional problems of the Brazilian retail systems might be close to their solutions, although gradually. The multiplicity of POS at the same merchants should be mitigated by the VISANET and CREDICARD's decision to install mutually compatible POS. The plan started in the year 2002 with at least 20,000 new generation integrated POS and gradually replace old machines. This represented a major efficiency improvement in the card industry. ATMs will continue not to be interoperable in the near future, but the new payments system is very likely to force a re-thinking of the strategy of those (few) banks that see their ATM network as a source of competitive advantage. *Banco Postal* is likely to play a key role to expand the population's access to the banking and payments services.

There is a considerable room for improvement in the efficiency of retail payment instruments and systems, which still lack interoperability. After approval from its Board of Directors, the BCB is currently working on what has been called SPB-2 (*Sistema de Pagamento Brasileiro-2*), a second generation reform aiming at the modernization of payment instruments, especially those intended for low value payments, in order to promote cheaper and more efficient substitutes for cheques and cash itself. Paper instruments, such as cheques and currency, demand high transportation and processing costs, a burden to both financial and non-financial system. Fraud and counterfeiting are also more likely to be associated with such instruments.

The following tables provide an overview of the retail payments system in Brazil.

Table X: Evolution of cheque usage in Brazil

	Volumes in million; Values in US\$ million				
	1999	2000	2001	2002	2003
Number of per capita issued cheques	16	16	15	14	13
Volume of cheques above treshold ^{1/}	455	465	472	481	505
Volume of cheques below treshold	2,157	2,172	2,128	1,916	1,741
Value of cheques as a percentage of G	179 %	164 %	157%	129 %	72 %
Value of cheques above threshold	867,902	891,838	725,420	522,024	301,666
Value of cheques below threshold	90,920	95,193	75,931	58,244	53,985

^{1/} The Central bank establishes a value threshold wich is used by Compe – the Check Clearing House – for settlement lag definition purposes. This threshold is currently R\$ 300,00

Source: Banco Central do Brasil

Table XX: Relative Importance of the Main Instruments Cleared and Settled in the COMPE

		1999	2000	2001	2002	2003
		(%)	(%)	(%)	(%)	(%)
Volume	DOC	1.8	2.1	2.4	3.1	3.0
	Checks	80.7	79.2	77.3	74.0	71.8
	Bloquetos de Cobrança	17.5	18.7	20.3	22.8	25.2
Value	DOC	46.2	37.5	42.7	35.9	8.9
	Checks	43.3	48.7	43.5	45.6	52.5
	Bloquetos de Cobrança	10.5	13.9	13.8	18.5	38.6

Source: Banco Central do Brasil

Table XX: DOCs and Bloquetos de Cobrança

		1999	2000	2001	2002	2003
DOC	Volume (in millions)	59	70	82	102	94
	Value (in US\$ billions)	1,024	760	786	449	60
	Average value (in US\$)	17,471	10,839	9,562	4,413	645
Bloquetos de Cobrança	Volume (in millions)	566	624	682	739	789
	Value (in US\$ billions)	232	281	253	232	262
	Average value (in US\$)	410	450	371	314	332

Source: Banco Central do Brasil

Table XX: Evolution of TED Usage

	TED Customers Payments					
	Volume			Value (in US\$ millions)		
	Total	CIP-Sitraf	STR	Total	CIP-Sitraf	STR
Jan/ 2003	1,382,924	107,352	1,275,572	58,183	692	57,491
Feb/ 2003	1,398,213	366,759	1,031,454	51,846	4,889	46,957
Mar/ 2003	1,459,955	546,693	913,262	56,779	10,560	46,219
Apr/ 2003	1,658,817	753,361	905,456	70,932	17,752	53,180
May/ 2003	1,780,800	906,670	874,130	77,469	23,229	54,241
Jun/ 2003	1,748,953	945,737	803,216	73,467	24,367	49,100
Jul/ 2003	1,962,874	1,109,439	853,435	78,347	28,822	49,525
Aug/ 2003	1,895,429	1,079,841	815,588	78,459	26,124	43,335
Sep/ 2003	2,094,599	1,195,858	898,74	81,155	29,162	51,993
Oct/ 2003	2,195,721	1,323,427	872,29	86,316	31,944	54,372
Nov/ 2003	1,988,541	1,235,428	753,11	78,213	30,472	47,741
Dec/ 2003	2,343,604	1,493,786	849,82	97,683	36,657	61,026

Source: Banco Central do Brasil

Table XX: Evolution of Credit Cards in Brazil

Year	Number of cards (millions)	Change to previous year (%)	Number of transactions (millions)	Change to previous year (%)	Value of transactions (US\$ billions)	Change to previous year (%)	Average value of transactions (in US\$)	Credit cards per 1,000 inhabitants
1999	23.4	-	553.2	-	19.6	-	35.4	142.9
2000	29.4	25.5	705.9	27.6	25.0	28.8	35.4	177.0
2001	35.4	20.3	825.0	16.9	23.5	20.6	28.5	205.2
2002	40.8	15.2	969.6	17.5	22.1	17.3	22.8	233.4
2003	44.0	8.0	1,083.5	11.8	25.1	19.2	23.2	249.0

Sources: Banco Central do Brasil, Instituto Brasileiro de Geografia e Estatística - IBGE and Credit Card companies

Table XX: Debit Cards

Accepting devices and transactions	1999	2000	2001	2002	2003
Number of networks	29	29	29	30	29
Number of terminals:	86,170	97,539	111,370	129,913	137,354
with open access	22,569	31,764	43,171	49,813	51,887
with limited access	63,601	65,775	68,199	80,100	85,467
Volume of transactions (millions)	n.a	n.a	3,817	5,546	5,672
Value of transactions (US\$ billions)	n.a	n.a	183	212	231

Source: Banco Central do Brasil, commercial banks and Tecban.

Table XX: Electronic Banking and ATMs

Year	Number of cards (millions)	Change to previous year (%)	Number of transactions (millions)	Change to previous year (%)	Value of transactions (US\$ billions)	Change to previous year (%)	Average value of transactions (in US\$)	Debit cards per 1,000 inhabitants
1999	67.4	-	106.9	-	2.8		25.9	411.3
2000	85.5	26.7	205.8	92.5	5.0	80.2	24.3	514.4
2001	101.1	18.3	326.2	58.5	6.0	20.5	18.4	586.5
2002	114.2	13.0	451.3	38.4	6.7	11.6	14.9	654.1
2003	162.8	42.6	661.6	46.6	9.6	43.2	14.5	920.4

Sources: Banco Central do Brasil, Instituto Brasileiro de Geografia e Estatística - IBGE and Acquirers

Recommendations:

36. *Effective interrelations between payment systems and credit reporting operators are both instrumental to enhance the reliability of payment instruments, and consequently on the efficient circulation of money, and to improve the quality of the information managed by the credit bureaus. Credit reporting systems in Brazil make use of some but not all the information potentially deriving from the payments system. In particular, the very low penetration of some instruments, such as the direct debit, and some technical aspects related to the use of other instruments (bloqueio de cobrança) do not allow credit reporting systems to have easy access to data on payments of utilities, which are important indicators to establish the payment pattern of individuals. On the other hand, the use of credit and debit cards is increasing in the country. The mission team believes that the use of electronic payment instruments should be promoted and extended all throughout the economy to support credit information systems to further differentiating good borrowers from others with occasional repayment failures.*
37. *In order to increase the use of data – both positive and negative - related to the use of different payment instruments by credit reporting systems, the mission team recommends that the authorities promote a series of meetings between payment system providers (e.g. COMPE, CIP, TECBAN, and card operators) and credit registries to further explore the interrelations of their corresponding businesses and the possible synergies that could be achieved by undertaking a collaborative approach.*

38. *In particular, consideration should be given to establish a unique database for the Bloqueios de Cobrança (BdCs), which could make more efficient both the retail payment and credit reporting systems. The BdC is a bar-coded document used to pay bills. A customer receiving a “bloqueio de cobrança” takes it to a bank and pays in cash, through a debit card or writes a check to authorize payment through his account. Alternatively, the customer can input the bar-coded numbers at an ATM, home-banking or internet-banking station. Banks charge the payee an interbank fee to use them. They are cleared and settled electronically and when it is the case the physical item is truncated at the collecting bank. Currently, there is no centralized information on the issuance of these instruments and the bar-code does not contain certain information which would make the storage of these instruments easier for credit reporting purposes. Making this information available in the clearinghouse would enhance the features of this payment instruments and facilitate the use of this information for credit reporting.*
39. *Current practices of some credit information providers might be leading towards a heavier use of relatively inefficient payment instruments. In particular, the coverage to cheques provided by some firms might be the cause of a larger use of this instrument. In addition, the cheque is always used more as a credit than as a payment instrument, creating some distortions in the retail payment systems. The current database for uncovered cheques seems to meet well the objectives for which it was created after some upgrades introduced in 2002.*
40. *Widening the range coverage of payment instruments in the population could have an impact on credit provision by microfinance institutions and smaller lenders. Some potential small lenders have manifested that one of the reasons that impede them from granting more micro-credit is the relatively high cost in receiving and processing the installments. On the other hand, one obstacle to a higher use of retail instruments is represented by the current taxation on financial transactions. The development of a strategic vision on the future retail payment system under discussion in the BCB could address some of the issues.*
41. *The BCB, in consultation with other authorities should synchronize the different regulatory and supervisory roles as overseers of both the payments system and credit reporting systems and identify appropriate means for the exchange of information and a modus operandi to achieve the objective of a safe and efficient financial infrastructure which is common to both functions. The BCB has already developed a framework for its payment system oversight function. This model could be used to guide the central bank action as overseer of the credit reporting industry (see below).*

OVERSIGHT AND COOPERATION IN THE CREDIT REPORTING SYSTEMS

Context

The smoothness and reliability of information flow and sharing mechanisms affect the efficiency of the real economy and the financial markets; they also have an impact on access to credit by different segments of the population and firms. Market forces alone may not be able to achieve the objectives of efficiency and reliability of the credit reporting systems since participants and operators may not have adequate incentives to share the information on creditors. In addition, the institutional structure of the credit reporting systems may not provide incentives or mechanisms for efficient design and operation.

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 overseeing the system as a whole.

The role of the authorities is particularly relevant in order to play a leading role in developing a vision for the systems, in coordinating with all stakeholders and in carrying out a reform plan, if necessary. This role stems from the need to ensure an adequate legal and regulatory basis, an efficient functioning of the credit reporting industry and public databases and the adequate level of consumer protection. In all cases, in order to pursue the public interest in the credit reporting systems, the authorities should ensure that the systems they operate are in line with best international practices, as overseers, to ensure the (financial and operational) reliability and efficiency of all the systems.

In light of the different perspectives authorities and stakeholders tend to take on credit reporting systems, it is particularly important that a framework to oversee the financial information industry be developed in each country. In particular, the credit report overseer could play a key role to reconcile conflicting public policy actions by finding a satisfactory equilibrium to issues that, if not properly addressed, have the potential to jeopardize the development of the financial sector or economic growth. The oversight framework includes specifying the objectives, policies and instruments the overseer(s) will adopt in carrying out the function as well as the cooperative framework.

It is appropriate that credit reporting systems oversight be explicitly entrusted to the authorities by law. Specifying the objectives in relevant legislation may be the most direct way for providing a well-founded legal basis for the overseer(s) to implement appropriate policies and make it accountable in pursuing its goal and mandate in the credit reporting area.

Since several authorities share responsibilities for the development and smooth functioning of credit reporting systems in any given country, it is of paramount importance that regulators and supervisors develop appropriate schemes of cooperation in this matter. In particular, effective cooperation among market participants, between regulators and market participants and among regulators is essential for the development of sound and efficient credit reporting systems. On the one hand, 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, within the credit reporting systems, 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 as to the system's reliability and efficiency. The credit reporting systems overseers are therefore entrusted with making up for a specific type of failure in the market for information sharing, i.e. the coordination failures.

With regard to the cooperation among regulators, the safety and efficiency objectives of credit reporting systems may be pursued by a variety of public sector authorities, in addition to the central bank and the banking supervisors. Examples of these regulators include: legislative authorities, ministries of finance, competition and consumer protection authorities. Appropriate cooperation among authorities can be achieved in a variety of ways, for example, exchanges of views and information between relevant authorities may be conducted by holding regular or ad hoc meetings. Agreements on the sharing of information may be useful for such exchanges.

Status in Brazil

The lack of a general legal framework for credit reporting in Brazil implies that no authority is currently empowered to oversee the credit reporting industry. Thus, at present there is no official control over private sector firms providing credit reporting services, access criteria to such services,

quality of information to be stored in their databases, permissible uses of this information, security issues, etc.

The supervisory and regulatory powers of relevant authorities were described and analyzed in Section 4. None of these authorities perform any oversight on the financial information system as a whole.

The team had access to a law project that, if enacted, would support the sharing of positive data and would also introduce some basic operating principles for the activities that credit registries and other database operators usually perform. This law, however, does not give powers to any public sector institution within the Executive branch to oversee the credit reporting industry (i.e. the industry would remain “controlled” solely through judicial proceedings).

Finally, cooperative arrangements for credit reporting systems do not exist in Brazil

42. *The mission team believes that a relevant authority should undertake the role of overseer of credit reporting activities to better monitor and exercise control over the system as a whole. The scope of this oversight role should extend over what could be called the “national credit reporting system”. Rather than focusing on a particular credit information database or service provider, the oversight of the national credit reporting system refers to deploying this function over the infrastructure, integrated by a set of public and private databases and institutions and other stakeholders, that facilitates credit decision through the provision of relevant information.*
43. *The Banco Central do Brasil may be well positioned to assume the role of overseer of the national credit reporting system by broadening its scope beyond improvements to the SCR. Reasons for this recommendation include the technical competency of the BCB and its understanding of the economic role to be played by credit reporting activities, its unique access to credit data from banks, and the importance of credit information for the assessment of risk in the regulated financial sector and its related impact on system soundness and sustainability.*
44. *While other public sector authorities may still have legitimate concerns over credit reporting issues (e.g. consumer protection in the case of unregulated credit providers), a leading institution is also necessary in order to develop a strategic vision for the credit reporting system as a whole, in coordinating with all stakeholders, and in carrying out the reform plan. The strategic vision must identify an accepted set of longer-term objectives and a credible action plan to achieve them. For the definition of this strategic process to upgrade the credit reporting system in Brazil, the mission team believes the BCB should play this leadership role.*
45. *The oversight regime must be effective, so that the laws that are passed can be enforced and consumer protections realized. To this end, the law should explicitly empower the BCB and specify its policy objectives in order to develop and implement appropriate policies and make it accountable in pursuing its goal and mandate in the credit reporting area. If necessary, secondary legislation (bylaws, circulars, etc.) should be implemented to ensure that this oversight function is done in such a way that contributes to the development of a credit reporting system that effectively contributes to the integrity, efficiency and safety of all financial markets.*
46. *In the context of establishing the oversight function, the BCB should disclose publicly its implementation strategies to achieve their objectives relating to all significant credit reporting systems matters. With regard to policy objectives, the mission suggests that the BCB broaden*

the scope beyond traditional main objectives like efficiency and reliability of credit reporting systems to a wider set of issues, including ensuring an adequate balance between competition and cooperation in the credit reporting market. These objectives might be pursued by the BCB especially in those cases not embraced by other regulatory or supervisory authorities. Instruments of oversight range from moral suasion to on-site inspections, from regulation to cooperation, from sanctions to the direct provision of credit reporting services.

47. *The BCB, in exercising its oversight role should have the ability to carry out this function effectively. To this end, it should:*
 - i. *Establish appropriate organizational arrangements and staffing. Skills of human resources involved in the function should be as wide as possible and include legal, operational and technical expertise as well as policy and economics;*
 - ii. *Ensure that an adequate degree of participant co-operation exists and is sufficient to promote and realize the desired organizational and operational arrangements;*
 - iii. *Verify that individual credit reporting systems satisfy user needs as well as risk and efficiency requirements through appropriate interventions both at the development stage and during the on-going system implementation and operational phases;*
 - iv. *Define and implement appropriate actions should participants not comply with published rules and regulations (e.g. the application of pre-determined penalties and sanctions for compliance failures);*
 - v. *Collect and distribute relevant statistical information to demonstrate the use being made of each system and the extent to which the systems are satisfying end-user and other market needs. Information and public policy statements relating to all substantial credit reporting system matters could be disclosed in a manner that assures wide dissemination among stakeholders.*
48. *Cooperation among regulators is an essential component of the oversight function and will need to be established in Brazil for the credit reporting system. All interested authorities (e.g. Ministério da Fazenda, Ministério da Justiça, other agencies responsible for relevant public registries, etc.) should identify and implement procedure and process changes to address any weaknesses or inconsistencies in the regulatory arrangements and assure a high level of co-operation in the way that policies are implemented. Consideration should be given to the need for creating a task force to coordinate all authorities' actions in this field, based on appropriate memoranda of understanding (see last paragraph of this section). At the international level, Brazilian authorities have a role to play to discuss any possible sharing of information and experience both within and beyond the WHCRI.*
49. *The mission suggests that public officials strengthen dialogue on credit reporting also with private sector stakeholders. The development of a shared vision for strengthening the credit reporting system and more broadly the financial information infrastructure in Brazil could benefit from a one to two day workshop which would involve key decision makers from both the public and private sectors. International expertise on key topics could be brought in for specific sessions and the event could provide opportunities for discussing how to move forward in the future.*
50. *In the mid-term, the mission suggests the authorities to formalize cooperative arrangements by promoting a Credit Reporting Systems Task Force. This body should include representatives*

from all major stakeholders with an interest in credit reporting systems and should be used as the main tool also to secure a constructive dialogue between regulators and market participants. The Committee will be led by the BCB. Sub-groups and working groups should work for the Task Force and under its coordination and should maintain their technical focus. All proposals of the working groups should be discussed within the Task Force. Over the years, the Task Force could evolve into a permanent Council and become a key permanent component of the credit reporting infrastructure of Brazil. Terms of Reference for the Credit Reporting Systems Task Force of Brazil are provided below.

Box 1 Credit Reporting Systems Task Force – Terms of Reference

Objectives

The Credit Reporting Systems Task Force aims to support the achievement of sound and efficient credit reporting systems in Brazil. It can also serve as a forum for cooperation to maintain orderly conditions in cross-border systems.

Main Tasks

- ◆ The Task Force works to facilitate the necessary cooperation between all market participants and regulators in the credit reporting area.
- ◆ The Task Force promotes common initiatives towards the implementation of the credit reporting systems infrastructure. These initiatives should not impede, and should in fact foster, healthy competition among market participants.
- ◆ The Task Force plays a key role in preparing strategic documents for the overall credit reporting systems in the country.
- ◆ The Task Force plays a key role in monitoring the implementation of credit reporting systems reforms.
- ◆ The Task Force plays a key role in facilitating the sharing of information on economic and business requirements.
- ◆ The Task Force helps to identify the impact of different options on participants' business and daily operations and on end-user interests.
- ◆ The Task Force plays a key role in endorsing the priority and the schedule of individual projects to be launched, financed and implemented.
- ◆ The Task Force promotes standardization of procedures and systems.
- ◆ The Task Force is responsible for promoting knowledge and education of credit reporting systems issues in the country. To this end, the Task Force uses any means it might find appropriate (workshops, seminars, web pages, newsletter, etc.).
- ◆ The Task Force seeks to promote cooperation among all institutions active in credit reporting systems within the region and at the international level.

Methodology

- ◆ The Task Force prepares ad hoc reports on credit reporting issues. The reports would not have a prescriptive nature. However, they would serve as a reference for the ongoing reforms in the country.
- ◆ The Task Force establishes ad hoc working groups on credit reporting systems matters. Working groups may or may not be composed of the totality of the institutions represented in the Task Force.
- ◆ The Task Force reports on its activities to the Top Management of the constituting institutions on an annual basis.

Representation and Organizational Structure

- ◆ The Task Force gives representation to all the stakeholders of credit reporting systems. These include: the Central Bank (BCB), the Ministry of Finance, Ministry of Justice, other agencies responsible for relevant public registries, the credit bureaus, FEBRABAN and the commercial banks, the non-bank credit providers, the end-users, and other regulators.
- ◆ The BCB serves as the secretariat of the Task Force.
- ◆ Appointed representatives of the stakeholders are senior managers with an involvement in credit reporting system matters. They report directly to the top management of their respective institutions.

- ◆ The Task Force is comprised of an appropriate number of experts. The composition of the Task Force should be consistent with the objective of having effective discussion in the meetings.
- ◆ The Task Force has an internal governance structure with a chairperson and deputy(s), an executive body, formal rules to determine the terms and conditions for the appointment of the executive positions, and formal rules to govern the activity of the executive body.
- ◆ In the early stage of its life, the Task Force might seek, if necessary, assistance from other national and international entities highly experienced in managing credit reporting system.
- ◆ The Task Force may invite, if needed, other institutions and/or individual experts to participate in its meetings.

NEXT STEPS

1. **Key areas of further developments include: the establishment of a sound legal and regulatory framework, modernization of key public data registries, strengthening the public credit registry in the SB, improving reporting practices by public service companies and utilities, a coordinated public education and outreach campaign, and the establishment of an oversight function on the national credit reporting system.**
2. **In sum, the mission considers that many elements are in place to undertake the necessary steps to enhance the efficiency and safety of the credit reporting system in Brazil and urges the Central Bank to engage as a matter of urgency in all necessary actions to achieve this objective. The World Bank and CEMLA, through the WHCRI and/or in their institutional capacity stand available to provide any support that the Central Bank deem appropriate in the finalization of the reform effort.**