ROLE OF CREDIT BUREAUS IN EFFECTIVE RISK MANAGEMENT

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INTRODUCTION

We are at an interesting time. Risk management has taken a deservingly central place in the management of financial institutions in most parts of the world. Now, quite a lot of countries have moved risk management to the executive floor and to the board level and to the front burner. But this was not to be until we have learnt bitter lessons from the failure of effective risk management. Between 2007-2009, the world witnessed a depression. There were great losses in financial asset resulting from erosion of value in the capital and mortgage/real asset and financial markets. The reserve banks and deposit insurance corporations stepped in to bail out banks and safe depositors from significant losses while also preventing systemic collapse of the financial systems.

Nigeria was not an exception. Between 2006-2009, eight banks were saved from imminent collapse, with the sum of N620 billion injection by the Central Bank. AMCON, set up as a bad bank, was saddled with taking over N770 billion bad risk assets. Furthermore, as at August 2008, the level of non performing loans (NPL) to total loans was a whopping 33 per cent with N2.5 trillion bad loans, according to the CBN. The microfinance sub-sector of the Nigerian financial system was not left out. In 2010, 224 of the 986 microfinance banks were liquidated by the CBN and handed over to the NDIC for liquidation resolution.

The Nigerian capital market did not fare better. Nigeria attained a highest level of market capitalization of N13.5 trillion in March 2008. Value erosion was so fast and dramatic that it hit its lowest ebb less than a year later in January 2009 at N4.6 trillion. The Nigerian government had to embark on forebearance and stimulus packages to revive the capital market. The so-called margin loans played a big role in the challenges faced by the Nigerian banking industry and the capital market. According to the then CBN Governor, a sum of N22 billion was injected by government to support the capital market. The insurance industry just fared slightly better. As at December 2012, N58.6 billion premium was outstanding to insurance companies.

There were many factors responsible for this. However, the failure of risk management process was generally acknowledged as one key factor. It was observed that countries that emerged from the depression with little negative impact continued to practice conservative and water-tight risk management. Little wonder, most countries that were affected decided to embark on solutions with focus on enhancing risk management frameworks and governance principles. In the financial services industry, Basel II and III Accords came into being and a lot of central banks across the globe began to drive their implementations.

Nigeria took the right credible and sustainable routes to addressing the failure of risk management in 2008. The Central Bank of Nigeria (CBN), Securities and Exchange Commission (SEC) and National Insurance Commission (NAICOM), took significant measures to address the issues that led to the collapse or failure of the money and capital markets. Apart from the rescuing operations of the eight banks and the purchase of six of them by government, AMCON was also established. Thereafter, a great deal of efforts went into changing the governance structure and risk management departments of banks, including reporting on risk management issues. CBN brought risk management and compliance functions to the front burner. In January 2013, NAICOM issued its popular 'No Premium, No Cover' policy to protect insurers and insurance industry. It also instituted other risk management policies to address the challenge of risk management in the insurance industry in Nigeria.

Lending at that time, before the private credit bureaus, was influenced by perception, personal relationship and size of collateral offered by customers. Lending was taking place in the dark and in the environment of information asymmetry. In credit analysis classes and programs, we are taught of all the 5 C's of lending, namely, Conditions, Capital, Collateral, Capacity, and Character, Character is the most important consideration. But how do we measure Character? This was the challenge the Nigerian financial system battled for decades until 2009, when the Nigerian government licensed three private credit bureaus. Today, Nigeria has joined the rest of the civilized world to introduce credit bureaus and collateral registry.

Risk is a fundamental aspect of any human endeavour. To financial institutions, they are basically involved in the business of risk. Risk refers to the chances of having an unexpected or a negative outcome. Risks are of different dimensions, cutting across business, non-business and financial. Financial risk in particular involves financial loss to firms, which generally arises due to instability and losses in the financial markets caused by movement in stock prices, currencies, interest rates and more. Financial risk includes risks associated with the market, credit, liquidity and operations. Each of these requires different approaches to manage. In the investment and financial services spheres, risk implies the possibility that an investment or an asset created would be worth less than the original amount or value invested or created.

Risk management is commonly and routinely perceived as a two-step process. Firms must have the capacity to analyse and identify risks associated with their investment and core operations. Secondly, and more importantly, they must be able to use the information obtained to lead to informed decisions.

Furthermore, some of the key challenges faced in credit risk management include absence of relevant information about borrowers, quality of data, information asymmetry, and managing collateral and security information. Banks and other financial institutions are faced with inadequate and incomplete information on borrowers. Fraudulent customers of theirs change identity, addresses and even their names at will. Some embark on serial borrowing and default. Some others wilfully and deliberately withhold information or even misinform their banks of critical information about themselves and their businesses. A great deal of the challenges faced by the financial institutions is from personal borrowers and micro, small and medium businesses (MSMEs).

How have the Nigerian financial institutions responded to these challenges? They concentrated their loans on high net worth individuals and large corporate. Over 80 per cent of loans from the banking system are still to large corporations. Relationship management dictated who obtained loans. Lending rates were high and excessive and most borrowers shared from the provisions banks make for the risk of lending in the dark. The only borrowers who were not charged excessive interest rates are the large businesses and high net worth individuals who also, more often than not, have deposits. Invariably, only few customers obtained credits of their choice and at the right price. The banking industry gave loans to less than 10 per cent of their customers. They were also unable to develop retail and consumer loans. Nigeria was worse for it because credit penetration was only about 5 per cent in 2009. More importantly, banks still lost a lot of money as non-performing loans was as high as 30 per cent.

Banks and other financial institutions can be assisted to mitigate risks and promote efficiency by the presence of relevant financial infrastructure. These financial infrastructures include the credit bureaus, collateral registries, robust identification system and efficient judiciary and legislation.

CREDIT BUREAUS AND THEIR ROLES

A credit bureau is a credit infrastructure that promotes information sharing among lenders and operators in the lending industry. As an infrastructure, a credit bureau is an enabler. It collects information from various sources and provides complete, accurate and reliable information on credit status, credit history and credit scores on borrowers. As a financial infrastructure, a credit bureau can also provide an array of risk management solutions and architecture, consulting and financial education, to its customers. A credit bureau is typically a neutral, third party service provider for a closed user group of its members. The furnishers of information to a credit bureau, typically would include banks, non-bank financial institutions and public sources. Credit bureau typical products would include credit information report, credit scores, monitors and alerts, portfolio review and monitoring, fraud detection and credit information verification.

Credit bureaus have helped to minimize challenges lenders face and positively influence risk management in several ways. Services of these bureaus, such as the Credit Information Reports, promote financial intermediation and inclusion as lenders are keen on granting credits to worthy individuals and corporate organisations with good payment history and with less emphasis on physical collaterals, thus minimizing exposure to risk for all parties. Borrowers also now have opportunity to build good reputations which enable them negotiate favourable credit terms.

Non-Performing Loans (NPL) remain a major risk in every country with a lending industry. This menace is certain to be high where viable measures to prevent reckless lending and over-indebtedness are lacking. Such economies experience disintermediation of bank-system lending caused by the erosion of banks' profitability, stagnation of economic resources particularly labor and capital with low productivity. NPLs reduction is enhanced by credit bureaus. India, for example, introduced her Credit Information Bureau (India) Limited – CIBIL incorporation in 2000 and had NPL to total loans dropped to 2.8% in 2007 from 10.4% in 2002. In Nigeria, the level of non-performing credit to total credit has dropped significantly to 4.5 per cent in 2013.

Information from credit bureaus provides financial services institutions and other stakeholders in the risk environment with improved portfolio quality. This enhance effective Portfolio Management which conventionally involves making decisions about investment mix and policy, matching investments to objectives, asset allocation for individuals and institutions, and balancing risk against performance. Since credit behaviour of most economic agents can be accessed, making investment decisions on either aggregated entities or single units become guided easily. Credit bureaus foster desirable risk management by providing a centralised database of the financial community thereby enhancing reduction and possible elimination of information asymmetry. For example, this uniformity blocks dubious lenders moving from one creditor to another, unnoticed.

Credit bureaus facilitate lenders to develop products, terms and parameters with the objective of either restricting exposures for situations with higher risks or encouraging activities for cases with lower risks. This is made possible since credit standings with future credit behaviour of individuals and organisations become predictable. Lenders are thus able to channel their services and resources towards getting the best out of their clients.

In addition, time has been recognized as the ultimate challenge in Risk Management. There are usually time lag in response to risky situations, time lag in feeding risk managers with needed data, and inability of these managers to prioritize risks at different situations to avoid relapse are among few challenges posed by time. Comprehensive and reliable data among other services of credit bureaus have enhanced quality decision-making and improve processing time of credit transactions.

MOVING FORWARD

Nigeria has joined the league of countries with established and functioning credit bureaus. Three credit bureaus now operate in Nigeria. CRC Credit Bureau has covered a large part of the lending industry with over four hundred institutions submitting credit-related information and accessing the data base as well. The lending segments covered include all commercial banks, all merchant/investment banks, all special vehicles and development financial institutions, mortgage banks, microfinance banks and finance houses. Others include leasing companies, asset management companies and non-bank unlicensed small lenders. We have moved forward to getting data from alternative sources such as retailers, cooperative societies, insurance companies, hotels, pharmaceuticals, auto dealers and travel agencies. We are happy to be supporting the only non-bank credit card company in Nigeria.

As an enabler and an infrastructure, we are happy that we are already impacting the Nigerian lending industry and the Nigerian economy generally. We are supporting the risk management process and framework in a big way. Non performing loans is at the lowest level in the history of Nigeria and it would continue to hopefully get better. Information asymmetry is becoming a thing of the past. Lending in the dark has taking a flight. New products especially for consumer loans and MSMEs are now available in Nigeria. Credit cards, mortgage loans, auto loans are now available in our country.

Since 2009 when the credit bureaus commenced live operations, access to credit in Nigeria has been credited with a lot of improvements. Credit penetration which was just about 5 per cent has moved to over 30 per cent in 2013. By the 2015 Doing Business Report of the World Bank, released recently, Nigeria now ranks among the top five economies in Africa in the ease of getting credit. Nigeria jumped 73 places to 52nd position out of 189 economies in the ease of obtaining credit. The World Bank attributed the impressive ranking of Nigeria to the licensing of private credit bureaus supported by a functional operational guidelines and the increase in the coverage rate of the Nigerian reporting system. This is a valid and encouraging news. CRC Credit Bureaus already has presence in seventeen states of Nigeria including the FCT.

And as Nigeria prepares to implement Basel III, the credit bureau industry is strategically placed to play our role as an enabler.

With the national identity management and the bank verification number (BVN) projects, we will be able to further support the democratisation and automation of access to lending. We look forward to a Nigeria where consumer loans are driven by auto processing. We also look forward to risk-based risk asset pricing where borrower’s riskiness, as determined by credit bureau’s information and scores, would determine his/her loan’s price.

Credit bureaus in Nigeria are still faced with the challenge of unique identification od borrowers, data quality, data submission and usage. Nigeria credit bureau would perform better with the availability of unique identification and collateral registry, two projects that are already on-going. The two projects, when available to credit bureaus, will enhance data quality and make possible the introduction of various other products that can enhance risk management process for lenders generally.