Benefits of sharing positive consumer credit data

by Banking Development Department

The first review by the HKMA of sharing positive consumer credit data has highlighted benefits to financial institutions in their ability to control bankruptcy losses. More importantly, consumers, particularly those who have taken out cheaper non-card credit to repay their credit card debts, have also benefited significantly from positive data sharing.

The HKMA's review, based on a set of indicators agreed with the Consumer Council, was conducted following the expiry, in June 2005, of a two-year moratorium on credit providers being able to access the credit data of their existing customers for credit reviews. The moratorium was imposed by the Privacy Commissioner to address concerns that his decision to allow the sharing of more positive consumer credit data in June 2003 might lead to a credit crunch.

Introduction

Positive data sharing was introduced in Hong Kong in June 2003 against a background of rising personal bankruptcies. In the years following the Asian financial crisis, a large number of borrowers found themselves in financial difficulty. The number of bankruptcy orders issued by the courts surged by over 27 times from 893 cases in 1998 to 25,328 in 2002. At that time, it was common for a borrower to accumulate an enormous, and obviously unsustainable, level of debt before going bankrupt. In an attempt to address this problem, the Office of the Privacy Commissioner for Personal Data (PCO), on the recommendation of the financial industry and the HKMA, relaxed the Code of Practice on Consumer Credit Data to allow credit providers to share a wider range of positive consumer credit information[1].

The decision was not without its share of controversy. The PCO received a wide variety of opinions during the extensive public consultation period before the relaxation was approved. Apart from worries over personal privacy, there were concerns that positive data sharing might force a large number of borrowers, who were already overextended, into bankruptcy and thus cause a credit crunch. In addressing this concern, the PCO introduced a two-year moratorium, prohibiting financial institutions from accessing positive data to conduct credit reviews. As a result, financial institutions could access positive data only for assessing new credit applications or restructuring existing credit. The ending of the moratorium in June 2005 was uneventful with no sign of a credit crunch.

Since then, the HKMA has been monitoring the benefits of positive data sharing using, among other things, a set of indicators agreed with the Consumer Council (see Table 1 for the indicators, which are broadly classified, for discussion purposes, into benefits to financial institutions and benefits to consumers).

[1] Prior to the relaxation in June 2003, credit providers were allowed to share limited positive information, such as data relating to applications for credit and enquiries about customers.

TABLE 1

Indicators for monitoring the benefits of positive data sharing

	Expected benefits of positive data sharing	Indicators
Financial institutions	Reduction in default rates	Level of credit cards charge-off rate
	Reduced level of over-indebtedness	Average indebtedness of bankrupts in terms of their monthly income
Consumers	More differentiation in interest rates	Changes in percentage distribution of credit card receivables by level of interest rates
	Reduction in costs	The level of fees charged on cash advances drawn under credit cards
	Expected increase in the percentage of customers eligible to obtain credit	Ratio of total personal loans to nominal GDP Aggregate number of individual customers taking out consumer credit from AIs

Under the agreement with the Consumer Council, the first assessment was to be conducted after the expiry of the moratorium and then annually. In agreeing to conduct the assessment, the HKMA cautioned that the benefits of positive data sharing would take a few years to be fully realised. In particular, the impact of positive data sharing was unlikely to be clearly visible from most of the indicators as credit reviews on existing customers were prohibited during the moratorium.

The HKMA has now completed the first assessment. In the process, it has analysed the data collected from authorized institutions (AIs), TransUnion Limited, the consumer credit reference agency most commonly used by AIs in Hong Kong, and the Office of the Official Receiver. It has also interviewed 14 financial institutions specialising in consumer lending. These include 10 banks, three restricted licence banks and deposit-taking companies, and one non-AI finance company. These institutions account for over 70% of the consumer credit market.

The assessment results

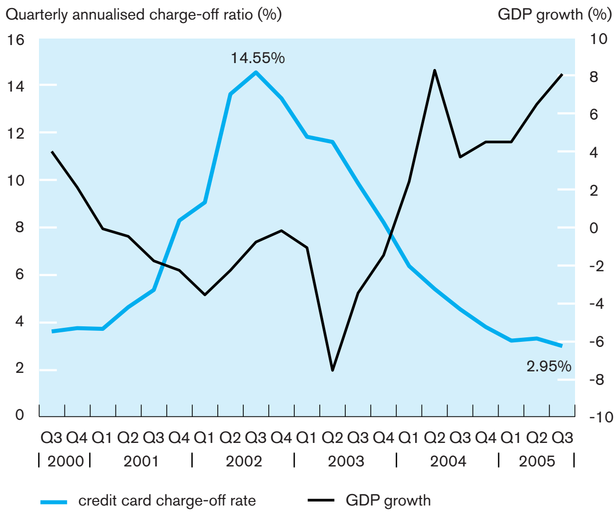
Benefits to financial institutions

With positive data sharing, financial institutions have fuller information to assess the credit worthiness of their customers, enabling them to avoid lending to borrowers who are already over-extended financially. The institutions are also in a better position to control their losses in consumer credit business.

Chart 1 shows the average credit card charge-off ratio of major credit card issuers in Hong Kong together with GDP growth for the period between the third quarter of 2000 and the third quarter of 2005. Following the Asian financial crisis, the average credit card charge-off ratio rose sharply and reached a peak of 14.6% in the third quarter of 2002. After the introduction of positive data sharing in August 2003, the ratio declined steadily and stood at 2.95% in the third quarter of 2005. This is comparable to the level before the Asian crisis.

CHART 1

Credit card charge-off ratio



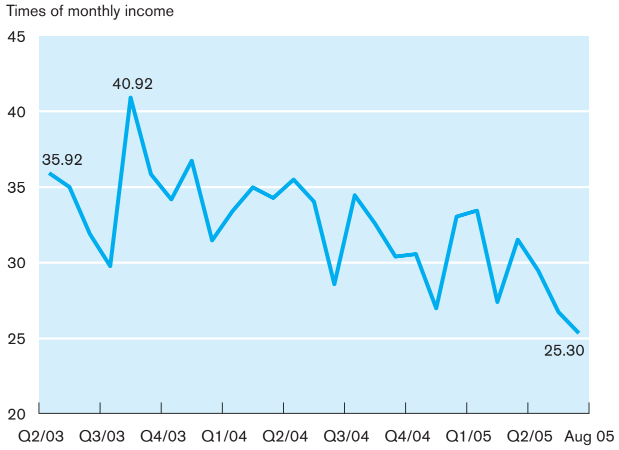
Source: HKMA and Census and Statistics Department

Despite the trend, caution is needed in attributing this solely to positive data sharing. The decline in the credit card charge-off ratio must be seen in the light of the improving overall economy. It is likely the economic recovery, which began in the third quarter of 2003, is a more important factor than positive data sharing in explaining the rapid reduction in the credit card charge-off ratio[2], given the two-year moratorium.

However, the conspicuous improvement in the problem of over-indebtedness strongly indicates the benefits of positive data sharing to financial institutions. Since positive data sharing was introduced in August 2003, the average indebtedness of bankrupts has declined from over 35 times their monthly income to 25 times in August 2005 (Chart 2)[3].

CHART 2

Average indebtedness of bankrupts in terms of monthly income



Source: Official Receiver's Office

This clearly shows that with positive data sharing financial institutions are in a better position to avoid lending to borrowers on the verge of bankruptcy. In fact, all financial institutions interviewed agree that positive data sharing has been a powerful risk management tool. But are these benefits flowing to consumers?

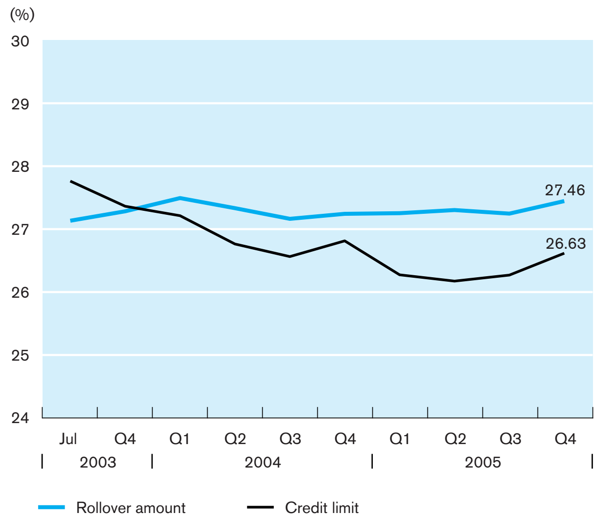
Benefits to consumers

Positive data sharing should benefit both financial institutions and consumers in the longer term. To the extent that positive data sharing reduces the credit loss of financial institutions, part of the benefits should be passed on to consumers in a competitive environment. Consumers with a good credit record should benefit from lower costs in obtaining credit, whereas overextended borrowers should find it more costly to borrow. Eventually, the overall cost of consumer credit should decline, and there should be greater differentiation in interest rates as financial institutions price credit according to the credit worthiness of individual borrowers. In addition, consumers should find it easier and quicker to have access to credit, resulting in a larger proportion of the population being able to obtain credit from financial institutions.

However, as we have cautioned the Consumer Council, we do not expect to see these benefits flowing immediately from the expiry of the moratorium. Charts 3 and 4 show the average interest rate on credit card lending and the standard deviation of credit card interest rates based on credit limits and

CHART 3

Average interest rate on credit card lending



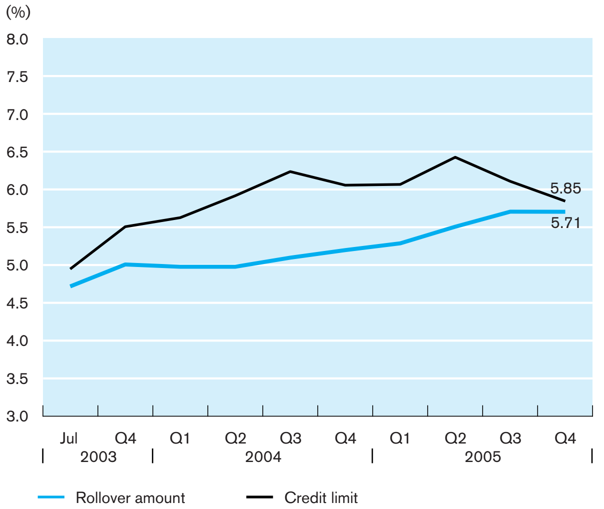
Source: HKMA

[2] The HKMA considered using econometric analysis to estimate the extent to which the improvement in the credit card charge-off ratio was due to positive data sharing. However, as positive data sharing was introduced only in August 2003, there were insufficient statistical observations to enable any meaningful conclusions to be drawn from such analysis.

[3] Based on an earlier report produced by McKinsey & Co (November 2001), the average indebtedness of bankrupts in the US is about 21 months of their monthly income.

CHART 4

Standard deviation of credit card interest rates

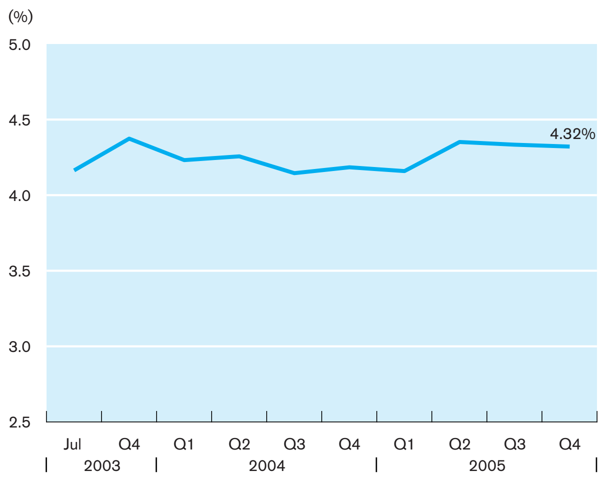


Source: HKMA

rollover amounts from July 2003. It can be seen from Chart 3 that the average interest rate on credit card lending has generally remained stable since the introduction of positive data sharing. The standard deviation of credit card interest rates increased by 0.9% for credit limit and by 0.99% for the rollover amount, between July 2003 and December 2005. The level of fees for cash advances drawn under credit cards since July 2003 is shown in Chart 5. It has remained largely unchanged.

CHART 5

Fees for cash advances drawn under credit cards



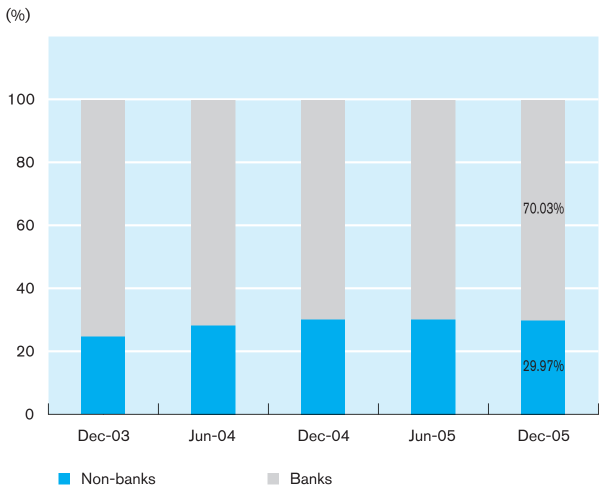
Source: HKMA

These indicators suggest that, as expected, the benefits of positive data sharing to consumers have yet to manifest themselves, at least as far as the credit card market is concerned.

There are, however, interesting market developments. The restrictions imposed by the moratorium on banks in respect of their existing customers seemed to have opened up opportunities for smaller players, who were active in the market of non-credit card revolving credit facilities[4] and instalment credit (non-card credit). Unlike the credit card market, which is dominated by banks, there are a significant number of non-bank financial institutions (restricted licence banks, deposit-taking companies and non-AI financial institutions) in the market of non-card credit. Shortly after the introduction of positive data sharing, many of them actively offered low-interest-rate products to attract borrowers to consolidate their credit card outstanding amounts. From the statistics provided by TransUnion, the market share of non-bank financial institutions in these products increased from 25% in December 2003 to 30% in December 2005 (Chart 6).

CHART 6

Market share of non-bank financial institutions in the non-card credit market



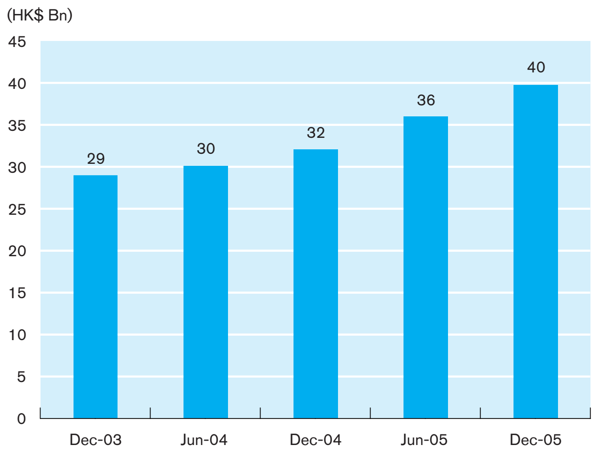
Source: TransUnion Limited

[4] Revolving credit facilities have been increasingly popular among consumers in recent years. A borrower can withdraw cash under a revolving credit facility and, unlike instalment credit, the facility can be re-used after the outstanding amount is repaid.

As a result, the non-card credit market expanded quickly after the commencement of positive data sharing. The aggregate amount increased by 38% from HK$29 billion to HK$40 billion from December 2003 to December 2005[5] (Chart 7). On the other hand, while the amount of credit card receivables picked up by nearly 10% between the second quarter of 2003 and the third quarter of 2005, the rollover amount declined by 17%. Accordingly, the rollover ratio dropped rapidly from 54% in the second quarter of 2003 to 41% in the third quarter of 2005 (Chart 8).

CHART 7

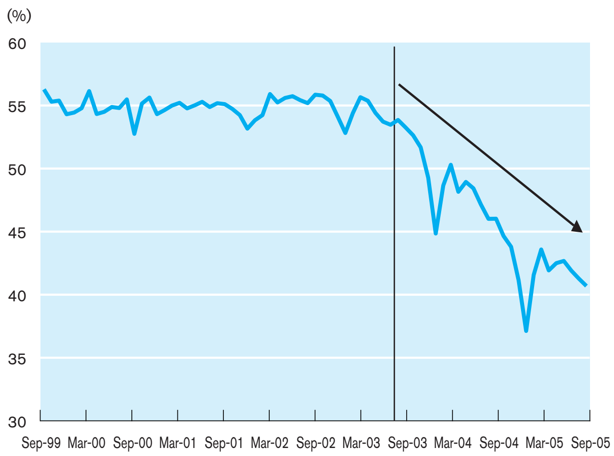
Aggregate amount of non-card credit



Source: TransUnion Limited

CHART 8

Rollover ratio of credit card receivables



Source: HKMA

[5] No figures for the second quarter of 2003 are available as positive data sharing actually took place in August 2003 (it took financial institutions about two months to amend their systems for sharing positive data).

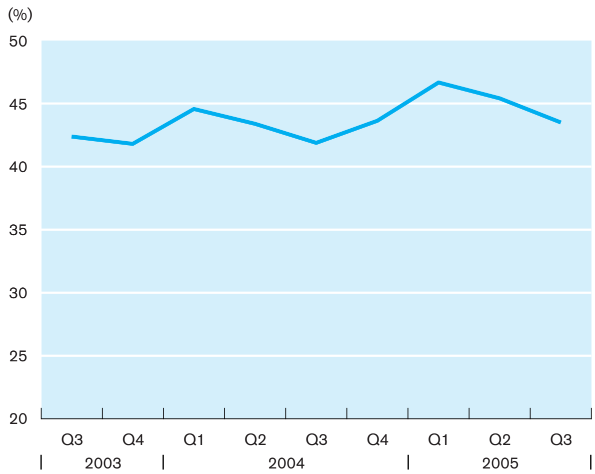
Financial institutions are aware of these developments. In interviews with the HKMA, a few non-bank financial institutions specialising in consumer lending said that without positive data sharing they would not have been able to offer lower interest rate products to their customers. More recently, banks have been showing increasing interest in this market.

Quantifying the benefits to consumers has been difficult because we do not know the amount of non-card credit applied to pay off credit card outstanding amounts. But given the substantial amount involved and the large interest rate differential between credit cards and non-card credit (6 - 10% according to industry practitioners), the savings in interest expenses by consumers is likely significant.

In relation to improving access to credit by consumers, both the ratio of total personal loans to nominal GDP, and the aggregate number of individual customers who have taken out consumer credit from AIs have increased steadily since the introduction of positive data sharing (Charts 9 and 10). While it is difficult to quantify the contribution made by the different factors, the interviews with financial institutions indicate positive data sharing has played a part.

CHART 9

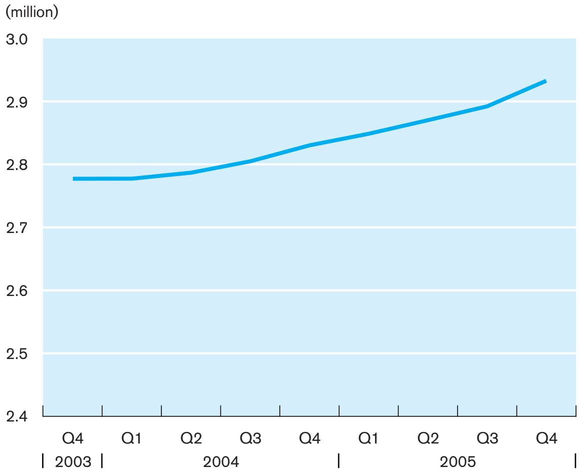
Ratio of total personal loans to nominal quarterly GDP



Source: HKMA and Census and Statistics Department

CHART 10

Aggregate number of individual customers who have taken out consumer credit from AIs



Source: TransUnion Limited

From this analysis, it is clear consumers and financial institutions are benefiting from positive data sharing, notwithstanding the restrictions on access to positive data during the moratorium.

One effect of positive data sharing, which is worth special mention, is its impact on financial over-extension. Positive data give financial institutions a better picture of an individual's financial position, and the financially stretched are less likely to obtain additional credit. Although we do not have data to show the extent of this effect, the conspicuous reduction in the average income multiple of bankrupts suggests that the over-extension of the non-bankrupts should have improved as well. We have not classified this as a benefit to consumers because of the difficulties in collecting data. However, the effect on the individuals concerned should be considered positive.

Overall summary

The HKMA's assessment shows there are obvious benefits of positive data sharing to financial institutions in their ability to control bankruptcy losses. More importantly, consumers are also benefiting, particularly those who have taken out non-card credit to repay their credit card debts.

Now that the moratorium is over, it is expected that more benefits of positive data sharing will flow to consumers. There are several developments in support of this assessment. From the interviews with financial institutions, most banks indicate they will make fuller use of positive data to provide better services to their customers. A few major players said they were proactively offering lower interest rate products to selected credit card holders - presumably as a response to the challenge coming from the non-bank players. New players continue to emerge and the consumer credit market has become more competitive. All these developments suggest that consumers will stand to benefit more from positive data sharing in the future.