
Reforming the credit bureau law

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Credit is now more accessible for Panama's citizens and businesses, thanks to an ambitious reform of the credit bureau law. Many of Panama's 300,000 small and medium businesses—employing 68% of workers in the country—were cut off from credit before the reform. And more than 40% of Panamanian adults, mostly the poorest, had no formal credit, forced to rely instead on pawn shops and street lenders.

Strong banking, weak credit

This was despite advanced financial markets. With more than 80 national and foreign banks, Panama has one of the highest ratios of domestic credit to gross domestic product in Latin America. Nearly three-quarters of formal workers have a bank account. The Panamanian Credit Association, the private credit information bureau established in 1957, covers about 60% of the adult population, more than twice the regional average.

So why the gaps in credit? Panama's 2002 law on credit bureaus forbade them from using scoring techniques or collecting information from utility firms, making it harder for poor people and smaller firms without bank loans or credit cards to build a credit history. And the system was opaque for consumers: they could see the information stored in the bureau only by requesting a report in person at the credit bureau's main offices in Panama City or in the City of David. "We were suddenly seen as the 'bad guy' who was denying credit to people," recalls German Espinosa, an officer at the Panamanian Credit Association.

Turning opponents into allies

"The bureau needed to allow Panama's small businesses to access the credit market," says Luz Maria Salamina, the new director of the Panamanian Credit Association who planned the bureau's three-year strategy in 2003.

But not everyone in Panama agreed on the direction to take. In 2003 Osman Gomez, a legislator from the ruling party, floated an amendment proposing to erase all data within 30 days after late payments and defaults are settled. The amendment would make it impossible to differentiate between a borrower who always pays on time and one who often pays late. Consumer groups and several members of Parliament argued that negative credit records should not be kept, citing cases when an individual or a business person went through a bad period but recovered. So the Panamanian Credit Association held meetings with them to explain the benefits of retaining data even when debt was settled. The draft bill was later abandoned.

And in April 2005 Yassir Purcalt, a newly elected legislator, made another proposal in the wrong direction. It would forbid credit bureaus from distributing data until three months after debt had become overdue. This proposal, by preventing financial institutions from differentiating between defaulters and non-defaulters, contradicted the objectives of a credit bureau. Again the Panamanian Credit Association stepped in to convince Purcalt of the benefits of distributing the data immediately. Purcalt proved receptive to their ideas, becoming an ally.

This strategy—turning potential foes into allies—became central to reform. Salamina says, “We needed to turn all these groups into advocates of our cause. If the Panamanian Credit Association says credit bureaus are great, we will never be believed; we need others to say so!” Because most actors did not know much about credit bureaus, the Panamanian Credit Association set out to educate them.

The Credit Association’s educational campaign

The Panamanian Credit Association targeted legislators—many of whom opposed the credit bureau in principle—and made tailored presentations to sympathetic groups of legislators. They also met with the party leaders, who led the debates and carried the votes of their followers. By the end of the campaign the Credit Association reached about 80% of the legislators, emphasizing the benefits to Panama’s 300,000 small and medium-size enterprises, a significant voting constituency.

To boost its argument, the Panamanian Credit Association organized discussions with the powerful consumer and small and medium-size enterprise associations, which initially opposed changing the law because they feared the abuse of personal data. The Credit Association emphasized the benefits of bureaus for consumers demanding better access to credit.

The Credit Association’s public relations campaign, launched in 2003, helped persuade doubters. The Credit Association got physically closer to consumers by moving customer service from the 17th floor of a high-rise building to an office on one of Panama City’s busiest streets, doubling consultations with the public. It opened another customer service office in 2005, in a new mall next to the bus station. Consultations reached new consumer groups coming from the countryside, doubling again to about 6,000 a month. Consumers were educated about the benefits of credit information and received free credit reports.

By 2005 more than 100,000 people had visited the center. Getting ready to handle more sophisticated operations, the Credit Association also started improving its hardware, software, and technological infrastructure. Emphasizing its commitment to high standards, the Credit Association gained International Organization for Standardization 9001 certification in January 2006.

Involving other independent technical bodies, domestic and international, gave the reform credibility. Both the Banks Supervision Agency and the Banking Association were keen for credit scoring to be allowed because it would give banks better tools to improve the quality of their portfolios. And in March 2005 the Panamanian Credit Association invited the International Finance Corporation, the private-sector arm of the World Bank, to evaluate its operations and propose amendments to the law.

The Credit Association pushes for reform—with help from new allies

The Panamanian Credit Association's strategy paid off in September 2005 when Yassir Purcalt became president of the Commission of Commerce, Industry, and Economic Affairs, responsible for financial sector laws in the National Legislative Assembly. In October Purcalt presented a new draft bill, heavily influenced by the Credit Association's ideas. The government's openness to new ideas and its willingness to hold discussions with stakeholders were keys to success.

In the debates before the legislative commission and Parliament the Credit Association held to its strategy—mobilizing sympathizers and turning foes into allies. The Ministry of Commerce and Industries fought an initiative to regulate the price of credit reports, arguing that this should be left to market forces. When a small group of legislators proposed cutting the time for keeping credit information to three years, the Banks Supervision Agency issued a written opinion that was crucial to keeping data for seven years.

The Commission for Free Competition and Consumer Affairs—a force behind the first credit bureau law in 2002—had long been an opponent of the Credit Association. But after the 2002 law regular meetings between the Credit Association and the consumer commission to evaluate complaints and design action plans to solve them built trust. The consumer commission was now very cooperative.

The Credit Association could mobilize all these actors and get their buy-in thanks to the credibility it had earned over almost 50 years—impressive, given that consumers and regulators easily become suspicious of a private entity handling sensitive credit information.

International support was also key in the debates. In November 2005 an Argentine expert from Experian, a global credit information company, made a presentation on credit scoring to the legislative commission. The Credit Association then sent a letter to encourage legal changes to allow the development of modern credit evaluation tools. Panama's high ranking in *Doing Business'* getting credit index also made legislators hesitant to take any action that would lower Panama's ranking.

Finally endorsed by the legislative commission in November 2005, the bill was sent to the National Assembly for approval. Debate on the final text started just before the Assembly started its annual recess in December.

The debates continued into March. Support for reform got a boost from a conference on credit reporting that the Credit Association organized to give the project a positive spin. The Credit Association was lucky—it had planned the conference not knowing whether it would take place before the vote. With more than 350 attendees, including many members of Parliament, the conference helped diffuse some lingering doubts. The International Finance Corporation's representative, Maddedu, was the main speaker, and the Credit Association held private meetings with legislators, the minister of commerce, and the powerful minister of housing. More than 29 different media outlets covered the conference, including 80% of the most popular television and radio stations.

After all the favorable media exposure, the National Assembly approved the law by a margin of 49 votes to 29. Indeed, the campaign generated such legislative and public support that even amendments not contemplated in the original draft, such as consumers' ability to request reporting from utilities, were adopted. The law was published in the official gazette on 18 May 2006.

Deeper information, more transparent access, more advanced scoring techniques

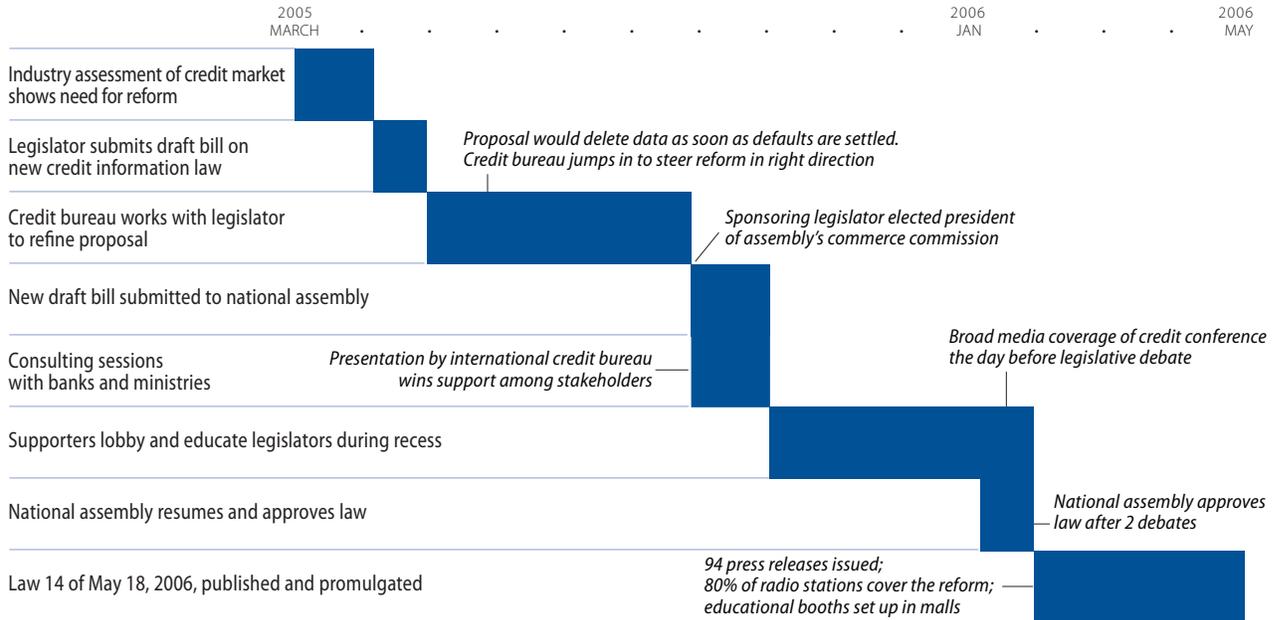
The new credit bureau law improved the depth of the credit information system, the quality of the data in credit databases, and the accuracy of the risk analyses. First, the new law allowed entrepreneurs and small and medium-size enterprises to request the addition of information on utility payments to their file. This way, entrepreneurs and smaller enterprises, even informal ones, can build a credit history, helping raise their chances of getting formal credit.

Second, the law made the system more open and transparent by significantly improving consumer rights. Credit bureaus must now promote consumer education on credit management. And consumers are entitled to free and unlimited access to unofficial printed credit reports, requested in person at the bureau's customer service centers. They can also obtain an official credit report by any means that the bureau chooses, including on the Internet or over the telephone. Previously, reports had to be requested in person. The law also gave consumers a bigger say in the content of their files. Consumers can request that the credit bureau include their telephone, address, and other demographic information in the database as an extra tool to verify their identity and prevent fraud. They can also request that credit references stay in the report for longer than the seven years established by law. And they can insert explanations or complaints about negative incidents.

FIGURE 1

How Panama reformed the credit information law

Source: Doing Business database.



Third, more advanced techniques were introduced for the analysis of credit data gathered by the credit bureau and for the evaluation of borrower risk. The law endorses the use of credit scoring, a powerful predictor of future repayments and a spur to bank lending.

Still a long way to go

The reform of Panama's credit bureau law was fast—the new law was passed in a year. In Brazil, by contrast, reform discussions have taken seven years, and still nothing has happened. The quick passage of the law was the result of the Panamanian Credit Association's meticulous preparation. More than a year before the reform reached the National Assembly, the Credit Association had already initiated a consumer education campaign and was reaching out to legislators. This helped the Credit Association steer reforms in the right direction, gaining early support in the National Assembly.

The task now is implementing the reform. Consumers have already started adding comments in their credit reports explaining past incidents. More than 1,000 people did so in the eight months following the passage of the law. And the Panamanian Credit Association is setting up a new system for consumers to get their credit report through the Internet.

But credit information problems persist. According to the new legislation, utility payment information can be reported, but only if consumers specifically request it. This is cumbersome for consumers, and a big pool of data is necessary for

credit scoring to be accurate. Only mobile phone information is automatically updated, because a release statement has been included in contracts since 2002. An automated process to handle information from water, electricity, and telephone companies does not yet exist, so adding information is still manual. The Credit Association plans to include a broader solution in the new proposed law on microfinance, including a provision for automatic reporting of utilities information.

Many challenges remain. The Panamanian Credit Association has chosen to develop a sophisticated credit scoring system from scratch, a completely new activity for the Association. It needs to develop new internal systems and to educate other financial institutions—accustomed to doing credit evaluation by hand—on using credit scoring.

How credit information tools develop in Panama remains to be seen. But with new finance reforms on the horizon, the pressure is now on the Panamanian Credit Association to show tangible results.