The More the Better? Information Sharing and Credit Risk

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Estimating correctly the borrower credit risks is the task of particular –and growing- importance for the banks all around the globe. Formal information sharing mechanisms are aimed to reduce information asymmetry in the credit markets and to enhance the precision of those estimates. In the academic literature, however, the answer to the question of whether more detailed borrower information accumulated and shared by credit bureaus and credit registries is always associated with higher quality of bank credit portfolios and lower credit risks is not very unambiguous. More credit information disclosed by information intermediaries tend to result into the weaker disciplinary effect of credit history, which means higher credit risks. At the same time, the accuracy of assessing the creditworthiness of borrowers grows due to an increase in the predictive power of scoring models, which leads to a reduction in credit risk.

In this paper we make a first attempt to examine the nonlinearity of this effect. We study the relationship between the depth of the credit information disclosure and the stability of the banking sector in terms of credit risks. We measure the former by the World Bank index of credit information depth from the Doing Business project; the latter is proxied by the share of non-performing loans. Based on data on 80 countries, collected from five World Bank databases for 2004-2015, we show that the relationship between disclosure and credit risk is non-linear: we observe the lowest levels of credit risk at minimum and maximum levels of disclosure depth. For the countries where the depth of disclosure index is of 3 out of 6 (or out of 8, depending on the approach to index construction, which is different for different time periods), we witness the highest levels of the non-performing loans share (see Figure 1). Higher levels of credit risk associated more details in credit reports is consistent with theoretical predictions by (Padilla and Pagano 2000; Sharma 2017).. The reduction in credit risk associated with more detailed credit information is in line with the results of the empirical studies (see, for example, (Jappelli

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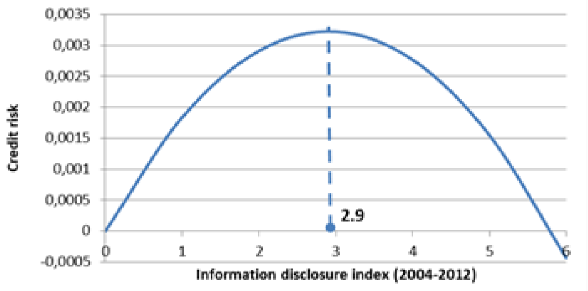
and Pagano 2002), (Kallberg and Udell 2003), (Doblas-Madrid and Minetti 2013), (Kusi et al. 2017), (Nakamura and Roszbach 2018).



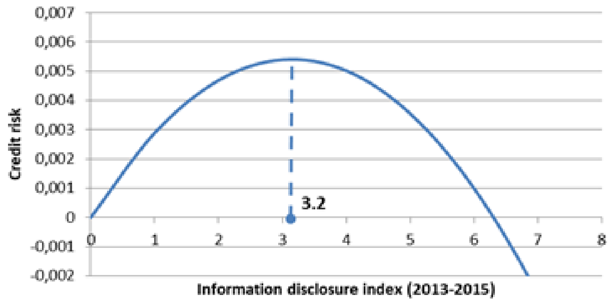


Figure 1: Credit risk and information disclosure index

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