Comments on “Credit Registries, Relationship Banking, and Loan Repayment”

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Brief Overview

- Model and experiment examine four alternative credit market structures:
  - No credit bureau, No relationship lending (NO-CB, NO-R)
  - Credit bureau, no relationship lending (CB, NO-R)
  - Relationship lending, with and without credit bureau (R, CB); (R, NO-CB)
Brief Overview

- Model assumes two borrower types, honest and opportunistic
  - Without credit bureau and not enough honest borrowers, market collapses
  - With credit bureau, opportunistic borrowers are disciplined and market is sustained
  - Little additional value to credit bureau when there is relationship lending
- Experiment affirms model predictions
General Observations

- Overall, nicely done paper
  - Concise, well developed theoretical model
  - Theory and experiment tie together nicely
  - Discussion of experimental results is thorough and well articulated
  - Paper demonstrates value of credit bureaus
- A few technical issues in relation to the model need to be addressed
General Observations

- Additional interpretation and “placing in perspective” of the model and experiment would be helpful
  - Highly stylized theoretical and experimental framework
  - How does it relate to the realities of credit markets?
Technical / Interpretive Issues

- Define *Perfect Bayesian Equilibrium* and explain why appropriate.
  - Audience for this paper not confined to those familiar with game theory.
  - Are “off equilibrium path” beliefs intuitive in the present context?
  - What are the limitations of this equilibrium concept in relation to the experiment?
Technical / Interpretive Issues

- In the experiment, was payment to a participant ("earned 55 Swiss francs on average") tied to performance?
- In text, condition for repayment by honest borrower \( (r \leq \omega k) \) is stated as an assumption; in Appendix A.1, it is derived
Technical / Interpretive Issues

- Interpretation of mixed strategies
  - Natural randomness in who repays, who is granted credit, after accounting for borrower type
  - In the context of the experiment, how did this randomness play out?
- What rules out a separating equilibrium, with different types choosing distinct price and approval probability combinations?
Technical / Interpretive Issues

- In the (NO-CB, NO-R) game experiment, why was anyone granted credit at all?
  - Lenders may have had an initial, optimistic assessment of the proportion of honest borrowers

- Proposition 2 states that the probability of receiving an offer is \( \lambda \in (0,1) \), but the proof solves for \( \lambda \).
Technical / Interpretive Issues

- I don’t see how Bayesian updating can depend only on default rates in the previous period.
  - It should also depend on whether the borrower was granted credit in the previous period.

- I don’t see how a zero-profit condition can be imposed each period in the relationship lending equilibrium.
Big Picture Observations

Paper clearly demonstrates economic value of credit bureaus

- Motivate borrowers to invest in reputation
- Enable better credit-quality borrowers to distinguish themselves
- Increase availability and reduce cost of credit to better credit-quality borrowers
Big Picture Observations

- In other contexts, reduced cost of credit may take form of reduced collateral requirements, higher credit limits
- Additional benefits may include lower costs of evaluating and monitoring borrowers; more competitive credit markets
Big Picture Observations

- In the context of the model and experiment, “selfish” borrowers motivated to repay
  - In other contexts, credit bureaus may motivate greater effort, reduce moral hazard, etc.
Big Picture Observations

- In the context of the model and experiment, prior default identifies lower credit-quality
  
  - More generally, credit quality is indicated by number and types of accounts, timing of account opening, timing of prior delinquencies, credit line utilization
Big Picture Observations

- Paper highlights interesting distinction between relationship lending and reputation building without long-term relationships
  - Equates long-term relationships with ability of borrowers to identify themselves as repeat borrowers with same lender
  - Suggests little value added from credit bureaus when relationship lending is feasible
Big Picture Observations

- This comparison may be overly simplistic
  - Why would long-term relationships ever *not* be feasible?
  - Competitive implications of borrower “lock-in”
  - Public credit record can add information beyond prior experience with borrower
  - Ignores potential advantages of relationships in certain contexts, such as when borrowers are subject to transitory shocks
Casual observation: credit bureaus dominate in consumer lending, relationships in small business lending

Can existing, bureau institutional and regulatory infrastructures be improved upon?

Not addressed in paper, but an important question