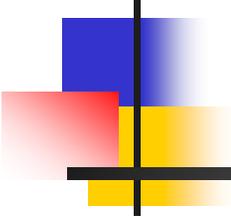


Comments on “Credit Registries, Relationship Banking, and Loan Repayment”

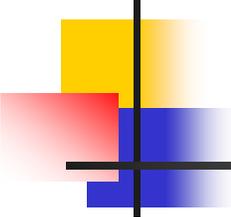


Prepared for Conference on Recent Developments
in Consumer Credit and Payment

September 30, 2005

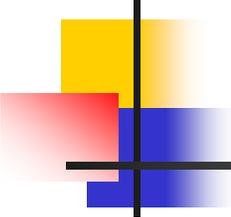
by Paul Calem

LoanPerformance



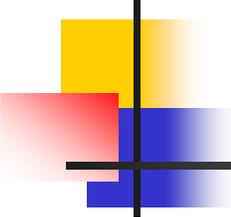
Brief Overview

- 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)



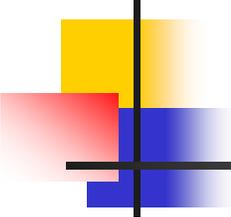
Brief Overview

- 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



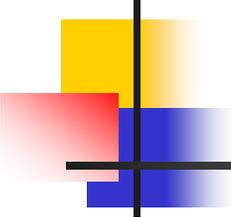
General Observations

- 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



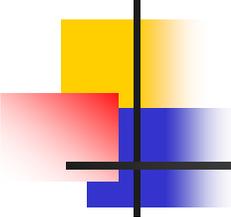
General Observations

- 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?



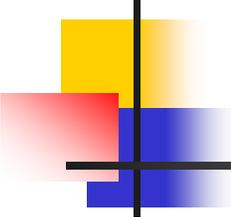
Technical / Interpretive Issues

- 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?



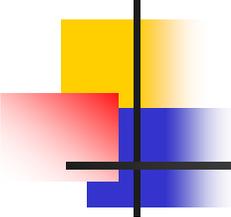
Technical / Interpretive Issues

- 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 ($r \leq \phi k$) is stated as an assumption; in Appendix A.1, it is derived



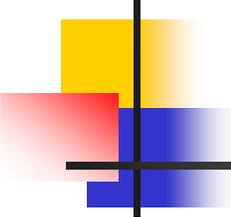
Technical / Interpretive Issues

- 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?



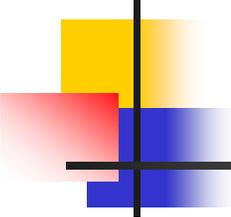
Technical / Interpretive Issues

- 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 λ .



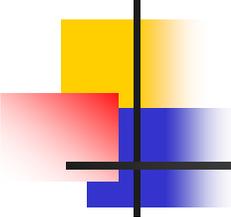
Technical / Interpretive Issues

- 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



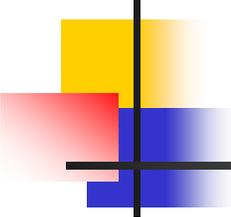
Big Picture Observations

- 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



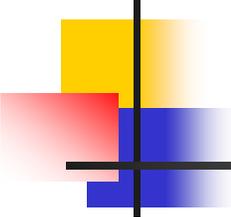
Big Picture Observations

- 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



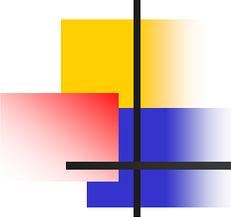
Big Picture Observations

- 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.



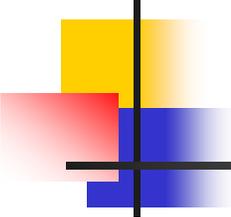
Big Picture Observations

- 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



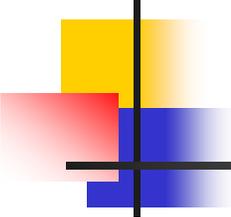
Big Picture Observations

- 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



Big Picture Observations

- 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