

Convergence Romania Financial Sector Modernization

Special Projects Initiative Public-Private Steering Committee



TERMS OF REFERENCE

Project: Expansion of Credit Bureau services

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Technical Anchor: Convergence Program / International Finance Corporation

I- Background

The Credit Bureau system is going to be developed in 3 phases:

- Phase I – negative information received only from banking sources (completed in August 2004);
- Phase II – negative and positive information (outstanding credits) collected from banking and non-banking institutions (ongoing, started in August 2005);
- Phase III – implementation of value added products, including the credit scoring (no implementation calendar for the time being).

At present, 27 banks share negative information (accounting for 96 percent of the retail market) of which 7 banks (accounting for 26 percent of the market) also share positive information.

The incentives for sharing negative information consist of banks being able to better ascertain the good borrowers from bad borrowers, which is likely to result in lower default rates.

Sharing positive information can result in an increase of the banks' loan portfolios (by enlarging their customer base and by lowering risk margins based on good credit histories). Positive information sharing may also reduce the risk of over-commitment by performing borrowers. Disposing of more comprehensive information on their clients, banks can have a better image of the total exposure of their clients towards the banking system, which may result in an improvement of the credit risk management, a decrease in the costs with provisioning, and lower default rates.

However, the benefits can only be fully exploited if all the banks are sharing positive information. The present situation does not ensure a level playing field for the banks that

share positive information and inform their lending decisions on more comprehensive disclosure by borrowers.

The reasons for not sharing positive information seem to be that banks are afraid that their clients may be “stolen” by other banks (although the information on clients can only be disclosed based on their permission); in some cases, banks observe the practices of their mother entities that do not share positive information; and there are banks that have a large market share and are able to rely on in-house information on their clients (although these ones could be as well clients of other banks). Some concerns may also arise with respect to the costs pertaining to sharing positive information (human resources, IT systems, etc.).

The lack of comprehensive positive information sharing also impairs the effectiveness of the application of the NBR rules on limiting the indebtedness of bank clients. Only within a widely-shared positive information environment, the risk of over-commitment by borrowers (i.e. level of indebtedness) can be effectively monitored, preventing situations in which a borrower takes credit simultaneously from several banks, without any of these being aware of the total amount of credit that the borrower has taken on. The NBR could be interested in positive information sharing to improve the monitoring of compliance with the stated norms and to ensure a level-playing field for all market players.

II - Project Objective

A recommendation to the banking industry in support of a Protocol for positive information sharing.

III – Intended Strategy

The project management group acts based on the mandate received from the SPI Committee to achieve a broad agreement within the banking industry on positive information sharing.

An initial consensus-building step is to facilitate a common understanding of the benefits and drawbacks of positive information sharing. In this respect, it is important to have a factual description of the current stage of implementation of Phase 2 contracts, together with the necessary measures and perceived drawbacks in carrying out this process. This information can be conveyed by the Credit Bureau and the major banks sharing positive and only negative information.

The NBR can provide an indication of impediments in monitoring the compliance of banks with the rules on limiting level of indebtedness of borrowers, outlining its findings on the supervision of banks that share positive information and in banks that are not sharing positive information.

The benefits of positive information sharing, as outlined in the existing literature and drawn from empirical evidence are lower default rates and greater availability of credit. These benefits are to be highlighted in a presentation prepared by the SPI Secretariat together with Convergence, which will also provide evidence on the opportunity cost for Romanian banking industry of not sharing positive information.

These inputs can help the PWG members to reach a common understanding on the following issues:

- systemic benefits of positive information sharing;
- potential losses for large incumbents and measures to mitigate operational costs and proposals aimed at addressing concerns of potential losers from generalized positive information sharing;
- possible regulatory actions to promote positive information sharing.

A consensus on these issues may lead market players to reaching an agreement on how the banking industry should commit to the prompt completion of Phase II. Likewise, in order to facilitate the speeding up of the Phase II completion, the Credit Bureau should also propose an action plan, detailing the necessary measures to be undertaken.

IV- Methodology: from kick off to the accomplishment of the project

Preparation of PWG 1st meeting (PM/DPM/ SPI Secretariat) - October (16-31)

PM/DPM/SPI Secretariat will meet with a small sample of players sharing positive and only negative information in order to get better acquainted with the difficulties in implementing the Phase 2.

PO/PM/DPM will send to the PWG members the SPI Committee Mandate Letter, together with the Credit Bureau paper (no. 1 below) and a document outlining the preliminary findings from the interviews, asking for their individual contributions to be sent by October (23rd) (no. 2 below).

1) Credit Bureau paper that:

- Describes Phase 1 and Phase 2 contracts signed with the Credit Bureau;
- Gives a picture on where banks currently stand (number of Phase 1 and Phase 2 contracts and market share for each of these clusters);
- Highlights conditions required from banks for joining Phase 1 or Phase 2 (detailed by technical, administrative, prices, etc.);
- Illustrates effective compliance with Phase 1 and Phase 2 conditions;
- Provides existing studies on information sharing through Credit Bureaus;
- Provide an estimate of the costs of inquiries under the scenario that more banks share positive information.

2) Individual contributions as follows:

- banks reporting positive information
 - Describe the organizational measures (human resources, IT systems, etc.) that were taken to comply with Phase 2 conditions and the types of costs incurred;
 - Describe the impact of disclosing positive information on the banking activity (lending activity, credit risk assessment, provisioning, pricing);
 - Describe compliance with NBR norms on limiting level of indebtedness of borrowers;
- banks reporting only negative information

- Stage with implementation of Phase 2 contracts (if the case) and problems encountered in implementing the requirements;
- Estimate costs of implementing the Phase 2 contracts;
- Describe compliance with NBR norms on limiting level of indebtedness of borrowers;
- Explanation of other reasons for delays.
 - NBR
- Indicate how compliance with NBR rules on limiting level of indebtedness of borrowers is monitored;
- Indicate findings of monitoring the stated rules in banks that are sharing positive information and in banks that are not sharing positive information.

The project management group will also present to the NBR the document outlining the findings from the interviews which, together with a document highlighting the potential opportunities for the Romanian banking industry from positive information sharing prepared by the SPI Secretariat and Convergence, will help to build a common ground and start identifying possible self-regulatory or regulatory solutions.

Before the PWG 1st meeting, PM sends the following documents:

- 1) PPT presentation prepared by the SPI Secretariat together with Convergence on the benefits of sharing positive information based on existing literature about experience of other countries and evidence on opportunity cost for Romanian banking industry of not sharing positive information;
- 2) Summary of information collected from banks and NBR.

PWG 1st meeting - November (7-11)

1. PWG members discuss the PPT presentation on the benefits of positive information sharing;
2. PWG members discuss the information collected from banks and NBR;
3. NBR makes a presentation on how positive information sharing improves credit risk management of banks and is essential for ensuring compliance with NBR rules;
4. PO/PM present the TOR to be endorsed by the PWG members;
5. PM/DPM assign detailed tasks for PWG members along the following issues:

Part I (to be discussed in second PWG meeting)

- How large are the systemic gains from positive info sharing (banks sharing positive information, Credit Bureau, NBR);
- What are the losses incurred by the large incumbents (banks sharing only negative information);
- How to minimize operational costs from positive info sharing (banks sharing positive information, and banks sharing only negative information., Credit Bureau)
- How to mitigate concerns from potential losers from generalized positive info sharing (outlining other additional benefits from positive info sharing that will be available to large incumbents) (NBR, Credit bureau, banks)
- What official regulatory actions could be available to promote positive info sharing in absence of self-regulatory actions? (NBR, Credit bureau)

Part II (to be discussed in third PWG meeting)

- How should the banking industry commit to prompt completion of Credit Bureau Phase II (protocol) (banks, Credit Bureau).

The individual positions by sub-project working groups will be sent to the PM/DPM and SPI Secretariat. SPI Secretariat will centralize the positions and circulate the paper before the PWG 2nd meeting.

PWG 2nd meeting - November (21-24)

1. PWG members consider the position papers on the following issues:
 - systemic benefits of positive information sharing;
 - potential losses for large incumbents and measures to mitigate operational costs;
 - proposals aimed at addressing concerns of potential losers from generalized positive information sharing.
2. Credit Bureau will make a presentation of a proposed action plan for accelerating the Phase II implementation;
3. NBR representative presents possible regulatory actions to promote positive information sharing;
4. PM/DPM propose an outline of PWG position paper and assign individual responsibilities on writing it.

The individual contributions will be sent to the PM/DPM and SPI Secretariat. SPI Secretariat will centralize the contributions and circulate the paper before the PWG 3rd meeting.

Follow up to PWG 2nd meeting

Credit Bureau General Director will deliver a presentation to the RBA Board on the international experience with positive information sharing drawn from a study written by the European Association of Credit Bureaus (to be finalized by mid October).

PWG 3rd meeting - December (4-8)

1. PWG members discuss the paper prepared after the PWG 2nd meeting and approve it;
2. PWG members discuss the document describing how should the banking industry commit to prompt completion of Credit Bureau Phase II (protocol);
3. PWG members write a recommendation to the banking industry in support of the Protocol for positive information sharing;
4. PWG members agree on the terms of the draft Protocol for positive information sharing.

IV- Output

PWG 1st meeting

- PWG members send individual contributions;
- PM/DPM prepare the outline of the paper.

PWG 2nd meeting

- PWG members reach a common position;
- PWG members discuss possible self regulatory / regulatory options.

PWG 3rd meeting

- Centralized document (finalized by PWG);
- Recommendation in support of the Protocol for positive information sharing;
- Terms of the draft Protocol for positive information sharing.

V - Project Team

The team will be composed of:

- Credit Bureau
 - (1) expert (Deputy Director);
- National Bank of Romania
 - (1) expert from the Supervision Department
- (4) Banks
 - (2) experts from banks sharing positive information from the credit risk management department (could be from the reporting department) and loans for individuals department;
 - (2) experts from banks sharing negative information from the credit risk management department (could be from the reporting department) and loans for individuals department.

The team will be chaired by the PM and co-chaired by the DPM.

PM/DPM will report to the PO [as decided at the Project Strategy Meeting].