Romania RIA Knowledge Transfer and Capacity Building Program

Consultation Document

Consultation Period	Start: 28.06.2007	End: 11.10.2007

Name of regulation	Regulation no. 3/2007 on restriction of the credit risk on credits granted to individuals

Participants of consultation process
Consumers
Commercial Banks
Non-bank financial institutions

The Romanian regulators are participating in an initiative organized by World Bank administered *Convergence Program*. The purpose of this initiative is to strengthen the participants' ability to use the disciplines of impact assessment (IA) in order to improve the way in which policy is made. IA does this by requiring policy makers to use evidence and economic analysis to justify and explain their proposals. Consultation with stakeholders is a key part of the IA process because it promotes public accountability and provides stakeholders with the opportunity to contribute to the evidence base that should underpin the policy making process.

The participants of this knowledge transfer and capacity building program are the following: National Bank of Romania, Prime Ministry's Unit, Ministry of Economy and Finance, National Securities Commission, Insurance Supervision Commission, Commission for Supervision of Private Pensions System and National Authority for Consumer Protection.

This IA training exercise involves the work group undertaking a retrospective IA on an existing piece of financial regulation. In this case, the financial regulation is *Regulation no. 3/2007 on restrictions of the credit risk on credits granted to individuals*.

One part of the Impact Assessment Exercise on the above mentioned regulation is represented by the **consultation process** which consists in gathering the opinions of all the key stakeholders affected by this piece of regulation.

The working gropu prepared a Consultation Questionnaire (annex 1) and sent it to the stakeholders.

The questionnaire is designed to provide evidence relating to:

A. The nature of the **problem** that the regulation is seeking to address; and

B. The costs and benefits incurred to banks and consumers taking into consideration **four options**.

<u>A. What is the problem?</u>

There are two distinct elements to be considered:

a) the repeal of the 2005 regulation, and

b) the introduction of the 2007 regulation.

The 2005 regulation needed to be repealed because of EU competition. Instead 2007 regulation was introduced in order to manage potential market failure consisting in not properly managing credit risk.

The stakeholders agreed that the **problem** was the one mentioned above but they raised an issue:

- the new regulation does not create a free competitive market.

Regarding the possibility that the policy concerns that gave rise to the 2007 regulation **would have been corrected by the market in the short term**, stakeholders opinions are the following:

- The market would have corrected some of the concerns, but it is hard to estimate if this would have happened on short term or medium term.

- An intervention was needed, but the way the 2007 regulation approached the issue was not appropriate.

- Credit restrictions, such as imposing maximum credit limits have unintended consequences on the financial market, and, consequently, a negative impact on consumers.

- Credit restrictions limit the growth potential, and more seriously, affect low income people capacity of dealing with some temporary difficulties, when they need relatively small amounts, on short term.

- Maintaining lending restrictions considerably affects the process of credit sector liberalization and does not lead to the results expected. As mentioned above, concrete data show that economies without credit restrictions operate more efficiently than the ones where such restrictions exist.

B. The four options

I. Do Nothing Option - Maintaining the provisions of Norms No. 10 of July 27^{th}, 2005 on mitigation of the credit risk related to credits granted to individuals;
II. Option 1 – The new Regulation no. 3/2007 on restriction of the credit risk on credits granted to individuals.
III. Option 2 - Self Regulation (e.g. A Voluntary Code elaborated by Lenders Professional Association)
IV. Option 3 – Bring amendments to Norms no. 10 / 2005 in order to keep uniform limits at the level of all financial institutions, but at the same time, adjusted to different categories of consumers (incomes)

I. Do Nothing Option - Maintaining the provisions of Norms No. 10 of July 27th, 2005 on mitigation of the credit risk related to credits granted to individuals.

<u>Costs to regulated banks</u>

The implementation of the old norms had some unintended consequences that caused distortions on the market:
- Lending on longer terms (to ensure that the monthly repayment rate is under the maximum limit), with a negative impact on costs and credit risk ;
- Increased bureaucracy;
- Financial exclusion of low income categories;
- Anti-competitive market – unfavorable treatment for NBFI's compared with banks.
- In effect consumers were charged higher interest rates for this option as they often repaid the loans earlier than term in order to borrow again.

<u>Benefits to regulated banks</u>

No benefits identified.

<u>Market impact</u>

This option created an anticompetitive environment for NBFI's, who were treated like banks, even though they do not compare to banks in terms of assets (NBFIs are not allowed to attract deposits) or in terms of portfolio of products.

- Quality of products offered:
  - ❖ Banks: no significant effect
  - ❖ Consumers: significant decrease – probably
- Variety of products:
  - ❖ Banks: significant decrease
  - ❖ Consumers: significant decrease
  - ❖ NBF: no significant effect
- Efficiency of competition:
  - ❖ Banks, Consumers, NBF: significant decrease

<u>Costs to consumers</u>

- Limited consumers' access to lending;
- A shift of costs from interest rate to loan fees and commissions;
- Favoring lending on longer terms, which increases the costs for the consumers. Categories of consumers on low income are financially excluded, which could encourage illegal lending.

<u>Benefits to consumers</u>

- The lending limits could protect consumers against over-indebtedness:

- ❖ Banks: No, as long as there is no nationwide database
- ❖ Consumers: Yes
- ❖ NBF: Yes/No

Unintended consequences

- Negative consequences:
- ❖ Limits the access of customers to mortgage loans (the regulated 25 % downpayment)
- ❖ Limits the access of medium to high income customers to loans with higher value.

- The unintended consequences of the old and current credit restrictions in Romania are:
- ❖ Lending on longer terms, with a negative impact on costs and credit risk
- ❖ Increased bureaucracy
- ❖ Financial exclusion of low income categories
- ❖ Anti-competitive market .

Impact on competition

- NBFIs shall not be subject to the same regulations as banks, as they do not compare to banks in terms of assets (NBFIs are not allowed to attract deposits) or in terms of portfolio of products.

Social impact

- Categories of consumers on low income are financially excluded, which could encourage illegal lending.
- Prices of houses could not increase too much, because customers were not able to access large value loans.

II. Option 1 – The new Regulation no. 3/2007 on restriction of the credit risk on credits granted to individuals.

Costs to regulated banks

Compliance costs to regulated banks.

Benefits to regulated banks

No estimation provided.

Market impact

- Quality of products offered:
  - ❖ Banks: no significant effect
  - ❖ Consumers/NBFI: significant increase
- Variety of products:
  - ❖ Banks: no significant effect
  - ❖ Consumers/NBFI: significant increase
- Efficiency of competition:
  - ❖ Banks: no significant effect
  - ❖ Consumers: significant increase
  - ❖ NBF: significant decrease

Costs to consumers:

- ❖ Limited consumers' access to lending (for customers with monthly income below 350 EUR and supporting a family of at least 3 members)
- ❖ Difficulties when comparing the credit offers
- ❖ Lending costs will increase (due to implementation and compliance costs)
- ❖ Lower income consumers will be disadvantaged because of taking in consideration the deductible expenses (living)
- ❖ Meal tickets are not considered as a part of the monthly income, even if these instruments are fully regulated.
- ❖ Consumers would need to use more resources (time, the documents needed to obtain the credit could vary very much form one bank to another, own rules of banks could become stronger) in order to find out and gather information and to obtain the credit.
- ❖ Banks will probably try to compensate the shrinking of the customer base with higher fees/commissions (not necessary higher interest rates) applied to loans.

Benefits to consumers:

- ❖ Improved access to lending for certain categories of consumers;
- ❖ Wider range of products.

Unintended consequences

- It would take time for consumers to familiarize with the new rules.
- Low to medium income customers will get no or less credit than under the previous regulations. Prices of houses may increase.
- Wealthy people will constantly increase their living standards, people whit below average income will pay more for financial services, especially loans.
- Significant distortions in the market due to:

- timing differences between the registration of certain NBFIs with the Special Register (and hence the application of the crediting constraints);
- the existence of two level of supervision for different players (those in the Special Register and those in the General Register)
- the existence of other passporting EU firms which do not fall under the NBR supervision.

Impact on competition

- On one hand it would increase competition between Romanian firms, on the other hand, it would determine distortion of competition between Romanian firms and other passporting EU firms which are not subject to the regulation.
- NBFIs shall no be subject to the same regulations as banks, as they do not compare to banks in terms of assets (NBFIs are not allowed to attract deposits) or in terms of portfolio of products. The current regulations are discriminatory also because NBFIs in the Special Registry have to comply with stricter rules that those in the General Register. The passporting rules are likely to increase unfair competition, because credit restrictions do not apply to the NBFIs set up in Romania by credit institutions based in other EU countries.

Social impact

- The customers that will not have aces to bank loans will move toward Non Bank financial institutions, which will ask higher prices for their loans, because there will be no competition against bank.
- The over indebtedness of certain customers, bad debts followed by debit execution.

III. Option 2 - Self Regulation (e.g. A Voluntary Code elaborated by Lenders Professional Association)

Costs to regulated banks

- Compliance costs to regulated banks.
- Significant resources (people, systems, processes) engaged in the elaboration process, that will be reflected in credit costs.
- For responsible lenders, lower costs than implementing mandatory legal provisions.

Benefits to regulated banks

No estimation provided.

Market impact

- Quality of products offered:
    - ❖ Consumers, Banks: significant increase
- Variety of products:
    - ❖ Consumers, Banks: significant increase
- Efficiency of competition:
    - ❖ Consumers, Banks: significant increase

Costs to consumers:

- ❖ Regulation in itself is not 100% effective in preventing companies from breaking or bending the rules. If NBFI’s agree to a strong code of practice, there is actually less chance of an individual company breaking it. A code of practice could cover all NBFI’s.

Benefits to consumers:

- ❖ Diversity of products.
- ❖ A more customer segment tailored approach may be taken, much more related to credit risk assessment and credit behavior.

Unintended consequences

- ❖ Distortion of competition; Lowering the level of protection of consumer against over-indebtedness; Romanian market and consumers not prepared for it yet.

- Loan values can be tailored according to the individual income and type of security
- Some banks may risk too much, breaking responsible lending practices, in order to gain market share at any cost
- This option would ensure a level playing field for all the players: Romanian companies, European companies and other international companies.

<u>Impact on competition</u>

- This option would ensure a level playing field for all the players: Romanian companies, European companies and other international companies.

<u>Social impact</u>

- This option is the least likely to exclude socially disadvantaged individuals.

IV. Option 3 – Bring amendments to Norms no. 10 / 2005 in order to keep uniform limits at the level of all financial institutions, but at the same time, adjusted to different categories of consumers (incomes)

Costs for regulated banks

Option 3 would have been not significantly different from Option 1

Benefits for regulated banks

No estimation provided.

Market impact

- Quality of products offered:
  - ❖ Banks, Consumers: significant increase
- Variety of products:
  - ❖ Banks, Consumers: significant increase
- Efficiency of competition:
  - ❖ Consumers: significant increase

Costs to consumers:

- ❖ Consumers with low monthly income would have very limited acces to loans or no acces at all
- ❖ The quasi-monetary incomes like meal tickets are not considered as a part of the monthly income, even if these instruments are fully regulated

Benefits to consumers:

- ❖ For some categories of consumers the access to lending could be improved
- ❖ More protection for consumers against over-indebtedness.

Impact on competition

- ❖ All the non Romanian banks (branches of foreign banks) will not be legally bound to observe the NBR regulations, and will grant loans according to their mother bank risk policy. Competition on the market affected.

Social Impact

- Depends on the limits imposed by the new regulation.

Further impacts not considered

- Depends on the limits imposed by the new regulation.

GENERAL CONCLUSIONS:

- Regulation no. 3 is not considered the best option for stakeholders interests.
- The NBR validation will improve credit quality.
- The new norms validated by the NBR will improve de portfolio of clients (mid to high monthly income clients).