

Convergence Romania Financial Sector Modernization

Special Projects Initiative Public-Private Steering Committee



SPI Project: The Expansion of Positive Information Sharing

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Abstract

The SPI Committee approved the undertaking of the SPI Project on the Expansion of Positive Information Sharing on September 14, 2006. The expected completion date of the project is December 2006. The project's objective was to ***“write a recommendation to the banking industry in support of a Protocol for positive information sharing”***.

The project has been placed under the ownership of Mr. Steven Cornelis van Groningen, on behalf of the RBA. The members of the working group have joined the team at various stages of the project. The NBR has not sent a representative in the project working group. However, the central bank was consulted on several occasions on issues of a great importance for the project. Meetings between the project working group members have been held between November 1st and December 15th, 2006.

Also, the project has benefited from the assistance received from two technical anchors provided by Convergence and International Finance Corporation.

Following the indications received from the project management group, the project working group undertook parallel actions with the market participants (positive and negative information banks) and authorities (NBR, NASPDP), based on a three pillar strategy outlined in the project terms of reference:

- Ascertain the need for possible regulatory actions to promote positive information sharing;
- Outline the systemic benefits of positive information sharing;
- Determine 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.

The present document outlines the findings of the project working group and outlines the recommendations that the working group has made with respect to the present situation of positive information sharing in Romania.

Executive Summary

A. Main findings of the project working group

Under present conditions, the application of NBR regulations on limiting the household lending is hampered by the lack of comprehensive positive information shared by banks. At the same time, given the rapid pace of growth of household lending in Romania, there is a real danger that bank borrowers could become over-indebted by taking credit simultaneously from several banks, without any of these being aware of the total amount of credit that the borrower has taken on, which could potentially lead to significant financial vulnerabilities, as witnessed by other countries' experience.

Discussions in the project working group and an independent assessment made by the SPI Secretariat, together with an International Finance Corporation credit bureau expert have led to the conclusion that the banking system does not presently have the organizational capabilities and the incentives to collect and process positive credit information.

To this, a recently proposed National Authority for Supervision of Personal Data Protection (NASPDP) regulation, which if enforced, would practically prohibit positive information sharing with credit bureaus, has created an environment where banks sharing only negative information may be even more reluctant to start sharing positive data before the issuance of the final regulation.

Currently, NASPDP is revisiting the proposed regulation, also based on extensive international information made available by the SPI Secretariat, and the SPI project technical anchors (Convergence and IFC) and proposes to reach a final decision after consultations with other EU data protection agencies and Romanian financial authorities and market participants.

B. Recommendations of the project working group

1. The need for NBR regulatory action

In the fluid context described above, the project working group considers that an NBR regulation aimed at promoting broad positive information sharing would go a long way to sending a policy signal about the importance of positive credit information sharing to both market participants and other public authorities. This signal would be consistent with the provisions of Directive 95/46/EC (Data Protection Directive), which indicate that the monitoring of important economic or financial interest prevail over the purposes of personal data protection.

The international experience on the matter shows that countries differ significantly in their approach to regulating credit information. In order to overcome difficulties related to the rapidly changing market conditions, many countries rely on general laws to manage macro level issues, such as privacy, but assign to the central bank the task of issuing specific rules and monitoring compliance.

Examples include Mexico, where **the central bank imposes a 100% increase in a bank's provisioning policy for not supplying data to a credit bureau**¹. This regulation does not impose the obligation of banks to report positive information, but provides the necessary incentives to banks to join positive information sharing. The visionary approach and facilitator role played by the Central Bank of Mexico could represent a possible quick and effective way to develop the regulatory environment for credit reporting in Romania, under the auspices of the NBR.

Should the NBR endorse this proposal, the SPI Secretariat and the SPI project technical anchors (Convergence and IFC) could support the NBR in preparing the background documentation for drafting such a regulation and the broad terms of the regulation. At the same time, the project working group members consider that the presence of an NBR representative in any further actions within the SPI project is absolutely necessary.

A possible alternative that the project working group envisaged could be the relaxation of the NBR regulations on limiting the lending to households for the banks that report and use positive information. Namely, the central bank could allow the positive information banks to have higher debt-service to monthly income ceilings (currently a debt-service ratio of 40 percent of the net monthly income of the borrower is applied by all banks). Such an approach would be consistent with the more prudent risk management of the positive information banks, which feel at disadvantage compared to negative only information banks when applying the relevant NBR norms (see Section II.2.1. Positive information banks).

2. The need for a concerted action to support the NASPDP in coming up with a regulation in line with international best practices and which responds to the specificities of Romanian lending market

The project working group considers that it is important to support the efforts of NASPDP in coming up with a regulation that is in line with both international best practices on the matter and responds to the realities from the Romanian market. In this respect, the project working group proposed the setting up a mix working group composed of representatives of the banking community, non-banking sector (including telecoms), credit bureau, NBR, SPI Secretariat, and NASPDP in order to enhance the effectiveness of the consultation process initiated by NASPDP regarding the draft regulation pertaining to credit bureaus.

3. The need for keeping all stakeholders engaged in the process of promoting of positive information sharing

The project working group also considers that all stakeholders should remain strongly engaged in the process of promoting positive information sharing. This recommendation triggers the authorities, but also the positive and negative information banks and the credit bureaus themselves, which represent the facilitators of the positive information exchange.

The project working group believes that an adequate system of incentives should be put in place in order to encourage a broad endorsement of positive information sharing. Such incentives could be provided by the central bank through a regulation that would create

¹ The information shortage faced by credit providers combined with overall imprudent credit granting practices led to a stunning level of defaults in 1994-1995. This experience - also known as the "Tequila Crisis" - has prompted credit providers and authorities to give more attention to reports on credit histories and other background checks that facilitate credit decisions.

stimulants for banks to disseminate positive information and by the credit bureaus through measures that would promote and facilitate the Phase II implementation.

In this respect, the credit bureaus should actively support market players in making the best use of the credit bureau system. Biroul de Credit has committed to undertake a review of technical problems reported by the Phase II participants and, where appropriate, to do a fine-tuning of the application in order to facilitate the Phase II integration and processing, to provide technical support and training for the potential participants, to start offering value added services (credit scoring or extended statistics built on positive data, pending the institution's board endorsement).

Biroul de Credit should also raise awareness of the market players regarding the existing services and the planned improvements and intensify the lobby process with big players that currently do not share positive information. At the same time, Biroul de Credit could conclude a cooperation agreement with NBR in order to strengthen the relationship with the central bank. Last but not least, Biroul de Credit could consider establishing a compliance committee to strengthen the governance framework of its operations and to build an image of best practices operational framework.

Furthermore, the existing experience of banks that currently share positive information will continue to play an important role in helping the credit bureaus to continuously improve their services and the other banks in making a decision in respect to positive information dissemination. At the same time, the banks that do not share positive information, but consider disseminating positive information in the near future should start planning ahead and preparing their systems, in close cooperation with the credit bureaus.

Likewise, a broad outreach event could be organized in cooperation with IFC regarding the international experience with positive information sharing.

C. Options for action considered and rejected

As mentioned above, the initial objective of the SPI Project was to “*write a recommendation to the banking industry in support of a Protocol for positive information sharing*”.

Following the assessment undertaken by the project working group, it resulted that it is unlikely that banks will reach a consensus with respect to joining positive information sharing, at least not in the close future. Therefore, the project working group has considered necessary the reassessment of the initial objective of the SPI project – the preparation of a Protocol for positive information sharing signed by banks, which under the present circumstances would not be feasible.

The project working group has therefore focused its attention on trying to identify a system of incentives that would encourage banks to join positive information sharing. The recommendations of the project working group closely reflect this approach.

D. Summary of Regulatory Impact Assessment (RIA) actions implemented

In order to support the analyses of the project working group, Convergence technical anchor has prepared a theoretical application regarding the possible benefits of a generalized positive information system in Romania. The presentation has been shown on the occasion of the

project strategy meeting and was further amended in order to include the suggestions received from project working group members.

The simulation (based on the findings of a research paper² by Powell, Mylenko, Miller, and Majnoni from 2004 for the case of Brazil) shows that banks could take substantial advantages from it such as increasing their lending business and improving the quality of their loan portfolios. It has been assumed that the loan approval rate can increase from 40 percent to 60 percent and the default rate can either keep unchanged or even decrease. Once all enabling environment is fully established, the estimated overall annual benefits for the banking system from generalized positive information sharing could rise at above RON 250 million³.

However, in practical terms, it is also assumed that it takes five years to have the approval rate shifted from 40 percent to 60 percent so that for the first year the lending increase is estimated at RON 8.7 million and the overall benefits (including both net margin and lower loan loss provisions) are worth RON 93 million⁴.

The main conclusions of the impact analysis are: positive information supports bigger and better loan portfolios, more efficient marketing strategies, and has positive financial stability and social equity (as negative only databases penalize good borrowers) implications.

E. Implementation

The project working group underlined the importance of remaining involved in the implementation actions pertaining to the SPI Project on the Expansion of Positive Information Sharing, following the endorsement and the guidance received from the SPI Committee. The following further steps may require the participation of the project working group in order to ensure continuity and consistency with the actions undertaken so far under the project:

- i) participation in the proposed working group that will support the NASPDP in drafting the final decision pertaining to information sharing through credit bureaus;
- ii) support NBR, as requested, in the process of drafting relevant regulations;
- iii) awareness raising regarding the benefits of positive information, including lobby with negative information banks;
- iv) feedback provided to credit bureaus for further improving the Phase II technical platform and the value-added services.

² Such findings are consistent with previous ones based on data from USA. See J. Barron, M. Staten, *The Value of Comprehensive Credit Reports: Lessons from the U.S. Experience*

³ Convergence, *The Value of Positive Information Sharing*, December 2006.

⁴ Convergence, *Expansion of Credit Bureau Services, Preliminary Impact Assessment*, December 2006.

Expansion of Positive Information Sharing

I. Benefits of positive information sharing

Theoretical studies and empirical evidence (see Annex 1) demonstrate that positive information sharing brings important benefits to virtually all financial sector stakeholders, namely:

for consumers of financial services:

- greater availability of credit for the potential borrowers that dispose of scarce physical collateral, but have instead a good history of debt servicing which can serve as a “reputation collateral”;
- a decrease of the cost of lending for the “good” borrowers, resulting from the amelioration of the adverse selection that prevents the lenders that do not have adequate information to differentiate among “good” borrowers and “bad” borrowers, thus charging all of them with an average interest rate that penalizes the “good” borrowers;

for providers of financial services:

- lower default rates and an improvement of the overall quality of the banks’ portfolios, as a consequence of the discipline effect induced to borrowers by positive information reporting and of the more accurate assessment of borrowers quality;
- better credit risk management by offering an additional tool through which banks can better determine the borrowers’ risk profile;

for financial markets authorities:

- greater financial stability as positive information reporting tackles opportunistic behaviors such as consumers opening multiple lines of credit with different banks which has a potential to generate systemic issues when a shock to the borrowers’ income occurs, as demonstrated by other countries’ experience.

In Romania, retail lending still shows modest levels compared to the other European countries (at the end of 2005, retail loans to GDP stood at 14% of the EURO zone average). Given the above financial penetration ratio, Romania’s potential for future growth is substantial, for both the consumers and providers of financial services perspective.

First, the Romanian consumers of financial services could benefit from improved access to credit and more favorable lending conditions that would result from broad positive information sharing. Second, the financial services providers would be able to improve their credit risk management, which would trigger lower default rates and an improvement of the overall quality of the banks’ portfolios. Third, the supervisory authorities would be assured that the risk of borrowers’ over-indebtedness is kept under control.

II. A diagnosis of the current situation in Romania vis-à-vis positive information sharing

II.1. Institutional set up: credit bureaus

In Romania, banks and other financial and non-financial institutions report positive and negative information on borrowers to private credit bureaus. Separately, for financial stability purposes, credit institutions report to the National Bank of Romania’s Credit Information Bureau data on the exposures to debtors that were granted loans and/or have commitments totalling more than the reporting threshold (RON 20,000), and on payments overdue more than 30 days, regardless of the amount.

At present, there are two private credit bureaus operating in Romania: the main one – Biroul de Credit SA, that was established in February 2004 as a private company owned by 27 Romanian banks (with capital stakes according to their retail market share) and Experian (in September 2005 Expert Credit Bureau was acquired by Experian), that has a rather modest presence and deals mainly with telecom information.

The main role of Biroul de Credit is to help its participants in assessing the credit risk associated to their potential or active clients, whether before the start of the relationship or during its development. The Credit Bureau Model, a system owned and operated by the company, is to be developed in 3 phases:

- **Phase I** – negative information (on debtors with over 30 days past due payments, on fraudulents and on individuals providing false statements) received only from banking sources;
- **Phase II** – negative and positive information (outstanding credits) collected from banking and non-banking institutions (consumer credit companies, insurance companies, leasing companies, telecoms);
- **Phase III** – implementation of value added products, including credit scoring.

In August 16, 2004, the Credit Bureau system **Phase I** started to function. Its main characteristics are:

- it operates only data on individuals;
- it registers overdue payments of more than 30 days;
- 7 years time period keeping of the data;
- flexible and open to further developments;
- daily up-date of the database;
- credit report delivered within seconds;
- high security level.

Presently, the retail banking market coverage by the Credit Bureau is 96% (22 banks).

Phase II was implemented between November 2004 and July 2005. For the “positive” stage of the system, the Bureau decided to apply an international data format, Metro 2, to be used by the banks for data reporting. The decision was taken from the perspective of Romania’s European integration, allowing for the data exchange with other systems and also taking into account Phase III and the scoring to be built on the basis of comprehensive data collection.

There are only 10 participants transmitting and receiving positive data in the system: 7 banks (covering 26 percent of the retail banking market), 2 consumer finance companies and one leasing company. Another four banks (accounting for 15 percent of the market) are considering sharing positive information by the end of 2006. Until the end of November 2006, the Credit Bureau’s system delivered more than 8.5 million reports and collected 3 million accounts. Also, the price of the credit report was reduced twice and it is the same for Phase I and Phase II.

Other facilities offered to participants are:

- training for the end-users, in order to ensure the proper utilization of the system at all levels. The courses are developed on two components (business and IT) for each category of end-users, in order to address their specific needs in utilization of the system or part of it;
- system facility for bulked inquiries in batch mode with audit trail;

- documentation for applications usage, such as: users manuals for each category of end-users; data flow document, describing the data collection and transmission; files models, detailed in the forms used in the transmission; document describing the API inquiries (server to server).
- statistical monthly report based on negative data.

An important recent development that has been registered in the bureau's activity is the signing of an information exchange Protocol with the National Bank of Romania, which entered into force recently. As an effect of the Protocol, banks will be no longer required to transmit the negative information on credits less than 20,000 RON to the National Bank of Romania, thus being avoided the present overlap between the data collected by the central bank and Biroul de Credit.

As for the Experian credit bureau, this collects only negative information from four banks and one telecom.

II.2. Market players

As mentioned above, at present only 7 banks (covering 26 percent of the retail banking market) report positive information on their clients. Another four banks have committed to start reporting positive information by the end of 2006. However, the two biggest banks operating in Romania (accounting for more than 40 percent of the retail banking market) share only negative information.

II.2.1. Positive information banks

The participation in the Phase I implied for many banks the development of in-house applications having as primary scope the collection of the necessary loan data from the core banking system and other applications (i.e., from the loans and the card system, from the overdrafts and revolving credit cards), processing the data, and reporting it to Biroul de Credit.

Regarding the Phase II implementation's impact, the positive information banks appreciated that the degree of complexity and the costs involved in the implementation of any solution for meeting to the Metro2 Standard of Credit Bureau was highly dependant on the IT system of any particular bank, which has to assess and design the best approach for interfacing the existing systems with the standards and requirements of Biroul de Credit.

The positive information banks have outlined the following Phase II project approach:

- Gathering and assessing of the real business needs related to Credit Bureau area
- Analysis of the current flow related to data whose source is the core banking system
- Analysis of the current flow related to data whose source is the cards system
- Analysis of the daily reporting flow
- Analysis of the operations related to communication between bank & credit bureau
- Analysis of the flow for corrections/claims
- Assessment of current processing time
- Assessment of current cut-off times
- Functional analysis and application design
- Interface Application development
- Internal testing

- End-to-end Testing
- Go live.

Regarding the **costs involved by Phase II implementation**, some positive information banks stressed that they were able to successfully use the existing infrastructure (network, application servers, file servers) and thus no additional costs with the infrastructure (hardware) were required. The costs for design and development were also considered relatively low.

The positive information banks appreciated that the success factors for the Phase II implementation were:

- Specialized project team;
- Management support for the project;
- Optimization of all processes related to credit bureau;
- Strong business involvement in the project;
- Suitable IT solution.

The positive information banks outlined a number of specific advantages of positive information:

1. Credit Report format:

One of the most important actions of Phase II is that the Credit Report's information is available in processing format (.xml), with the following main benefits:

- a. makes possible to develop an IT application for automatic data interpretation depending on each bank's risk policy (Decisional Tree);
- b. data from each Credit Reports can be stored and based on statistical methods for assigning ratings, allowing for the possibility to develop a per formant scoring system;
- c. in the view of Basel II application: banks can base their decision-making process on a risk assessment mechanism with two components: ranking (assign a risk class to each borrower) and calibration (accuracy of prediction of risk level associated with a group of loans through PD=probability of default, LGD=loss given default, etc.). In this respect, Basel II requires the banks to use all available information, including external information. Other countries' experience shows that incorporating credit bureau information, and particularly credit bureau scoring, in an internal ratings model, results in increased accuracy and in more powerful estimate of the PD, even in cases where the bank owns a good internal information frame.

2. Benefits for the specific departments of banks, as follows:

a. Consumer Lending Sector is using the positive information to ensure more precise assessment of the creditworthiness of our customers in terms of debt to income ratio.

b. For the Mortgage Lending Division, should the credit bureau provided information be complete and fully reliable, the advantages would be that the bank will have a single point of entry for getting the data based on which it calculates the debt to income ratio, one of the most critical ratios used when granting a mortgage loan. This could result in saving time (avoiding interrogating alternative data bases like the NBR credit registry) and saving money (in interrogation fees). One of the issues is that banks can not rely entirely on the Biroul de Credit information, because they have identified cases when clients reported to the NBR credit registry were not found in the Biroul de Credit database.

c. Small Business Banking Division: Their target clientele being both small companies and individual entrepreneurs, in assessing the associated risk of each client the bank is able to give significant importance to the whole existing credit exposure of the client. For the companies, Small Business Banking Division includes in the analysis and credit criteria check the

evaluation of the short term bank debt, as well as the consumer loans of the major shareholders. Because presently positive information banks do not have consistent information regarding the whole banking system, they are focusing on the exposure within the respective banks correlated with the declaration of the client for other banks' exposures. All the above mentioned apply also for our individual entrepreneurs clients, in this case such data being of even greater importance, given the fact that this type of clients behave in most cases dually: individual person/individual entrepreneur. Therefore, for this type of clients the consumer loan exposure (for example) of the entrepreneur affects the entrepreneurship's behavior more than the exposure of one shareholder may affect the financials/activity of the company.

In conclusion, the positive information banks stressed the following **benefits of positive information**:

1. obtaining more accurate credit risk information;
2. growth and diversification of the banks' portfolios with lower risk;
3. avoiding the debt overload by being able to correctly calculate the level of indebtedness;
4. reducing the risk of granting doubtful loans;
5. decrease of the credit risk provisions;
6. fraud prevention;
7. develops a performant scoring system;
8. the possibility to make a dual check of client's identification data and the declared data on the size of the other obligations;
9. for clients: easier access to loans with lower costs, faster loan decision and application processing, simplified loan forms, improved quality of customer service, etc.

However, the positive information banks also outlined the **drawbacks** of the current situation, mainly related to the low number of participants in the Phase II. First, the banks that currently share positive information dispose of an incomplete image of their client's risk profile and indebtedness, implying that the banks have to interrogate alternative data bases as well (such as the NBR credit registry), which leads to an increase in both workload and expenses. Second, in practice, the positive information banks have noticed that their clients became more diligent in reporting the overall exposures vis-à-vis the banking system, which in some cases lead to the decision of not granting the loans and thus losing business. Third, the positive information banks feel at disadvantage compared to the negative information only banks when it comes to the application of the National Bank of Romania rules on limiting the household lending.

Namely, while the negative information only banks rely exclusively on the bona fide declarations of customers on the overall debt to banks, the positive information banks have an additional instrument of checking the borrowers' declarations which can potentially decrease their business. Nonetheless, despite the potential reduction in lending, the positive information banks believe that their business is safer with positive information.

In addition to this level playing field issue, the positive information banks outlined some other issue encountered in the implementation of Phase II such as:

- Large amount of data required from the banks' databases for reporting to Biroul de Credit (Metro 2 Standard);
- Inadequate interface for correction (an online interface is required);
- Between hours when is run the daily export it's impossible to access the report of own clients ;

- The important number of quarantine persons impose on-line corrections;
- Incorrect field in Credit Report for “Approved Limit” in case of Credit Cards.

At the same time, the positive information banks appreciated that some of these issues could be solved in close cooperation with Biroul de Credit and undertook the actions outlined under Section III.1.1.

II.2.2. Negative info banks

The banks that currently share only negative information outlined the following issues that prevent them from sharing positive information:

“Political”

- in principle, the majority of big banks are favorable to positive information sharing, but at present this ranks low in their agenda of priorities (some of these banks are currently involved in large restructuring processes due to privatization or mergers);
- banks feel that the information provided by them is far more relevant to the other banks than the information received; these banks rely extensively in their risk assumption process on in-house information regarding their clients;
- some banks observe the practices of their mother entities that do not share positive information;
- some banks feel that other banks should pioneer positive information sharing and they could follow at a later stage, when the costs and logistics efforts involved would be simpler to assess;
- banks are afraid that clients may be “stolen” by other banks; with information equally distributed to the market participants, the information holding will not be a competitive advantage any longer. Thus, smaller or niche banks could use their better pricing or other product features to attract “best” clients from large banking institutions;
- lack of knowledge on the benefits of positive information sharing, necessary steps to initiate positive information sharing, lack of initiative in the organization (some small banks);

Technical / administrative

- technical drawbacks: lack of a unitary database, inconsistency between banks’ and Biroul de Credit databases (mentioned by small and big banks alike); having an IT system compatible with the requirements of Biroul de Credit seem to be the most crucial impediment against small and medium sized banks entering positive information sharing;
- lack of available time to study necessary requirements to adapt IT systems in order to comply with Biroul de Credit format (both small and big banks);
- A number of banks are not aware of the necessary steps to initiate positive information sharing, and suffer of lack of initiative in the organization (especially small banks). Namely, who should initiate contacts with the Credit Bureau, who should propose internally and to what management level in the organization positive information sharing. The initiative should be embraced by top management of the bank; otherwise, it is hard to obtain a critical mass to push the project forward, ahead of other business related projects.

II.3. NBR role and position

At present, the application of NBR regulations on limiting the household lending is hampered by the incompleteness of information on borrowers’ bank exposures available to banks. The NBR Norm no.10/2005, amended by Norm no.20/2006 sets a monthly debt-service ceiling equal to 40 percent of the net monthly income of the borrower, the debt covering the sum of all commitments (principal, interest, and any other loan related costs), *regardless the creditor*.

Moreover, the monthly debt service ceilings for consumer and real estate credits are limited to 30 and 35 percent of monthly net income, respectively.

These regulations can not be effectively applied unless banks dispose of accurate and complete information on the overall indebtedness of their clients vis-à-vis banks. The overall exposure of borrowers towards banks can only be determined if all banks would report information on the debt servicing of individual borrowers, i.e. positive information. As outlined above, even the banks that currently report positive information have only a partial image of the overall indebtedness of their 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 (see considerations outlined above by positive information banks).

At the same time, given the rapid pace of growth of household lending in Romania, there is a real danger that bank borrowers could become over-indebted by taking credit simultaneously from several banks, without any of these being aware of the total amount of credit that the borrower has taken on without adequate risk mitigation measures in place. The default of such borrowers can create a domino effect on the multiple lenders and can lead to significant financial vulnerabilities, as witnessed by other countries' experience.

Moreover, according to the NBR Norms no. 3/2002 regarding the know-your-customer standards, the banks should adopt efficient policies and procedures of knowing their customers. In this context, the positive information could be an additional instrument available to banks in order to better assess their customers.

II.4. Possible regulatory challenges: National Authority for Supervision of Personal Data Processing

In October 2006, the National Authority for Supervision of Personal Data Processing (NASPDP) has posted on its website a draft *decision regarding the processing of personal data through credit bureaus*, requesting for comments to be received by November 10, 2006. The draft decision (attached) **practically banned the processing of positive information through credit bureaus** and contained some other provisions that would have detrimental impact on Romanian society. Amongst these, those that would have the strongest detrimental effect were:

article 1 – the provision according to which *credit bureaus can only gather information from banks and non-banking financial institutions* implies that an incomplete assessment of the borrower's characteristics can be made;

article 4 (1) – the provision according to which *only overdue payments of more than 120 days can be reported to credit bureaus* is not in line with NBR and Basel II regulations that set out shorter default periods for prudential purposes;

Article 4 (3) – the provision according to which *the retention period of data by the credit bureaus of 1-2 years* is not in line with Basel II provisions which require a data history of minimum 5 years.

Established and operating in conformity with relevant EU legislation on personal data protection (i.e., Directive 95/46/EC), NASPDP is looking into other EU countries experience in implementing EU legislation. In the EU, the application of personal data protection legislation pertaining to the financial sector has resulted in different models that reflect the historical characteristics, the stage of development, and the structure of the respective financial markets. A vast majority of the EU member states share both negative and positive data, with the two countries not sharing yet positive information being France and Hungary.

The draft decision was brought to the attention of the project working group, which, in cooperation with the SPI Secretariat and IFC representatives has undertaken the actions outlined under Section III.1.2.

III. Actions undertaken so far by under the SPI project

Following the indications received from the project management group, the project working group undertook parallel actions with market participants (positive and negative information banks) and authorities (NBR, NASPDP), following a three pillar strategy outlined in the project terms of reference:

- Ascertain the need for possible regulatory actions to promote positive information sharing;
- Outline the systemic benefits of positive information sharing;
- Determine 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.

According to the terms of reference, a consensus on these issues could have lead market players to reaching an agreement on how the banking industry should commit to the prompt completion of Phase II, possibly through the signing of a Protocol for positive information sharing.

The project working group has started its activities by trying to build a common understanding of the benefits and drawbacks of positive information sharing. In this respect, the project working group outlined a factual description of the current stage of implementation of Phase II, together with the necessary measures and perceived drawbacks in carrying out this process. This information has been conveyed by the Credit Bureau and the major banks sharing positive and only negative information.

At the same time, the project working group held consultations with the NBR in order to determine the impediments perceived in monitoring the compliance of banks with the rules on limiting level of indebtedness of borrowers, the central bank's view on the potential risks that could arise from the uncontrolled accumulation of debt by small borrowers, and the possible regulatory actions that the central bank could take.

While not envisaged at the project outset, the draft decision of NASPDP was followed by a prompt reaction of the project working group, supported by the SPI Secretariat, and the project technical anchors – Convergence and IFC. The actions undertaken are highlighted below.

Likewise, in order to raise awareness on the benefits of positive information sharing, as outlined in the existing literature and drawn from empirical evidence, Convergence prepared a

case study for Romania, outlining evidence on the opportunity cost for Romanian banking industry of not sharing positive information.

III.1. Actions undertaken with

III.1.1. market participants

Within the project, the positive information banks have shared their experience with Phase II implementation. This exercise was meant to:

- serve as an illustrative example of implementing positive information reporting;
- constitute a stock taking of the practical implementation issues and the benefits drawn from positive information sharing.

The positive information banks have also prepared a common document on the technical issues related to the Phase II implementation which was submitted to Biroul de Credit. Biroul de Credit considered the issues raised by banks and made clarifications and took actions as outlined in Section III.1.4. Solving the existing technical issues was perceived as an important comfort element for the banks wishing to join positive information sharing regarding a smooth integration and utilization of the system.

The negative information banks have also performed a stocktaking of the perceived impediments in sharing positive information. From the interviews that the project working group held with negative information banks it resulted that in principle, a vast majority of them is favourable to the idea of sharing positive information. Moreover, all negative information banks recognize the importance of having positive information for an improved risk management.

Some of the major negative information banks are currently engaged in restructuring processes due to either privatization or mergers that make the implementation of positive information reporting a low priority on their agenda. However, from the interviews held, none of these banks has concrete action plans for implementing the Phase II.

III.1.2. NASPDP

As mentioned above, the publication of the draft decision by NASPDP on the authority's website for consultations was followed by a very prompt reaction by the project working group members, SPI project support (SPI Secretariat and SPI technical anchors) and SPI Committee members, as follows:

1. **A letter was sent by Mr. Radu Gratian Ghetea and Mr. Shkelqim Cani on behalf of the Steering Committee to the President of NASPDP**, on November 3, 2006, outlining the potential dangers that such a regulation could carry for Romanian users of banking services and for banks. Also, the letter stressed that the proposed provisions contradict international best practices on information sharing for the benefit of financial services users and, as such, could have the potential to bring serious damage to the stability of the Romanian financial system. Finally, the letter expressed the availability of the SPI Committee to provide additional information as required by NASPDP for the purpose of avoiding unintended negative consequences on users of financial services.

2. **A technical meeting was held with between the SPI Project technical support (SPI Director of Analytics and Policy and SPI Technical Anchors – Convergence and IFC) and the management of NASPDP on November 15, 2006.**

It was stressed in the meeting that the draft NASPDP decision has the potential to harm the interests of Romanian consumers of financial services and, as a second round effect, also the stability of the financial sector. From both emerging and developed countries experience, positive information sharing improves access to credit, and contributes to strengthening the financial system stability by offering an additional instrument for credit risk management, lowering default rates and cost of credit.

On the other hand, it was stressed that the lack of positive information accentuates the asymmetry of information available to financial markets players and, in many cases, has contributed to destabilizing financial crises. Following such experiences, the International Finance Corporation (part of the World Bank Group) decided to contribute to the improvement of an important component of the financial market infrastructure through an ambitious Global Credit Bureau Program, established in 2001.

Moreover, it was outlined that given the rapid pace of growth of household lending in Romania, there is a real danger that bank borrowers could become over-indebted by taking credit simultaneously from several banks, without any of these being aware of the total amount of credit that the borrower has taken on without adequate risk mitigation measures in place. The default of such borrowers can create a domino effect on the multiple lenders and can lead to significant financial vulnerabilities, as witnessed by other countries' experience.

At the same time, the public good value of positive information sharing is well acknowledged in EU regulations. Directive 95/46/EC indicates that for the purpose of monitoring important economic or financial interest, member states may impose limitations on personal data protection.

Another aspect clarified relates to the relationship between the private credit bureaus and the public credit register. While also the National Bank of Romania Credit Registry is set up to collect both negative and positive information, private credit bureaus help financial and non-financial institutions in assessing mainly small borrowers (individuals and SMEs) characteristics, while the public Credit Registry collects data only from regulated aimed at monitoring systemic risks.

NASPDP welcomed the opinion provided by the IFC expert and appreciated the discussion, stressing that this point of view based on global experience will be taken into consideration. The NASPDP stated that a final decision on the draft decision will be made by the NASPDP board upon consultations held with other EU data protection agencies and with financial authorities and market participants in Romania.

3. **A follow up letter with supporting documents and assistance were submitted to NASPDP by the SPI Project technical support on November 17, 2006.**

The SPI Project technical support has also sent a letter and additional documents on the role and importance of credit reporting. Also, the SPI Project technical support expressed its availability to remain open to provide NASPDP with any information considered necessary in order to better inform its decision and to avoid unintended negative consequences on users of financial services and on the stability of the Romanian financial system. The SPI Secretariat and IFC also stated that they could organize a follow up meeting with NASPDP representatives in order to clarify any remaining issues.

Nonetheless, the SPI Project technical support stressed that it is very important that the NASPDP continues its consultation process with both the authorities and market participants in order to agree on a regulatory action that serves best the interests of consumers and providers of financial services in the context of the overall public interest.

4. **A document outlining a practical example of the consultation process** that has been held in Italy between the Data Protection Agency and the financial market participants and authorities **was also submitted to NASPDP by the Convergence technical anchor on November 22, 2006.**

The document outlined the concrete steps that have been followed in the preparation of the regulation hoping which could serve as a helpful reference for the NASPDP in coming up with the final decision.

5. Separate meetings have been held with NASPDP by Biroul de Credit.

The most recent developments indicate that, also following the above mentioned actions undertaken, NASPDP is currently reconsidering the elements of the draft decision. According to information received by the project working group members:

- NASPDP could be now in favor of positive information sharing;
- NASPDP is thinking to modify the provision according to which only overdue payments of more than 120 days can be reported to credit bureaus to stipulate only 60 days. This is still not fully in line with prudential rules;
- NASPDP does not want the telecoms to report to credit bureaus, which will have a negative effect on the efficiency of the information provided to lenders.

The project working group members will continue to follow up with NASPDP on these issues and to argue for a concerted position of all stakeholders. At the same time, the project working group proposed that a working group is set up in order to carry out the consultation process with NASPDP on the drafting of the final regulation.

III.1.3. NBR

So far, three meetings have been held with NBR representatives by the project working group members / SPI Project technical support. While the positive information sharing issue did not enjoy the interest of the Financial Stability Department, the Regulation and Licensing Department is well aware of the importance of positive information and could consider regulatory actions aimed at promoting it.

From the discussions held, it resulted that the NBR is not in favour of having positive information sharing imposed on banks as mandatory as it may encounter the resistance of market players. Instead, the NBR is willing to consider a system of incentives for positive banks, in line with other countries' approach, which imposed stricter provisioning requirements (100%) for banks which are not requiring positive credit reports. The NBR would be also in favour of receiving a background study from SPI on the relevant international regulatory practices and a proposed outline of possible regulations.

III.1.4. Credit bureaus

Taking into account the importance of extending the reporting of positive information for the efficiency of services provided to its participants, the Credit Bureau is taking into consideration the following actions:

1. In relation with the Romanian Data Protection Agency: to continue the dialogue for promoting the modification of this institution's draft decision.
2. In relation with the Romanian Banking Association: cooperation for the promotion of the positive data reporting through NBR regulation.
3. In relation with the Participants:
 - technical support for the four potential participants (accounting for around 15 percent of the total banking sector assets) which are presently testing the positive info reporting and will go live with Phase II by the end of 2006;
 - to intensify the lobby process with big players that currently do not share positive information;
 - offering value added services according to Phase III, such as extended statistics built on positive data;
 - to organize a roundtable on positive data transmission at the Biroul de Credit;
 - to undertake a review of technical problems reported by the Phase II participants and, where appropriate, to do a fine-tuning of the application in order to facilitate the Phase II integration and processing;
 - to provide training to the participants willing to join the Phase II.

III.2. Conclusions

Under present conditions, the application of NBR regulations on limiting the household lending (NBR Norm no.10/2005, amended by Norm no.20/2006) is hampered by the incompleteness of information on borrowers' bank exposures available to banks. These regulations can not be effectively applied unless banks dispose of accurate and complete information on the overall indebtedness of their clients vis-à-vis banks, i.e. through comprehensive positive information.

At the same time, given the rapid pace of growth of household lending in Romania, there is a real danger that bank borrowers could become over-indebted by taking credit simultaneously from several banks, without any of these being aware of the total amount of credit that the borrower has taken on without adequate risk mitigation measures in place. The default of such borrowers can create a domino effect on the multiple lenders and can lead to significant financial vulnerabilities, as witnessed by other countries' experience.

Discussions in the project working group and an independent assessment made by the SPI Secretariat, together with an International Finance Corporation credit bureau expert have led to the conclusion that the banking system does not presently have the organizational capabilities and the incentives to collect and process positive credit information. Therefore, the project working group has considered necessary the reassessment of the initial objective of the SPI project – the preparation of a Protocol for positive information sharing signed by banks, which under the present circumstances would not be feasible.

To this, the proposed National Authority for Supervision of Personal Data Protection (NASPDP) resolution on positive information sharing has created an environment where banks sharing only negative information may be even more reluctant to start sharing positive data before the issuance of the final regulation.

NASPDP management has acknowledged the need to strike a reasonable balance between the need to protect individual data and the right of individuals to use their good reputation to access financial services. Accordingly, NASPDP is now revisiting the proposed regulation,

also based on extensive international information made available by the SPI Secretariat, and the SPI project technical anchors (Convergence and IFC) and proposes to reach a final decision after consultations with other EU data protection agencies and Romanian financial authorities and market participants. There are indications that NASPDP is prone to consider allowing positive information sharing with credit bureau and also to give up some other stipulations from the initial draft decision.

IV. Recommendations

1. *The need for NBR regulatory action*

In the fluid context described above, the project working group considers that an NBR regulation aimed at promoting broad positive information sharing would go a long way to sending a policy signal about the importance of positive credit information sharing to both market participants and other public authorities. This signal would be consistent with the provisions of Directive 95/46/EC (Data Protection Directive), which indicate that the monitoring important economic or financial interest prevail over the purposes of personal data protection.

The international experience on the matter shows that countries differ significantly in their approach to regulating credit information. The European Union and several other European countries regulate credit reporting activities under the framework of broader Data Protection Laws. These laws cover not only credit bureau activities but any other relationships and transactions related to data management and exchange. Another approach is to regulate credit reporting activities through a specific credit bureau or credit reporting law. Countries that have adopted such an approach include the U.S., Thailand, Russia, Kazakhstan, Peru, Ecuador, Ghana, and Ukraine to name but a few.

Some governments, e.g. Belgium, Bangladesh, Colombia, Ecuador, Malaysia, Nicaragua and Pakistan, have actively helped facilitate the development of the information sharing industry by requiring that lenders obtain a credit report before granting a credit facility. Others make it compulsory for lenders to submit the details of outstanding loans to the private sector credit bureaus, e.g. Turkey, Chile, Hungary and Pakistan.

While the creation of a sound legal framework is a fundamental requirement of developing an effect and fair information sharing environment, legislation can be time consuming to enact and inflexible in a rapidly changing market. For this reason many countries rely on general laws to manage macro level issues, such as privacy, but rely on the central bank to administer specific rules and monitor compliance with directives.

Examples include Mexico, where **the central bank imposes a 100% increase in a bank's provisioning policy for not supplying data to a credit bureau**⁵. This regulation does not impose the obligation of banks to report positive information, but provides the necessary incentives to banks to join positive information sharing. The visionary approach and facilitator role played by the Central Bank of Mexico represents a possible quick and effective

⁵ The information shortage faced by credit providers combined with overall imprudent credit granting practices led to a stunning level of defaults in 1994-1995. This experience - also known as the "Tequila Crisis" - has prompted credit providers and authorities to give more attention to reports on credit histories and other background checks that facilitate credit decisions.

way to develop the regulatory environment for credit reporting in Romania, under the auspices of the NBR.

Should the NBR endorse this proposal, the SPI Secretariat and the SPI project technical anchors (Convergence and IFC) could support the NBR in preparing the background documentation for drafting such a regulation and the broad terms of the regulation. At the same time, the project working group members consider that the presence of an NBR representative in any further actions within the SPI project is absolutely necessary.

A possible alternative that the project working group envisaged could be the relaxation of the NBR regulations on limiting the lending to households for the banks that report and use positive information. Namely, the central bank could allow the positive information banks to have higher debt-service to monthly income ceilings (currently a debt-service ratio of 40 percent of the net monthly income of the borrower is applied by all banks). Such an approach would be consistent with the more prudent risk management of the positive information banks, which feel at disadvantage compared to negative only information banks when applying the relevant NBR norms (see Section II.2.1. Positive information banks).

2. The need for a concerted action to support the NASPDP in coming up with a regulation in line with international best practices and also responds to the specificities of Romanian lending market

The project working group considers that it is important to support the efforts of NASPDP in coming up with a regulation that is in line with both international best practices on the matter and responds to the realities from the Romanian market. In this respect, the project working group proposed the setting up a mix working group composed of representatives of the banking community, credit bureau, NBR, SPI Secretariat, and NASPDP in order to enhance the effectiveness of the consultation process initiated by NASDPD regarding the draft regulation pertaining to credit bureaus.

3. The need for keeping all stakeholders engaged in the process of promoting of positive information sharing

The project working group also considers that all stakeholders should remain strongly engaged in the process of promoting positive information sharing. This recommendation triggers both positive and negative information banks, but also the credit bureaus themselves, which represent the facilitators of the positive information exchange.

The project working group believes that an adequate system of incentives should be put in place in order to encourage a broad endorsement of positive information sharing. Such incentives could be provided by the central bank through a regulation that would create stimulants for banks to disseminate positive information and by the credit bureaus through measures that would promote and facilitate the Phase II implementation.

In this respect, the credit bureaus should actively support market players in making the best use of the credit bureau system. Biroul de Credit has committed to undertake a review of technical problems reported by the Phase II participants and, where appropriate, to do a fine-tuning of the application in order to facilitate the Phase II integration and processing, to provide technical support and training for the potential participants, to offer more value added services.

Biroul de Credit should also raise awareness of the market players regarding the existing services and the planned improvements and intensify the lobby process with big players that currently do not share positive information. At the same time, Biroul de Credit could conclude a cooperation agreement with NBR in order to strengthen the relationship with the central bank. Last but not least, Biroul de Credit could consider establishing a compliance committee to strengthen the governance framework of its operations and to build an image of best practices operational framework.

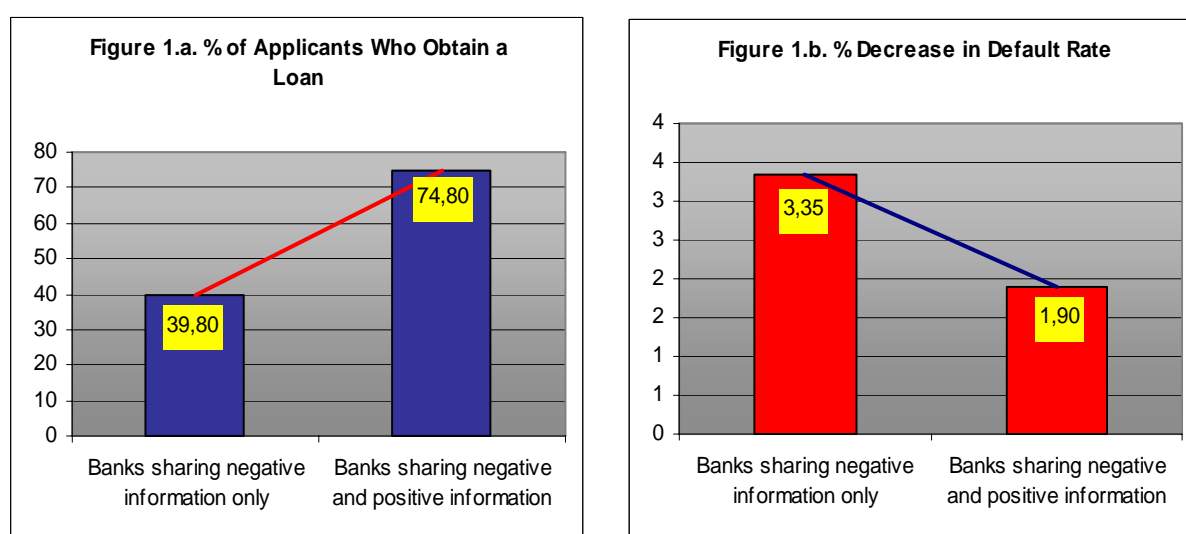
Furthermore, the existing experience of banks that currently share positive information will continue to play an important role in helping the credit bureaus to continuously improve their services and the other banks in making a decision in respect to positive information dissemination. At the same time, the banks that do not share positive information, but consider disseminating positive information in the near future should start planning ahead and preparing their systems, in close cooperation with the credit bureaus.

Likewise, a broad outreach event could be organized in cooperation with IFC regarding the international experience with positive information sharing.

Appendix 1. The Benefits of Positive Information Sharing. Theoretical and Empirical Considerations

Positive information (total amount and types of loans, accounts currently open and active, balances, credit limits, etc.) carries net benefits over negative information only (delinquencies: non-payment of a debt, arrears, bankruptcies, etc.), which is traditionally disseminated in a vast majority of financial markets. According to Barron and Staten (2003), broader information sharing expands credit and decreases loan losses. As shown in Figures 1.a. and 1.b., out of 100,000 applicants 35,000 potential good customers are lost if the assessment is based on negative info only. At the same time, given an acceptance rate of 60 percent, positive information sharing triggers a 43 percent decrease in the default rate.

Figure 1. The Net Benefits of Positive Information Over Negative Only Information



Source: Barron and Staten (2003). Note: Figure a) shows the simulated credit availability assuming a target default rate of 3%. Figure b) shows the simulated credit defaults assuming an acceptance rate of 60%.

Table 1. Coverage of Positive Information around the World

#	Countries	GDP (2005, USD mil.) (*)	Are both positive and negative data distributed? (**)	Private credit reporting (***)	Are both individuals and firms listed in credit registry? (**)
1	United States	12.455.068	Yes	Positive	Yes
2	Japan	4.505.912	Yes	Positive	Yes
3	Germany	2.781.900	Yes	Positive	Yes
4	China	2.228.862	Yes	Does not exist	Yes
5	United Kingdom	2.192.553	Yes	Positive	Yes
6	France	2.110.185	No (currently considering sharing positive)	Does not exist	Yes
7	Italy	1.723.044	Yes	Positive	Yes
8	Spain	1.123.691	Yes	Positive	Yes
9	Canada	1.115.192	Yes	Positive	Yes
10	Brazil	794.098	Yes	Negative	Yes
11	Korea, Rep.	787.624	Yes	Negative	Yes
12	India	785.468	Yes	Positive	No
13	Mexico	768.438	Yes	Positive	Yes

#	Countries	GDP (2005, USD mil.) (*)	Are both positive and negative data distributed? (**)	Private credit reporting (***)	Are both individuals and firms listed in credit registry? (**)
14	Russian Federation	763.720	Yes	Positive	No
15	Australia	700.672	No	Negative	Yes
16	Netherlands	594.755	Yes	Positive	Yes
17	Switzerland	365.937	Yes	Positive	No
18	Belgium	364.735	No	Positive	Yes
19	Turkey	363.300	Yes	Positive	Yes
20	Sweden	354.115	Yes	Positive	Yes
21	Saudi Arabia	309.778	Yes	Positive	Yes
22	Austria	304.527	Yes	Positive	Yes
23	Poland	299.151	Yes	Positive	No
24	Indonesia	287.217	Yes	Does not exist	Yes
25	Norway	283.920	No	Positive	Yes
26	Denmark	254.401	No	Negative	Yes
27	South Africa	240.152	Yes	Positive	Yes
28	Greece	213.698	Yes	Positive	No
29	Ireland	196.388	Yes	Positive	Yes
30	Iran, Islamic Rep.	196.343	Yes	No information	Yes

(*)= Source: <http://siteresources.worldbank.org/DATASTATISTICS/Resources/GDP.pdf>.

(**)= Source: The World Bank, *Doing Business* - Credit Information, 2006. www.doingbusiness.org. According to the methodology, the term "credit registry" encompasses both public and private credit registries.

(***)= Source: IFC. This column refers only to private credit bureaus.

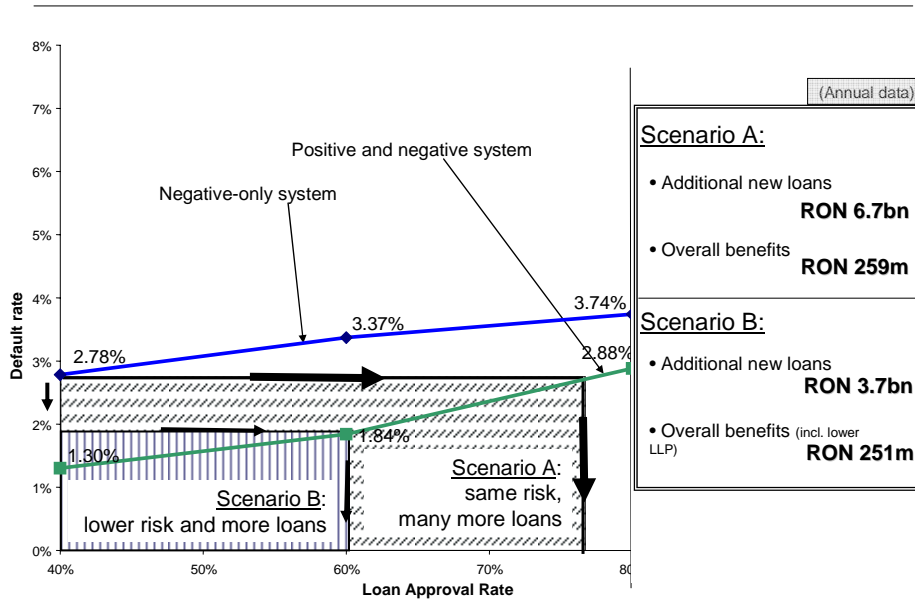
Around the world, approximately 70 percent of all private credit bureaus provide positive information on individuals and almost 50 percent provide positive data on firms. Table 1 shows how most countries disseminate positive information. It is expected that the group of countries sharing positive information will continue to grow as all major financial markets are currently moving towards generalizing the reporting of positive information (i.e. the UK embraced positive information sharing in 2006 and even more "conservative" countries in this area, such as France, are currently considering sharing positive information).

A theoretical application regarding possible benefits for Romania

A theoretical application regarding the possible benefits of a generalized positive information system in Romania shows that banks could take substantial advantages from it such as increasing their lending business and improving the quality of their loan portfolios. The simulation (based on the findings of a research paper by Powell, Mylenko, Miller, and Majnoni from 2004 for the case of Brazil) demonstrates that:

- a) under scenario A which implies the same risk level and many more loans granted, the additional annual credit to households is RON 6.7 billion and the overall annual benefits for banks amount to RON 259 million;
- b) under scenario B which implies lower risk and more loans granted, the increase in household lending is estimated about RON 3.7 billion with overall annual benefits for banks at RON 251 million.

Figure 2. An Illustrative Scenario for Romania



Convergence calculations on IMF data [IMF, *Romania: Selected Issues and Statistical Appendix*, May 2006].

Appendix 2. International Experience with Regulating Information Sharing

The main objective of a legislation that will enable credit reporting is to balance the ability of institutions to exchange credit information in the normal course of business, whilst simultaneously protecting individuals' rights to privacy. Two broad approaches to the regulation of credit reporting can be identified. They include: 1) the use of data protection laws or 2) the use of a credit bureau or credit reporting law.

The European Union and several other European countries regulate credit reporting activities under the framework of broader Data Protection Laws. These laws cover not only credit bureau activities but any other relationships and transactions related to data management and exchange. In recent times, several emerging markets have followed this approach with Chile passing a Data Protection Law in 1999 and Argentina passing a similar law in 2000. Another approach is to regulate credit reporting activities through a specific credit bureau or credit reporting law. Countries that have adopted such an approach include the U.S., Thailand, Russia, Kazakhstan, Peru, Ecuador, Ghana, Ukraine to name but a few.

Countries differ significantly in their approach to regulating credit information.

Some governments, e.g. Belgium, Bangladesh, Colombia, Ecuador, Malaysia, Nicaragua and Pakistan, have actively helped facilitate the development of the information sharing industry by **requiring that lenders obtain a credit report before granting a credit facility**. Others make it **compulsory for lenders to submit** the details of outstanding loans to the private sector credit bureaus, e.g. Turkey, Chile, Hungary and Pakistan.

The extent of credit information that financial institutions may share with private bureaus is typically proscribed by secrecy provisions within the banking laws or by data protection/privacy laws. In some countries, e.g. Australia and Paraguay, sharing positive information is prohibited. These rules are often intended to protect the rights of individuals, but are frequently counter productive and hinder the development of the information sharing environment. Recent changes of the Privacy regulations in Hong Kong, **allowing banks to share positive information**, resulted in the number of borrowers covered by the credit bureau doubling. This had a significant impact on the ability of the banks to recognize and prevent over indebtedness.

A good enabling legislation will incorporate the following aspects:

- **Both positive and negative information should be shared.** Lenders are generally hesitant to share positive information out of the fear that their competitors might poach their best customers once positive information is made available. However, the enabling legislation can provide for information access rules that restrict the ability of banks to poach other banks' customers. For example, a lender can only access information in the bureau if an individual or a firm has applied to it for credit.
- **Open system.** Reporting and access should be open to both financial institutions and non-bank creditors such as retailers, telecom companies, debt collectors and utility companies.
- **Permissible purpose.** The legislation should protect the rights of individuals and firms to ensure that data is not misused, whilst permitting the sharing of

information. Typically access to information is only allowed for a certain identified purpose such as credit approval, portfolio monitoring, debt collection and employment.

- **Access to the information.** Information in the bureau may only be accessed by authorized parties. Information may only be used for permissible purposes. Depending on the legislation, borrower consent or notification may be required to access information.
- **Consent.** Depending on the jurisdiction, explicit or implicit individual borrower consent may be required to provide data to the bureau and to access a credit report. The objective of the consent is to enable the data subject to control the information flow. In several EU countries, Thailand, Kazakhstan and many other countries, explicit borrower consent is required to provide information to the bureau (usually included in the loan agreement) and to access a credit report (usually included in the loan application). In the interest of maintaining operational efficiency, the onus of obtaining and maintaining a record of borrower consent for data submission lies on lenders. In the event of a dispute, the lender must be able to demonstrate that it had obtained borrower consent in accordance with the law. Some countries, including the U.S. for example, do not require explicit consent. The consent of the borrower is considered to be implicit if the borrower has originated a transaction with the lender.
- **Credit history length.** The legislation should stipulate a certain length of time during which information should be stored. Historical information enables lenders to assess a borrower's credit quality over a period of time. At the same time there should be a cut off period, after which information is erased to enable borrowers to have a fresh start. Payment history information is usually maintained for a minimum of five years. Information on defaults should not be erased once loans are repaid and stored together with the rest of the file for the assigned period of time. Public records relating to bankruptcy are usually retained for a longer period of seven years or more. According to a World Bank survey, out of 78 private credit bureaus, 57 preserved historical information over 5 years, with 34 credit bureaus preserving data between 5–7 years.
- **Consumer protection.** Individuals should have the right to check their own information and the bureau should have a mechanism for correcting information. The regulation should also create grievance and dispute-resolution mechanisms. These mechanisms usually include limits on the time the bureau may take to respond to the borrower complaint. In most countries this period ranges between 10 and 20 business days. During this period the bureau must put a notice into the credit report indicating the dispute.
- **Licensing and registration.** In some countries, such as Mexico, Thailand, India and Kazakhstan, credit bureaus are required to obtain a license from the supervisory authority to operate. Licensing requirements usually require credit bureaus to meet certain financial, security and governance standards. In most countries, where the specific credit bureau laws have been passed recently, either the Central Bank, the Bank Superintendent, or the supervisor of a non-bank financial institution can perform the licensing function.
- **Supervision and Enforcement.** Enforcement is an essential element of the legal and regulatory framework necessary to enable the operation of the credit information industry. Countries have taken two broad approaches to enforcement, which in large part reflects country's legal traditions:

- 1) A **strong supervisory authority** with the power to license, register and control credit bureaus. Its functions usually include issuing industry regulations, issuing licenses, conducting or requesting audits, receiving and analyzing complaints and imposing penalties. Such approach is used in Mexico, Kazakhstan and Thailand. To ensure the smooth implementation of a credit bureau law, it is critical to build the capacity of the supervisory authority. In several cases implementation of the law was delayed or had a significant negative impact on existing bureaus due to the lack of enforcement capacity. For example, in Russia a credit bureau law was passed in December 2004. The law required that all financial institutions submit information after acquiring borrower consent, to a registered credit bureau. However, a supervisory authority was appointed after much delay and could not develop a registration procedure in time. As a result, the implementation of the law had to be postponed by more than a year. Due to the lack of supervisory capacity, the authority also was unable to provide guidance to financial institutions on compliance with the law.
- 2) Industry **self-regulation** within an established legal framework, where the enforcement authority's role is limited to issuing clarifying statements, collecting complaints and in some cases bringing class action suits in case of systematic violations. This type of enforcement mechanism is prevalent in the UK, Hong Kong, Australia and South Africa, where credit bureaus operate on the basis of a Code of Conduct (COC) under broader privacy legislation. A Code of Conduct is a binding agreement signed by the members of the bureau. It provides the rules that govern the operations of a credit bureau and mechanisms for resolving disputes amongst its members. In countries where more than one bureau exists, such as in South Africa, the CoC is endorsed by all credit bureaus operating in the country. The enforcement mechanism for the CoC in this case is an Association of Credit Bureaus.

The creation of a sound legal framework is, however, a fundamental requirement of developing an effect and fair information sharing environment. They protect both the rights of data subjects and provide comfort to the data providers that their information will be managed responsibly. *But legislation can be time consuming to enact and inflexible in a rapidly changing market.*

For this reason many countries rely on general laws to manage macro level issues, such as privacy, but **rely on the central bank** to administer specific rules and monitor compliance with directives. Examples include **Mexico** where the central bank imposes a **100% increase in a bank's provisioning** policy for not supplying data to the bureau.

The Mexican case

Mexico's authorities have put in place one of the most effective, complete and unambiguous legal frameworks existing in the financial and credit information sharing sectors. These regulations are also adopted as a legal standard by supervisors and legislators in other Latin and Central American countries when drafting new legislations and norms regulating credit information sharing in their countries.

Until the early 1990s, very little credit information was available and shared in the Mexican financial markets. Before 1993, Mexico had neither enforced a regulation or legislation concerning the information sharing industry, nor a data privacy law. Also, information sharing industry was practically inexistent; the only information sharing mechanism available at that time was the National Service for Bank Credit Information (Servicio Nacional de Información de Crédito Bancario, SENICREB), a public credit registry established by Banco de México in 1964. The SENICREB collects positive and negative information (late payments defaults and other irregularities) on loans above approximately USD 18,000 and distributes this information back to banks.

The information shortage faced by credit providers combined with overall imprudent credit granting practices led to a stunning level of defaults in 1994-1995. This experience - also known as the “Tequila Crisis” - has prompted credit providers and authorities to give more attention to reports on credit histories and other background checks that facilitate credit decisions.

A regulatory change in 1995 required banks to obtain, review and document a borrower’s past repayment performance and the actual financial situation before granting a loan. Consumer and mortgage loans, extended without following these procedures, were subject to a specific reserve requirement equal to 100% of the loan balance. Though reluctantly at first, bankers embraced the new regulations, and created their own Credit Bureau (Buro de Credito) which, for the last ten years, has been the only, single, unopposed actor in the information sharing industry in Mexico.

In January 2002 a Credit Bureau Law (Ley de Sociedades de Información Crediticia) was enacted in an attempt to further regulate the activities of private credit bureaus. This law, further amended in January 2004, aims at strengthening the credibility of the credit bureaus by reinforcing their operational rules. Furthermore, this law includes mechanisms for protecting data subject rights, such as consent requirements, guaranteeing access to credit reports, and low cost procedures for challenging and correcting erroneous information. Under this law, private credit bureaus must be authorized to operate by the Ministry of Finance (Secretaria de Hacienda y Crédito Público, SHCP) and are subject to the regulations issued by Banco de México. The National Banking and Securities Commission (CNBV) is in charge of the supervision of these firms.

At present, a private credit registry, Buró de Crédito, is by far the most important credit information source in Mexico. Most banks participate in the Buró de Crédito, as well as a number of non-bank financial institutions, retailers and other creditors. In total, more than 600 credit providers feed the databases of Buró de Crédito.

Currently, with historically low domestic interest rates following nearly a decade of financial stability, new opportunities for financing have emerged. Several segments of the Mexican credit market are already experiencing fast growth, particularly the consumer lending and residential mortgages sectors. The visionary approach and facilitator role played by the Central Bank of Mexico represents a possible quick and effective way to develop the regulatory environment for credit reporting in Romania, under the auspices of the NBR.