REPORT ON REVISIONS TO THE REGULATIONS OF THE CREDIT RISK INFORMATION CENTRAL OF THE NATIONAL BANK OF ANGOLA

ANGOLA FINANCIAL SECTOR PROJECT

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INTRODUCTION

The USAID Angola Financial Sector Program supports the USAID/EGAT strategic goals of increasing trade and investment and supporting secure and stable financial markets. It supports the USAID/Angola Mission goal of supporting economic reform.

The Emerging Markets Group, Ltd. (EMG), under the auspices of USAID, is advising BNA on a series of financial sector initiatives. EMG has created a comprehensive work plan to assist BNA in its efforts to improve and expand the financial sector in Angola. The main objective of this Work Plan is to expand access to credit in Angola.

A major objective of the Government of Angola's (GOA) financial sector reform and development is the expansion of credit and improved access to credit. A primary objective of the Financial Sector Program (FSP) is to assist BNA by developing an effective regulatory environment. Both the National Bank of Angola (BNA) and EMG consider the establishment of an effective and safe public credit risk registry as an important step in this development process.

PREFACE

"The 5 Cs of Credit"

In making loans, creditors analyze the following basic elements of lending:

1. **Character -** moral quality, defined as the predisposition to meet obligations. The best form of predicting future behaviour is analyzing past behaviour.
2. **Capacity -** internal generation of sufficient operating earnings or salary to meet repayment of loan principal and interest instalments.
3. **Capital -** analyzed in relation to the level of indebtedness of the borrower and his/her repayment capacity when earnings fall short.
4. **Collateral -** real assets or personal guarantees pledged to meet repayment obligations if character, earnings or capital are lacking.
5. **Conditions -** affecting the firm and the market in which it operates as well as the individual borrower.

Creditors have a disadvantage to the loan applicant as they do not have access to all pertinent information. This is known as moral hazard. Public credit risk registries warn lenders of recent and current levels of debt and the repayment history of debtors. In addition, public credit risk registries can assist a supervisory agency measure lending risk and the level of provisions to be required of lenders for possible loan losses.

Causes of Bank Failures

In order of importance, financial institutions frequently fail due to the following:

1. Illiquidity
2. Excessive concentration of risk in one debtor or business industry
3. Insider lending to shareholders or management
4. Loans to related parties
5. Over leveraging, usually due to poor estimates of credit risk and of portfolio quality, and also due to under provisioning for possible bad loan losses.
6. Management incompetence
7. Fraud

8. *Shocks* in the market or to the economy

A public credit risk registry helps bank examiners monitor and control loan concentration, insider lending, and loans to related parties.

Loan Risk Classifications

Supervisory agencies require lenders to classify individual loans and to establish write off provisions for possible bad loan losses. Classifications and write off provision examples are:

	Classification	Provision
I	Normal	0%
IA	Possible deterioration in repayment capacity, capital, conditions, etc.	2%
II	Sub standard.	15%
III	Doubtful	50%
IV	Loss	100%

Despite regulations, loan classification and the estimated provisions remain a matter of judgement on which bankers, auditors and regulators may disagree. The public credit registry can help all parties to determine loan classifications and the amount of provisions required.

The Why of Public Credit Registries

Public credit risk registries serve three fundamental purposes:

1. Protecting depositors, by centralizing data and informing financial institutions of the total level of actual debt and/or contingent debt of an individual borrower or guarantor (including business groups and related parties). Informing financial institutions of the various loan classifications in the financial system of an individual borrower or guarantor.
2. Allowing the supervisor or regulator to better carry out its policy, regulatory, and supervisory duties including, but not limited to: statistical compilation and analysis; requiring financial institutions to adjust loan provisions; monitoring legal lending limits; controlling insider lending; and limiting illegal activities such as money laundering and terrorism financing.
3. Lowering risks and costs by facilitating the exchange of credit references with lenders and fostering the orderly expansion of credit to more enterprises, individuals and families.

Credit Risk

Defined as the probability that financial institutions may suffer a loss (in their financial statements, off balance sheet, or on behalf of third parties) from counterparts in contracts such as loans, credits, discounts, warranties, guaranties, bonds, advances, securities, commitments under financial instruments, and other legal transactions related to financial intermediation..

The Position of the International Finance Corporation on Public Credit Risk Registries and Private Credit Bureaus

¨IFC focuses on the introduction of positive information, (for example in Brazil and Pakistan) and the development of credit scoring by developing a micro credit bureau score, for example as in South Africa.

In some countries the development of the private credit reporting industry is hampered by misguided public policy. For example, expansion of public registries to cover all retail loans issued by regulated institutions is costly and undermines private sector initiatives. Empirical research and international practice have demonstrated that private registries are better suited to serve the needs of lenders.[1] *Public registries may play an important part in improving banking supervision and monitoring systemic risks, but they should not serve as the main information providers to commercial institutions. Mandatory collection and provision of information -- often at subsidized prices -- distorts market incentives for financial institutions to develop a private registry. A case in point is the expansion of the public registry in Bulgaria, which put on hold the development of a private registry that was almost ready to start operations.*

Discussions of a public registry expansion in Armenia resulted in making banks unwilling to join a private credit information-sharing enterprise. While the development of a public registry might appear to be an effective means to fill the gap of available credit information, in the medium to long term it undermines private initiatives and thus hurts creditors who will not have access to a broad set of credit data, including the information from non-banks that is usually collected by private bureaus. Creditors who rely on public registries will not be able to benefit from value-added services such as bureau scores, moreover, which allow them to maximize the value of credit information. At the same time, the public sector could play a very important role in supporting the development of private credit reporting by providing an adequate legal and regulatory framework, and by making information from public registries available to private sector operators as, for example, in Chile.

REVISING THE BNA CIRC REGULATIONS

The establishment and implementation of a public credit risk center by the BNA involves drafting appropriate regulations, drafting operating procedures, designing and procuring the hardware and software applications, and implementing the system, with due regard to the initial constraints to be faced by both the BNA and the financial institutions.

BNA’s goal is to provide the appropriate regulatory environment and credit culture for a credit bureau but not to restrain the development of a private sector credit bureau.

The consultant concentrated his work on the regulations but also provided advice on the other phases of the CIRC start up. The consultant reviewed the banking legislation in Angola as well as the relevant regulations affecting the establishment of a public credit registry to be implemented by BNA in Angola. The consultant also performed a review of the FIRST Initiative public credit risk registry regulations, as drafted.

The consultant communicated with the International Finance Corporation (“IFC”) regarding standards for credit registries as well as international best practices in developing nations with a focus on countries comparable to Angola. He also researched applicable legislation in several countries and examined the rapid growth of bank credit in Angola in recent years, including small or micro lending.

While Angolan financial institutions recognize that there is value in sharing information on the negative repayment history of borrowers, there is some reluctance in sharing much needed positive information. In addition, lenders prefer at this time that CIRC credit references do not identify the name of the creditor institution.

For loan transactions involving personal guarantors, the guarantor's name, identification code, guaranteed amount, and the condition of the guaranteed loan, are as important in the collection and reporting process as the information for the direct borrower. In fact, many individuals are both direct and indirect (guarantors) borrowers.

As defined above, credit risk involves more financial intermediation transactions than just loans.

The consultant conducted an analytical review of regulations drafted by the First Initiative, comparing them to international best practices and IFC standards. Based on all the above considerations, the consultant revised and expanded the draft CIRC regulations for Angola to better reflect international best practices and IFC standards. This included the following aspects which were not present in the early draft CIRC regulations prepared by First Initiative:

- A concise, complete and clear definition of the objectives of the CIRC;
- The capture and sharing of positive information on borrowers;
- The capture and sharing of full information on personal guarantors;
- A broad definition of credit risk and types of transactions;
- A format for reporting non loan transactions;
- Clearer definition of the integrity of data and the related consumer protection clauses as well as the time period for terminating the reporting of old transactions;
- Specific provisions for validating reported borrower information with the corresponding data line items of the charter of accounts in monthly statements.

The BNA held meetings with banks and other financial institutions that are to participate in the CIRC. The BNA also revised the draft regulations originally prepared by First Initiative. While in Luanda, the consultant held several meetings with concerned officials of the BNA including the Manager and Deputy Manager of the Financial Institutions' Supervision Department; the Division Chief of Financial Institution Supervision, Inspectors and other officials.

The first exchange served for the BNA to familiarize the consultant on its near and medium term intentions and of the understandings reached with banks and other supervised creditors. In turn, the consultant was able to brief the BNA team on evolving best practices and experiences. Subsequently, both parties worked at refining the attached CIRC regulations contained in the revised draft CIRC Aviso and Instrutivo.

Both parties also held open discussions on the value of the CIRC to enable bank inspectors to better supervise loan classification and provisioning requirements.

Now that the CIRC will track credit risk more broadly, the BNA also agreed with the consultant´s recommendation to emphasize in its training of bank supervisory staff the understanding and monitoring of inherent credit risks and the probability of contingent liabilities that non loan financial transactions can have on financial institutions.

The consultant recommended that, until such time as it will be practical to report the *name* of the specific lending institution for each transaction of a borrower or guarantor, the CIRC should, at a minimum, report the *type* of lending institution involved (bank, credit cooperative, microfinance institution, leasing company, factoring company, or other finance company).

The consultant recommended, and the BNA agreed, that the CIRC alert lenders when a borrower has a loan at another institution with a lower loan classification. As supported by the IFC, the consultant also recommended to the BNA to not expand the CIRC to commercial creditors in the future, but to consider exchanging information with eventual private credit bureaus that may be established. He proposed that private Credit Bureaus can be regulated by the BNA as auxiliary credit institutions as it is done in several countries, such as Mexico and Ecuador.