

THE WESTERN HEMISPHERE CREDIT & LOAN REPORTING INITIATIVE



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Project Summary

The *Centro de Estudios Monetarios Latinoamericanos* (CEMLA), with the support of the World Bank, is launching the Western Hemisphere Credit & Loan Reporting Initiative.

Following on the successful experience of the Western Hemisphere Payments and Securities Clearance and Settlement Initiative (WHI) funded by the World Bank and CEMLA, the central banks' Governors from Latin America and the Caribbean (LAC) agreed at a meeting held in September 2003 in Dubai to replicate the WHI model to credit and loan reporting systems within LAC through an initiative named the Western Hemisphere Credit & Loan Reporting Initiative (WHCRI).

The WHCRI comprises two major elements:

1. Definition of policies and actions for sub-regional integration of credit and loan reporting systems (CLRSs) in the LAC region.
2. a) Assessing (using a common assessment methodology) the CLRSs in seven LAC member countries (Mexico, Colombia, Brazil, Costa Rica, Peru, Trinidad and Tobago and Uruguay) in two phases.
b) Developing strategies and action plans for CRSs in the seven LAC member countries.

CEMLA and the World Bank have requested the FIRST Initiative funding to support this project. While the World Bank and CEMLA will fund the first element of WHCRI, FIRST will provide funding to support the following:

- The development of a common assessment methodology for CLRSs in LAC.
- Assessing, in a first phase and using the common assessment methodology developed, the CRSs in three LAC member countries (Mexico, Colombia and Brazil).
- Developing strategies and action plans for CRSs for these three LAC countries.

At the end of this phase, FIRST will consider additional funding support for the other four countries in order to complete the second element of WHCRI.

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Project Description

I PROJECT BACKGROUND AND RATIONALE

I.1 Introduction

The project named Western Hemisphere Credit & Loan Reporting Initiative (WHCRI) tries to replicate a successful experience in the payments system area in the LAC Region in which partnership between a regional (CEMLA) and an international organization (The World Bank), a cooperative approach with other international organizations and institutions with a high level of expertise in the area, country ownership and a high level mandate are the key factors for the success. The Western Hemisphere Payments and Securities Clearance and Settlement Initiative (WHI) is an example of a Regional Initiative that has created momentum for strengthening payments and securities settlement systems in LAC. It has a number of features that can easily be adopted for other areas of the financial sector and other regions. Thus, CEMLA and the World Bank representatives initiated conversations in spring 2003 to replicate the WHI model to other important areas of the financial sector in LAC.

Following these conversations, CEMLA and World Bank representatives made a presentation about the WHI and the possibility to replicate this experience to other areas of the financial sector in LAC at the XL Meeting of Governors of Central Banks of the American Continent (LXXV Meeting of Governors of Central Banks of Latin America and Spain) held in Seville (Spain) on May 15th and 16th, 2003. The Governors of the central banks of Latin America and the Caribbean recognized the success of the format of the WHI and decided to replicate the model in other financial sector areas. The Governors of the central banks of Latin America and the Caribbean met again in Dubai, prior to the World Bank-IMF Annual Meetings in September 2003, and gave the mandate to CEMLA to launch a Western Hemisphere Credit and Loan Reporting Initiative by identifying institutional and organizational arrangements as well as funding for this project. The Governors have also requested the direct involvement of the World Bank in the effort, recognizing the effective role played by the World Bank in the WHI.

I.2 The Importance of Credit & Loan Reporting Systems

Credit & Loan Reporting systems (CLRSs), which provide rapid access to standardized information on the past performance of borrowers (including both firm and consumer records), are an important institutional element for financial markets. Until recently, CLRSs had received only limited attention by policy makers, but this situation is changing in several ways:

- Advances in computer and telecommunications technologies in developing countries have made it easier and cheaper to develop effective databases.
- Many bank supervisory agencies have established or expanded credit registries with the goal of improving their information on aggregate exposures and risks of borrowers. Public registries both support supervisors' oversight of regulated institutions and, through distribution of this data in the market, improve the quality and scope of credit information available to banks for credit analysis.
- Decision tools, such as credit scoring, have also increased the value of credit histories and strengthened the incentives that banks have to share their credit data.

Many of the countries in LAC face similar difficulties with respect to credit reporting systems, including problems with the legal framework, lack of institutional capacity to enforce laws and regulations on credit reporting, limited availability of positive credit data and several weaknesses in the credit registries operated for supervisory purposes. These issues have also been identified as concerns through the FSAP process in LAC countries.

More specifically, in many LAC countries commercial (private) credit registries and/or credit registries established for supervisory purposes do not provide the full range of services that can be expected from this market infrastructure. Despite some progress in commercial credit registries in recent years, in many cases, creditors still refer to the registry for loan applications only because this is mandated by regulations. Financial intermediaries in many countries are also loathe to loose their "information rents" from their exclusive knowledge of their customer base and invoke bank secrecy laws to discourage the development of credit registries. Furthermore, databases are not very reliable due to the lack of a uniform, nationwide identification code for persons and firms, which means that a single person may have multiple entries in the system. Others are relatively new and have limited historical data on which to base credit ratings. These and other problems show a lack of awareness of the potential benefits of robust and efficient private CLRSs. In turn, CLRSs are not regarded as very useful by market participants, thereby forming a vicious circle that impedes further progress.

In LAC countries the credit registry industry is underdeveloped, typically dominated by a single firm or by non-profit organizations such as chambers of commerce or bank associations that collect credit data on behalf of their members. The limitations of private credit registries together with, in some cases, a legal and regulatory framework that discourages information sharing in the private sector, have prompted government officials in many nations to establish publicly operated credit information registries, typically through the central bank or the banking supervisory agency.

Most countries in LAC have developed this type of credit registries, but their role is very limited in terms of information sharing, more related to the supervisory activity. The latter systems can be characterized as "centralized credit risk registries". In general, the necessary functionalities have not been developed in such systems to trace promptly new credit extensions and other events that could have an impact on the aggregate risk for the banking system of business conglomerates. Thus, aggregate risk analysis in supervisory

agencies cannot be systematized and depends mostly on the criteria of individual analysts. Furthermore, the information collected and processed by supervisory agencies is not shared with market participants, which would probably enable the banking system to prevent (and not only to monitor on an *ex post* basis) undue concentrations of risk. In many cases, there are limits on the information provided by centralized credit risk registries, such as focusing only on large loan sizes or aggregating information so that the exposure of an institution with a given borrower is not disclosed.

I.3 The regional approach

Countries often face similar challenges in developing and modernizing their financial sector infrastructure. The ability to share experiences, problems and solutions across countries can strengthen (and accelerate, through peer pressure) the policies that each nation adopts and reduce the time and cost of modernization. By working together, countries may also identify areas where harmonizing policies would be beneficial. This has been the case with the WHI. The WHI has already assessed 21 countries in 4 years and as a result major improvements have been implemented. The WHCRI Project will attempt to replicate this successful model in the area of credit and loan reporting.

In summary, there are strong arguments to support a regional approach:

- As stated previously, many of the countries in LAC face similar difficulties with respect to credit reporting.
- Knowledge developed in one country can readily be shared and applied in others and policy makers will benefit from an exchange of ideas and information on this topic.
- A common regional approach to strengthening credit and loan reporting, including the development of a common assessment methodology and comparable reports, will facilitate change in individual countries and lay the groundwork for future regional co-operation. For example, in the European Union, publicly operated centralized credit risk registries share their data across country borders to help supervisors assess risk concentrations and connected lending.
- The establishment of a regional working group will give continuity to the reform process beyond the two-years proposed for WHCRI and beyond the seven initial countries selected.
- Regional projects create peer pressure.

II PROJECT ORGANIZATIONAL STRUCTURE

A core team of four/five technical staff will be formed within CEMLA (1/2 staff) and the World Bank (3 staff) to manage the project. One manager from CEMLA (CEMLA's Director General) and two managers from the World Bank (Financial Sector Manager for LAC and Payments System Unit Manager) will overview the work. Technical staff will include a combination of skills in the management of similar initiatives and in the technical area of credit and loan reporting systems. The core team will be directly responsible for the implementation of the project. Among its main activities will be: 1) developing a common framework for undertaking the studies; 2) organizing country studies by staffing the international team and working out relations with local authorities;

3) leading field activities and finalizing deliverables; 4) informing the International Consultative Committee (see below) and organizing its meetings; and 5) disseminating information about the Initiative inside and outside CEMLA and the World Bank.

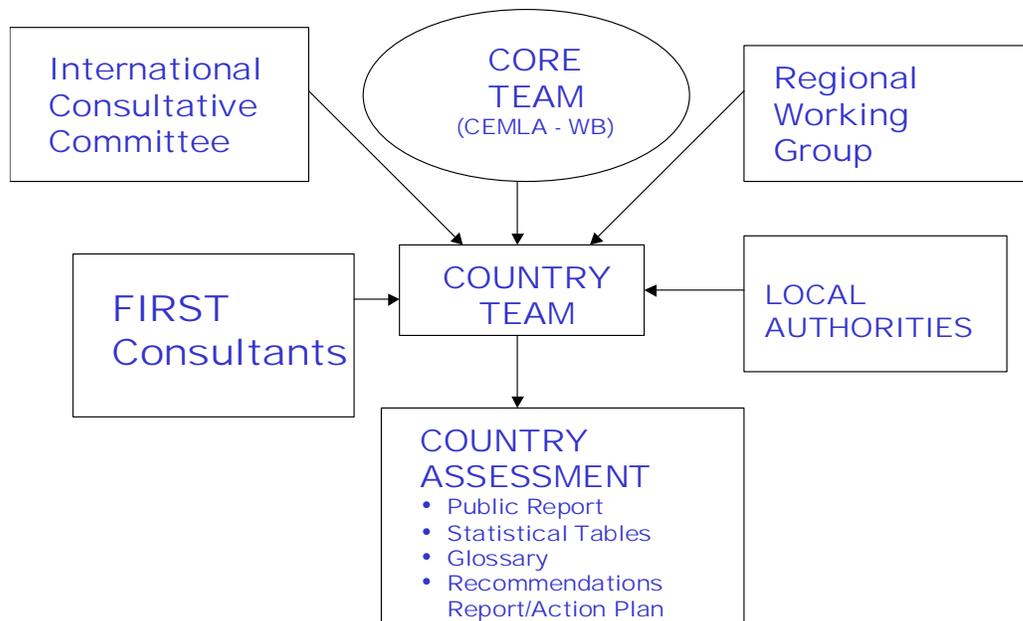
CEMLA will act as the Secretariat for the Initiative and will be committed to making the process sustainable through its extension to all the countries in the Hemisphere. The Initiative, with this purpose in mind, will help strengthen CEMLA's in-house expertise. The endeavors of the working group in coordination with CEMLA will maintain the infrastructure created under the Initiative and will provide a permanent forum for the countries in the Region to discuss, coordinate and add a collective impetus to the work in the area of credit reporting systems.

An International Consultative Committee (ICC), comprised of experts in the field from several institutions, will be established. In addition to representatives from CEMLA and the World Bank, the Committee will include members from other multilateral institutions (e.g. the IADB and the IMF), international authorities and market practitioners. The ICC will be designed as an integral part of the WHCRI project structure and its major objectives will be to: 1) bring to bear international and national expertise on the strategy and content of the Initiative (policy and practice) from institutions with diverse experience; 2) provide advice and guidance on specific credit reporting system issues; 3) help identify appropriate resources for technical assistance and for project support; 4) assure consistency with the most up-to-date thinking on the area; and 5) provide advice and ideas to encourage the development of the working group.

FIRST Consultants will support all activities of the project.

The organization of the project is shown in Figure 1.

Figure 1. Organization of the Project



III PROJECT OUTPUTS AND ACTIVITIES

III.1 Project's Outputs

The WHCRI will strengthen and enhance credit and loan reporting in LAC, contributing to the development of sound, competitive and modern financial markets in participating countries. Following on the successful experience of the WHI, the WHCRI will combine partnership between international and regional organizations (CEMLA-FIRST-World Bank), co-operation with other international organizations, country ownership and a reform-oriented approach.

The WHCRI comprises two main elements:

1. Definition of policies and actions for sub-regional integration of CLRSs in the LAC region. The key outputs of this element will include:
 - Standards and best practices in credit reporting will be defined.
 - Methodologies and tools for using credit information available in the CLRS in banking supervision will be developed.
 - Action plan for sub-regional integration of credit registries will be defined.
 - Rules, regulations and operational procedures for the data handling will be prepared.
 - Educational materials and consumer outreach strategy on credit reporting/credit culture will be developed.
 - Commonly shared regional policy document on credit reporting will be prepared.
 - The creation of a web page to present the outputs of the Initiative and other information of interest in the credit and loan reporting systems area.
 - The promotion of working groups to ensure continuity to the project.

2. Assessing (using a common assessment methodology) the CLRSs in LAC countries with a view to identifying weaknesses in their CLRSs regimes. The CLRSs assessments will also develop strategies and action plans to increase CLRSs usefulness, efficiency and economic impact while strengthening consumer protection and addressing privacy and security concerns. The key outputs of this element will include:
 - The preparation of public reports containing a systematic in-depth description of each country's credit and loan reporting systems. Public Reports are essential in creating a benchmark for the region in this area.
 - The delivery of Recommendations Reports to country authorities on a confidential basis, covering practical and strategic suggestions for exploiting improvement opportunities including: 1) short-term improvements, in streamlining rules, procedures and organization of credit reporting systems; and 2) long-term improvements, to ensure that credit reporting systems satisfy the evolving needs of all sectors of the economy (individuals, retail, industrial and commercial, government, supervisory authorities, financial markets and international sector) for financial sector related services.

- During country assessments, the organization of workshops and events focusing on issues of particular interest at the request of the authorities.

III.2 Project Activities

The main activities envisaged for the WHCRI are the following:

1. Launch Workshop. A workshop will be held at the beginning of the project (August 2004) to engage all involved parties in a discussion on the objectives, methodologies and outputs of the project. Through this participatory approach, stakeholders will have an opportunity to influence the project preparation, which will ensure country ownership. Furthermore, country representatives will begin a dialogue at a regional level, which will result at the end of the project in sustainable cooperation. Finally, the outcomes of the workshop will facilitate the in-country work of the consultants. The workshop will be held in Mexico City at CEMLA headquarters. CEMLA will act as coordinator of the workshop. Regional attendees will include representatives from a selected group of countries and from central banks, banking supervisory agencies and banker's associations. Consultants identified to carry out all the other project activities will attend and coordinate the discussions. World Bank staff highly experienced in the technical field and in managing regional initiatives will also support the workshop activities.

2. Field Work: Seven countries have been selected (Argentina, Brazil, Colombia, Costa Rica, Mexico, Peru and Trinidad and Tobago) and will be assessed by a team of international experts that will work in close coordination with local authorities. The team will prepare a confidential report identifying the main shortfalls in credit reporting systems and the policies, strategies and actions to enhance their performance. Descriptive reports on the status of the country will also be prepared to enhance the dissemination of information both within the country and at the regional level on these important issues. The international team will comprise 4-5 experts with CEMLA and consultants focusing mainly on implementation matters and the World Bank staff on policy advice and integration with other related issues (e.g. payment system matters). In particular, three countries will be covered in a first phase of the project (Mexico, Colombia and Brazil in expected chronological order) before results are evaluated and the project extends to the rest four countries. It is expected that all other countries in the LAC region be covered, should the project convert into a sustainable effort.

3. Policy Documents: Some important policy documents will be prepared by CEMLA and World Bank staff, with important inputs from the field work of the consultants, and will be discussed with country authorities and the ICC. Four main relevant policy issues have been identified:

- The definition of standards and best practices in credit and loan reporting activity.
- The definition of an action plan for sub-regional integration of credit registries.
- The preparation of typical rules, regulations and operational procedures for the collection, synthesis and dissemination of data.
- The preparation of a commonly shared Regional Policy Document on credit reporting issues.

4. Publications: Policy documents and descriptive reports will be edited and published in both English and Spanish (and in Portuguese in the case of Brazil).

5. Workshop 2005: A second meeting will be organized at CEMLA headquarters in 2005 to discuss the interim reports and status of the Initiative and agree on following steps.

III.2.1 Technical Secretariat Activities

The Technical Secretariat will be coordinated by CEMLA. The World Bank will also support the Secretariat activities in light of the unique experience accrued to World Bank Staff in the management of the WHI.

The Technical Secretariat will: 1) develop a common framework for undertaking the studies; 2) coordinate with all institutions involved; 3) organize country studies by staffing the international team and working out relations with local authorities; 4) lead field activities and finalizing deliverables; 5) inform the ICC and organize its meetings; 6) disseminate information about the Initiative; 7) administrate the Initiative web page in Spanish and English; 8) manage the network of communications within and outside of the project with participants and interested parties; 9) administrate the relevant documentation, in Spanish, English and Portuguese; 10) support conferences on relevant topics, organized on its own or sponsored by the Initiative, and 11) support to the regional working group.

The activities of the project are shown in Figures 2 and 3.

Figure 2. Activities of the Project: Phase I

Phase 1 (From May 2004 to August 2004)

Preparatory Work

- Preparation of relevant documents
- Initial contacts with ICC members
- Initial contacts with countries in the Region
- Identification of consultants

Workshops

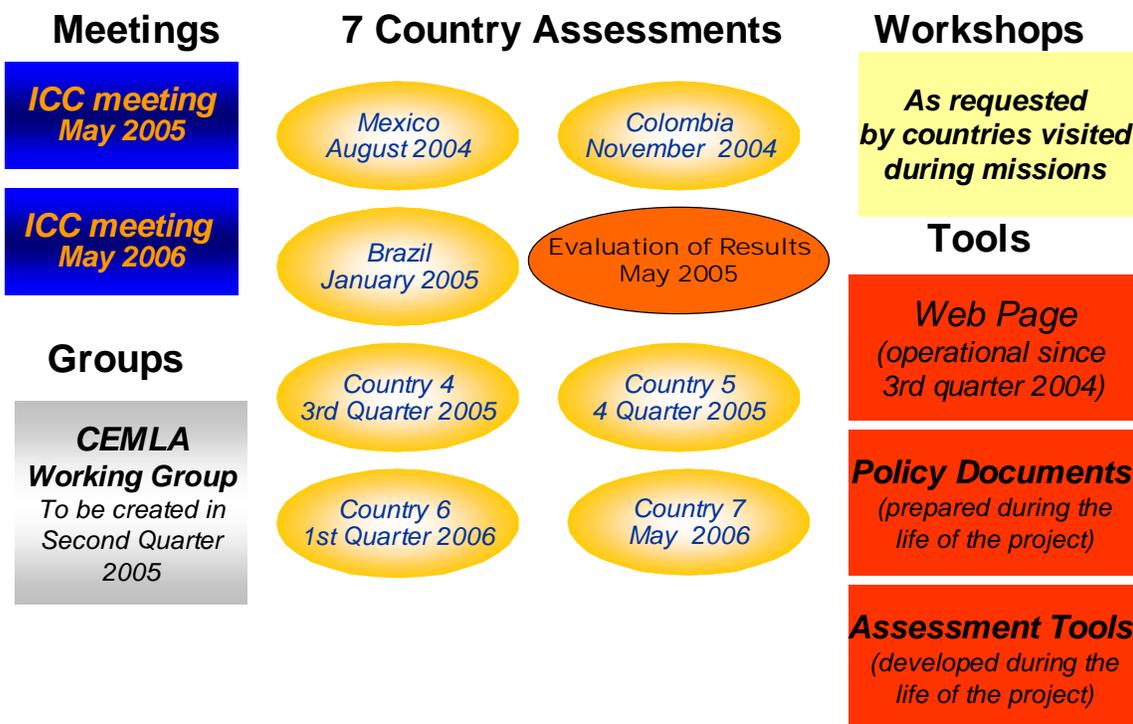
Launch Workshop August 2004

Meetings

ICC meeting August 2004

Figure 3. Activities of the Project: Phase II, III and IV

Phase II-III-IV (From August 2004 to May 2006)



IV PROJECT BENEFITS

The main benefits that are expected to accrue from the WHCRI are the following:

- A) An increased awareness in the LAC Region on credit reporting issues, which will create the momentum for the implementation of comprehensive reforms.
- B) An effective diagnostics and cost effective access to international experts, through the ICC and the Working Groups.
- C) The identification of a set of immediate actions and timetable for each country to improve its credit reporting schemes.
- D) A relevant improvement of information on the region's financial infrastructure, through the "Public Reports". A more informed debate on sub-regional harmonization and eventual integration of financial sectors, especially in the Caribbean and Central America. The establishment of working groups to give continuity to the reform process, which have already proven to be able to move forward their agendas effectively and independently. The strengthening of a Secretariat to give continuity to the regional effort and, in particular, the strengthening of CEMLA's in-house expertise.
- H) The development of specific country-studies tools based on international standards and best practices.

- D) The introduction of important economies of scale with FSAPs, whose assessments could benefit from WHCRI country missions, just as it has been the case with the WHI.
- J) The creation of a critical mass of local regional policy and operational experts, thus, facilitating harmonized and practical improvement in all significant aspects of credit reporting systems in the region, as well as the critically important oversight capability by country authorities over such systems.

V PROJECT TIMETABLE

The initial timeframe of the proposed project is two years. Several follow up implementation projects are expected, as in the case of the WHI. Also, the move from the Initiative format to the creation of a permanent Forum is envisaged after two years, as in the case of the WHI, in order to build a sustainable effort.

For the first two years the project will be divided into the following four phases:

Phase 1: Launch Workshop

A workshop will be held in Mexico City (at CEMLA headquarters), at the beginning of the project (by August 2004) to engage all involved parties in a discussion on the objectives, assessment methodologies and outputs of the project.

Before the start of the workshop, FIRST consultants, in co-operation with CEMLA and World Bank experts, will prepare the presentations for the workshop on the following topics: proposed objectives and outputs of the project; proposed methodology for assessing the credit reporting systems in the LAC countries.

FIRST consultants will attend and co-ordinate the discussions during the launch workshop. World Bank staff, highly experienced in the credit reporting area and in managing regional initiatives, will also support the workshop activities.

Phase 2: Field work in first three countries

FIRST consultants will refine the assessment methodology for credit reporting to incorporate the comments received during the launch workshop.

In close co-ordination with local authorities in the three countries, CEMLA, FIRST consultants and the World Bank will participate in the country studies of Mexico, Colombia and Brazil.

For each of the three countries, the following documents will be prepared using the agreed assessment methodologies:

- A descriptive report on the status of the credit reporting of the country. This public report will contain a systematic in-depth description of each country's payment system and will be disseminated both within the country and at the regional level.

- A confidential report identifying the main shortfalls in a country's credit reporting system and the policies, strategies and actions to enhance its performance. This report will be delivered to country authorities on a confidential basis and will include: short-term improvements needed in streamlining rules, procedures and organization of credit reporting; long-term improvements, to ensure that credit reporting satisfies the evolving needs of all sectors of the economy (banks, leasing firms and microfinance institutions, consumer and privacy advocates, etc.). The scope of the report will be broad and the systems will be assessed taking into account different aspects (legal, risk management, regulatory and supervision, IT, efficiency, cost of change, etc).

Phase 3: Workshop 2005

A second workshop will be organized at CEMLA headquarters in 2005 to discuss the results of the assessment undertaken in the first three countries, estimated to be concluded by the end of the first semester of 2005. FIRST consultants together with CEMLA experts, World Bank experts and ICC will review the reports on the three countries and discuss any amendments required to the assessment methodology. ICC will also provide input for future work and guidance of the WHCRI and for the rest of the Project.

At the end of this phase, FIRST will review the results achieved by the project and based on this will decide whether to fund the work in Phase 4 below.

Phase 4: Field work in other four countries

This phase will be the subject to a supplemental submission to FIRST's Steering Committee.

The consultants will provide support, at a level to be agreed, for country studies in Costa Rica, Peru, Trinidad and Tobago, and Uruguay.

The contents of the above reports will be similar to the contents of the reports produced under Phase 2 but will be produced mainly by CEMLA experts. FIRST consultants will provide advice to CEMLA experts on a when needed basis. This approach will ensure that the international consultants build capacity within CEMLA for carrying out the assessments in the remaining countries within LAC.

After the initial first two years the project will continue with phase 5:

Phase 5: Field work in the remaining countries of the LAC Region

The initiative will gradually convert into a permanent forum. The World Bank role will evolve from coordination to support of the initiative's activities. This will represent the achievement of one of the initial objectives of the WHCRI, namely the creation of capacity within the region to give continuity to the effort. The WHCRF (Western Hemisphere Credit & Loan Reporting Forum) will assess CLRSs in additional countries at the authorities request.

As mentioned before, the project has been designed so that CEMLA is represented in the missions to accrue expertise to effectively support the working group that will be created to make the project sustainable over the years. In this way, CEMLA experts and working group members will be able to take over the technical leadership of the project within 2 years. This was what happened in the case of the WHI, where CEMLA and regional experts members of the Working Group on Payment System Issues of Latin America and the Caribbean (WGPS-LAC) took the leading role in the tenth country mission. Since then, CEMLA and one WGPS-LAC member has led or co-led all other country missions (*i.e.*, 11 new missions out of a total of 21).

The WHI experience can also help to predict how the assessments of the remaining LAC countries in the area of credit and loan reporting will be financed. Starting with the 11th WHI country mission and on, assessments have been carried out solely on the basis of specific demand. The argument of a fully demand-driven task has enabled the involved institutions to allot resources from their regular budgets to finance team members.