

Timor-Leste: Strategy for Establishing a Credit Registry

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Abbreviations and Glossary

BPA	Banking and Payments Authority of Timor-Leste
BSD	Banking Supervision Department
CR	Credit Registry
FIRST	First Initiative Donor Group
IMF	International Monetary Fund
ISP	Internet Service Provider
LOE	Level of Effort
RFP	Request for proposal
TA	Technical Assistance
UID	Unique Identification Number
UNDP	United Nations Development Program
USAID	United States Agency for International Development
WB	World Bank

EXECUTIVE SUMMARY

The Banking and Payments Authority, and the Government of Timor-Leste, support the creation of a Credit Registry for Timor-Leste. This consultancy was initiated by the BPA and their support of the creation of a BPA registry was reconfirmed during this mission.

Support continues to exist, within banking sector, for the creation of a CR. All Timor – Leste licensed Banks support the creation of a CR. Management of these banks are familiar with the concept and purpose of a CR and, with one exception, have had direct experience in utilizing the information that would be provided by a CR.

Support continues to exist, in the non Banking sector, for the creation of a CR. MFI continue to grow and need a registry to provide enhanced information. The non bank micro finance industry has considered the establishment of a CR, for their proprietary information, but has not been successful.

Adjustments have been made, to the draft Central Bank Law that will allow for the creation of a BPA credit registry. It is anticipated the draft Central Bank Law will be in effect in mid 2007 thus allowing for the creation of the registry.

Many action items of the initial Future Road Map have been resolved. The BPA have made good progress and any incomplete actions could not be resolved until the consultant's return.

Further action items have been advanced, during this mission. There are many issues around the creation of a registry and there will be additional action items as the creation of the registry moves forward.

A technical report has been completed that outlines options for the creation of a BPA credit registry. That report is a separate document that has been provided to the BPA.

There is a need for TA for creation of Regulations and activity directed to the creation of a BPA credit registry. Technical assistance is required to assist the local BPA lawyer to create the document that will outline terms and conditions under which the credit registry will function. Preliminary discussions were held with the lawyer and examples of registry regulations, along with a statement of principles were provided.

Efforts are underway to source additional TA financial support. Meetings have been held with donors and the report outlines the TA required.

A determination as to how the purchase of hardware and software, for the creation of the registry, is to be made. The mission has moved as far as it can and now the effort should be directed to forming the registry and sourcing the funds required to build it.

A summary of current recommendations, and reference points, is found on Page 25 of this report.

1.2 Project Activity

This is the second mission of the project and presents an update of the Future Road Map issues from the first mission, actions resulting from the update, further recommendations, suggested next steps and, under separate cover, a Technical Report outlining suggestions for establishing and operating a credit registry in Timor – Leste.

1.3 Comments on Project Activity

BPA staff has been positive in their support of this mission's activity in arranging and facilitating office support, transportation, meetings and a workshop. There is a strong commitment from the private banking

sector, and non banking sector, towards the creation of a CR.

1.4 Other Comments

1.4.1 INTRODUCTION

The goal of this project is to deepen and extend the banking sector in Timor – Leste by strengthening the credit culture.

The purpose of the project is to establish the feasibility and roadmap for developing a Credit Registry for Timor – Leste.

To achieve the goal, the main objective is the development of a credit information system for Timor – Leste that would provide timely, accurate and reliable information regarding individual, SME and corporate credit payment behavior. Ways and means are continually being identified in order to enhance credit reporting in Timor-Leste that will ultimately lead to widespread use of this credit registry system in mobilizing retail, SME and corporate credit in Timor-Leste.

1.4.2 ACTIVITY SINCE FEBRUARY 2006 MISSION

The 2006 mission report included a number of action items which formed a ‘Future Road Map’. Following receipt of the mission report, a steering committee was formed that included Deputy General Manager Maria Jose Sarmento (BPA), the General Managers of each of the four commercial banks, representatives from two MFI that had automated databases (one of which has since gone out of business) and Helen Todd, program director with Moris Rasik, MFI.

The General Manager of the BPA held a meeting with commercial banks and representatives from two MFI, on February 20, 2006 to review findings and to reach consensus on a number of the action items.

On March 2, 2006 the Deputy General Manager conducted a meeting with a number of MFI as an informational session on credit registry activities.

It was anticipated the consultant would return to Timor in May 2006 to update progress on the Road Map, to assist with resolution of any outstanding issues and be accompanied by a technical expert who would provide a report on how to structure and implement a BPA credit registry.

Unfortunately civil unrest occurred in Timor resulting in the mission being cancelled, on the advice of the BPA and the World Bank.

It was not until January 2007 that clearance was received for the resumption of activity.

Since the two meetings, noted above, there have been two significant events. First was the appointment of Rafael Borges, a BSD Officer, as the manager of the proposed registry. Second was the important change to Article #36 of the draft Central Bank law that will be discussed later in this report. During the mission the draft Central Bank Law, that includes authority for the creation of a BPA Registry, was presented to the Government’s Council of Ministers.

1.4.3 TIMOR – LESTE FINANCIAL SECTOR

The Banking sector is still in its infancy and with the exception of the CGD bank, there have not been many credits granted, by commercial banks. There are three banks, and one quasi bank, supervised by the BPA. Combined they have a total of 15 branches for this country of 850000 people.

Name of Bank	# Offices	Start Date	Ownership	Credits Offered
Caixa Geral de Depositors (CGD)	Eight	2000	Subsidiary of Portuguese Bank	Consumer and business – no credit cards
Bank Mandiri (BM)	One	July 2003	Subsidiary of Indonesian Bank	Business only – no c.c.
Instituicao de Microfinancas de TL (IMfTL)-quasi Bank	Five	May 2002	Foundation of Poverty Reduction and Deposits	Consumer and Business – no credit cards.
ANZ	One	January 2001	Subsidiary of Australian Bank	Consumer & Bus – no c.c. are considering a joint retail credit project with MFI

The country's population is 850000 and the limited number of credits is a reflection of the conservative lending practices in Timor – Leste. These conservative practices are a result of the inability of Banks to determine and/or verify credit applicant's paying habits and debt structure. As well, there is a poor credit culture and most Timorese lack the discipline to properly repay their credit. In fact, the United Nations, in conjunction with ANZ bank, are soon to launch a financial literacy program to educate the local population in budgeting and debt repayment, among other topics.

1.4.3.1 THE MFI SECTOR

This sector is more active, than the banking sector, relative to providing credits to individuals and small entrepreneurs. **Appendix 'E'** represents a survey completed under the sponsorship of the DSP and UNDP, in September 2005, of selected financial service providers, including MFI, Credit Coops and NGOs. The non banking sector totaled **24547** credits.

1.4.3.2 HISTORIC INITIATIVES TAKEN IN THE CREATION OF A TIMOR-LESTE CR AND THEIR STATUS

On October 22, 2002 a meeting was held with banks, and other interested parties, at the BPA offices in Dili. It was agreed that the BPA would introduce an elementary register as the first step towards a more comprehensive credit registry. As a result of that meeting, a proposed database format, sample reports and a draft credit sharing agreement were developed. Unfortunately, other priorities emerged and the project was suspended. There had been no further activity until the FIRST Initiative approved this current activity.

1.4.4 UPDATE ON RECOMMENDATIONS FROM THE FIRST MISSION INCLUDING FUTURE ROAD MAP

During the 2006 mission a 'Future Road Map' was provided with action items that were to be addressed prior to this mission. The update on those action items are noted below:

1.4.4.1 Legal

The draft law for the Creation of a Central Bank of Timor-Leste was presented to the Government's Council of Ministers on February 19, 2007. This draft law contains Article # 36 that deals with 'Credit Information System'.

During the last mission it was recommended that wording be changed that would allow any credit registry to be open to credit information not only from entities supervised by the BPA but also to non bank supervised entities who conduct credit granting and other credit related activities. This is a best practice.

February 2007 Status: The recommendation has been accepted and the sections now read as follows (with changes noted in underline italics):

Art. 36

Credit Information System

1. The bank may operate, regulate, license, register and supervise credit information systems to collect and disseminate credit information amongst financial and other institutions and may issue regulations to effects its implementation.
2. The information collected and maintained in credit information systems referred to in the previous paragraph shall only be used for the purpose of improving the quality of credit. (the phrase 'bank credit' was reduced to 'credit')

Once the draft Central Bank Law is passed, and comes into effect, it will formalize the creation of a BPA credit registry as well as allowing for regulations to be created that will outline how the registry will function.

1.4.4.2 Steering Committee

It is suggested that a steering committee be immediately struck to commence a dialogue to deal with issues noted below. The committee should be comprised of representation from the BPA, banks and non banks. The committee should be chaired by a senior office of the BPA and driven by that person.

Some of the issues noted below, should be easily solved while others will require further input from international expertise. In reviewing the call reports, contained in Appendix 'B', it is obvious there are some significant differences to be addressed in a number of areas and it is important that the 'Greater Good of Timor-Leste' be the constant in working out consensus in these and other areas.

February 2007 Status: A steering committee has been created.

1.4.4.3 Should the providing of data to a CR be mandatory or voluntary?

The success of any CR is based on the amount of information that is provided for its database. In many jurisdictions the contribution of data is voluntary while in a few, it is mandatory, given the reluctance of data providers to share their information and it has been determined that a CR will not be successful without that information. Any mandatory sharing of data is normally directed to banks and mandated by Central Bank regulation. Local discussions have indicated data contribution will be voluntary and this should be confirmed, in writing.

Best Practice is that users of a CR must also provide their proprietary credit data in order to use the services of a CR. This approach should be included in any CR regulations.

February 2007 Status: It has been agreed, by all parties, that reporting of data to a CR will be mandatory. This mandate will be included in BPA credit registry regulations.

1.4.4.4 Who will participate in a CR and provide data?

Given the limited credit granting activity in the marketplace, the fact that both banks and non bank MFI are desirous of a CR, and the fact high delinquency percentages result from the lack of a CR, it would seem to make sense that both groups would participate in the creation and use of a CR.

A decision needs to be made on this issue.

February 2007 Status: It has been agreed that, in the first stage of the creation of a CR, that data from banks and the only automated MFI will be used to populate the database.

The rationale is that the commercial banks and selected MFI have automated databases and are able to provide data in automated format to a registry. Other MFI are not as sophisticated and when they, too, are automated, they would be considered for participation in a second stage, subject to BPA registry approval.

1.4.4.5 What data will be provided to a CR?

What information will be provided to a CR for distribution to authorized users? Best practice is noted in the charts below, for both credit information and demographic information. During meetings with various constituent groups, there was no consensus on what data will be shared. Some favored Best Practice while others were in favor of only limited information being shared. This needs resolution to understand the detail and of data that will populate a CR.

Credit Information (all data mandatory)

<i>Name of credit grantor</i>
<i>Date account opened</i>
<i>Original balance</i>
<i>Monthly payment</i>
<i>Date of last payment activity</i>
<i>Balance</i>
<i>Credit by sector</i>
<i>Manner of payment (1 to 9)</i>
<i>Security</i>

Demographic Information (* = Mandatory)

<i>*Name</i>

*Name
*Electoral Card# an/or Registration # for individuals and the <u>Taxpayer ID # for businesses</u>
*Address – Present and past
Birth date
City of birth
Marital Status – Spouse’s name
Employment History
Telephone or cellular #

February 2007 Status: It has been agreed that the recommended data will be reported to the credit registry. There have been several adjustments. First, the Manner of Payment will be replaced by the BPA Asset Classification Codes that are noted below. Second, for business credits, the identification will be the Tax Identification Number (noted above). ANZ bank, IMfTL and CDG Bank currently use the BPA Asset Classification codes. Bank Mandiri and Moris Rasik were alerted to the fact they will be expected to follow suit when they report credit data.

Assets Classifications

1. Standard- Unless one of the following definitions applies, an asset is Standard if it (1) is current; (2) the obligor is complying, and is expected to continue to comply, with all term of the contract; and (3) there is no reason to believe that the bank is now, or will be, subject to risk of loss.

2. Under Supervision- An asset should be classified as Under Supervision if potential weaknesses exist in the obligor’s financial position and/or the collateral pledged. Assets which are Under Supervision require the close attention of bank management, because if left unaddressed or uncorrected, these potential weaknesses could result in the deterioration of the repayment prospect for the asset or in the bank’s position in the future.

3. Substandard- An asset should be classified as Substandard if the asset has one or more well-defined weaknesses that make the full collection of principal and interest questionable: (1) the obligor’s financial condition (including net worth and/or repayment capacity) is unfavorable and is deterioration; (2) the pledged collateral (if any) is insufficient or is deteriorating; (3) other adverse factors exist which cause concern regarding the ability of the obligor to repay the credit in accordance with the existing repayment terms; and/or (4) there has been an actual breach of contract.

2

Assets classified as Substandard require management's active attention because there is a distinct possibility that the bank will sustain some loss if the deficiencies are not corrected. While losses will be realized in the total amount of all assets classified as Substandard, a loss will not necessarily be realized in each individual asset so classified. Non performing assets, which are at least 90 days past due, are at a minimum classified Substandard.

*4. **Doubtful** – An asset shall be classified as Doubtful when weaknesses exist which make collection or repayment in full highly questionable and improbable based upon currently existing circumstance, conditions, and the estimated recovered amount of the pledged collateral (if any). The possibility of losses very high; however, because of certain important and reasonably specific pending circumstances which could strengthen the asset, classification of the asset as Loss is deferred until it's more exact status is determined.*

Non performing assets which are at least 180 days past due are classified Doubtful.

*5. **Loss**- At the time of classification, the asset is deemed uncollectible and such little value that it should not be included on the accounts and financial statements of the bank. The classification of an asset as Loss does not defer writing off this basically worthless asset even though at least part of the value could be recovered in the future. Such classification does not cancel the obligor's obligation to repay, nor does it mean that the bank should not further exercise its full legal right to collection or repayment. Non performing assets which are least 270 days past due are classified as Loss.¹*

Of the four commercial banks in Timor, three currently utilize these classifications and are able to report them to a BPA credit registry. Bank Mandiri would have to make programming changes to provide this data and this has been reviewed with the General Manager of that bank.

It is anticipated that when data providers contribute their credit information, also included will be their proprietary credit identification numbers that will be captured by the system. Those numbers will be the key attribute for locating credit records, and placing data, when those records are updated.

It is understood that data contribution/transmission will be by automated medium only.

1.4.4.7 Will there be consumer rights and protections?

Best practice is that consumers have a right, entrenched in legislation, to receive (at no or minimal charge) a copy of their Personal, or Business, credit report on an annual basis. They have the right to challenge information they deem to be incorrect and the CR has the responsibility to investigate. This is a large cost center and experience has shown that in the initial stages of consumer rights, a CR will be

¹ Banking and Payments Authority of Timor-Leste Instruction CPO/B-2001/4. Asset Classification.

inundated with requests for information which will place a great burden on the CR and its costs. Some jurisdictions delay the offering of this option and wait for a year or two until the registry is fully operational and they are better prepared to handle consumer activity.

Timor-Leste does not currently have any consumer protection laws covering any subject.

If a decision were made to offer consumer rights and protections for a credit registry, the creation and passage of a comprehensive credit reporting law that would include consumer rights and protections.

A decision must be made on this subject.

February 2007 status – It has been agreed there will be consumer rights and protections, for Timorese, given it is a constitutional requirement even though there is not a consumer protection law in place. It has been further determined that these protections will not come into force until the credit registry database has been fully constructed and credit files are available to users.

1.4.4.8 A consent clause must be developed and included with credit applications.

It has been determined that, in order for banks to share information with other banks and non banks that the express written consent of consumers is required. To that end a standard ‘consent clause’ needs to be agreed upon and credit grantors who will use a CR must include it in their credit contracts in order to have access to CR information. A sample ‘consent clause’ was included in the mission report.

February 2007 Status: It has been agreed that a ‘Consent Clause’ will be mandatory however a specific clause has yet to be developed.

To further assist the BPA, attached to this report are four examples of ‘consent clauses’ as **Appendix ‘A’**.

New recommendation: That the consent clause examples be placed in the regulations, as examples to be used by registry users, in their credit applications. Use of any other consent clause should require the approval of the BPA.

1.4.4.9 Regulations must be developed for use of a CR.

There are concerns expressed that some users will indiscriminately check the CR in order to mine the information for potential future business. This, and other concerns, must be addressed in regulations that need to be developed by the BPA, with expert assistance. Efforts should commence towards the creation of such regulations.

February 2007 Status: During this mission discussion was carried out with the BPA legal officer and examples of best practice regulations were provided. The creation of regulations was not a deliverable of this project however funding should be sought to complete this project and it is estimated it could take four weeks of LOE for completion. See section 1.4.6.4 for details of meetings with BPA lawyer.

New recommendation: The BPA should seek funding for a consultant to assist with the creation of BPA credit registry regulations.

1.4.4.10 What type of Registry will this be?

In order to prepare a proper business and technical plan the type of registry that is envisioned must be agreed to by constituent groups.

There are three options:

1. A ‘full service’ registry that would include data from many suppliers, both bank and non bank, public record and any other potential sources. A ‘select’ service registry that would include data from a limited number of suppliers, both bank and non – bank but no other public record information. The size of the database would probably be no greater than 500000 files and 1 million trade lines. It would allow for web based access in addition to system to system access and other features. The data populating the database would normally reflect Best Practice.
2. A ‘basic’ registry that would contain a limited number of files and trade lines. Credit and demographic information would *not* reflect best practice but would be sufficient to correctly identify individuals to ensure accurate placement of information in the database and accurate retrieval of requested information. It would be a web based service that would provide only basic information on a borrower’s indebtedness and payment habits. It may be that this registry would be limited to banks and microfinance institutions, only, to start and then have the ability to expand beyond that group.

Following the conclusion of the workshop there was an informal discussion, with two of the banks, and the opinion seemed to be they would consider providing monies for a CR on the basis it would be an investment for the future. There was no commitment made but the tone of the discussion was encouraging. Prior to the workshop, all banks reconfirmed their view they would see any registry being housed and operated by the BPA.

February 2007 Status: There was no resolution to this issue, prior to commencement of this mission, nor was there expected to be one. The separate Technical Component report provides detail on how the technical consultant is recommending that the BPA proceed using Option # 3. Based on the presentation of the technical consultant, the BPA is now better able to determine which is the best option. Costing is also included in the technical report.

1.4.4.11 Who will pay the cost of building and operating the Registry?

Once the type of registry is selected, and there is an understanding of the construction costs, a determination will need to be made to where the funds will be sourced to pay for the costs on the assumption it will be a public registry. A business plan would then need to be created to anticipate operational costs and a determination if they will be funded by user fees and if the users are prepared to pay the costs.

February 2007 Status: Not as yet determined however the technical consultant has provided a cost estimate of hardware and software procurement necessary for the creation of the consultant’s recommended solution for the creation of a BPA CR. Once the BPA have made their decision on which database to create, they will have to secure funding.

During the mission, briefings of the project and discussions were held with USAID, IMF and World Bank officials to gauge their interest in assisting financially in this endeavor. Banks were also appraised of the needs for funding support.

1.4.4.12 Who will own the CR and will it be public or private?

While the SOW of the mission indicates the BPA desires to establish and operate a CR it is not clear whether or not there will be an owner of a CR. This will have to be established. As noted above there will be a cost component to be incurred and it is not clear if the BPA will absorb those costs or if banks will make a contribution and in so doing want ownership with the BPA operating the CR. It may be that others may be willing to make a contribution. Or it may be a donor that will provide the funding. Once a cost

base has been established, this issue will need to be resolved. It would be better that, between missions, some consensus is achieved on this issue and that some preliminary discussions occur on the willingness of banks, non banks and donor groups to consider contributions.

If there is a private investment component, will it be a private company?

February 2007 Status: Agreed the CR will be public and in the near term will be owned by the BPA.

1.4.4.13 Where will the CR be physically housed?

On the assumption that it will be a public registry, operated by the BPA, will it be in the BPA building or will it be at an off site location? If off site, there will be additional cost for plant security etc. The current BPA building has sufficient room to house a small computer system that would house the CR data and be manned by two or three staff.

If it were a private registry, there would be similar considerations and if it were a regional CR then a database would already be in place.

February 2007 Status: It has been agreed the CR will be housed in BPA premises.

1.4.4.14 Who will manage the CR?

Assuming a CR is housed by the BPA, should an outside expert be hired, for an interim period, to oversee construction and management of a CR? Or should someone from Dili, who is experienced in database management be hired and be supported by international expertise?

February 2007 Status: It has been agreed the CR will be managed by the BPA and to that end, Rafael Borges (BSD Officer) has been appointed Manager of the CR.

1.4.4.15 How will Individuals and Business be identified?

There are several numbers issued to individuals. Two of these should be selected as key identifiers for placement in a CR database. Factors to be considered, in this decision, are the total number of cards issued for each of them; the reliability and currency of each of them and which ones are used by credit grantors to identify their customers.

February 2007 Status: It has been agreed that two types of identification number will be used for individuals and one for businesses. For individuals, the electoral card and the registration card will be used and for businesses the Taxpayer ID # will be used.

1.4.4.16 Determine the number of credit applications taken by future participants in a CR

Once it has been decided which companies will participate in a CR, a survey should be completed of those companies to determine the number of credit applications taken, on an annual basis, by each one. This information will be used in preparing financial projections for a CR as well as capacity needs in a credit registry to meet the demands for inquiry searches of the database. It is anticipated that each application will result in a search of a CR database and there will be a fee for each search that is completed. Searches are the revenue generator for a near term CR.

February 2007 Status: During the mission, a survey was completed of the four banks, and Morris Rasik MFI, who would be the data providers and users of a BPA registry in the first phase of development..

1.4.4.17 Study Tour

A donor should be approached to obtain funding for a study tour of credit registries in other countries. As example, Portugal has both a private CR and a public CR. It would be practical to see the registries first hand and find out how they operate and learn from their experiences. At least two countries should be visited and the tour should also include meetings with industry regulators. Contact was made with USAID, by the consultant, to suggest they provide funding for a tour as a component of their financial services project.

February 2007 Status: There will likely be a study tour arranged but dates have not been set nor has a locale. It is probable the tour will visit the Central Bank of Portugal.

1.4.4.18 A System Development plan must be created

There needs to be road map for the creation of the registry database. This would include a work plan with system components, database design, data model and timelines for completion. This would be created by an international consultant with expertise in the creation of CR databases. The plan would then be executed or presented to potential vendors who may have some software that would provide the base for a CR and would need customization. This will also include data formats, processes for transmission of data, construction of system logic for placement and retrieval of data, access methods for requesting information, format of reports that will contain requested information etc.

There are many other more detailed issues, that will arise, but these are some of the major issues that could be immediately undertaken for discussion and those that cannot be resolved could be left for the next mission when guidance could be provided by the consultant.

The question has been asked by a number of individuals. “Will our CR be like other registries?” The answer is always the same. It will be a local solution, based on unique local circumstances and determined by stakeholders. No credit registry is the same.

February 2007 Status: One of the purposes of this mission was to engage a technical consultant who would assist with the creation of this document. The plan is contained in the separate Technical Report.

1.4.5 ADDITIONAL RECOMMENDATIONS AND ACTION ITEMS

1.4.5.1 Management Reports

The primary purpose of a public credit registry is to assist banking authorities in discharging their responsibility of ensuring the safety of the banking sector. This is accomplished by creating relevant management reports from the credit data collected from commercial banks, which populate the public registry database. These reports are analyzed to identify possible trends in banking sector credit weakness, growth and any other need that might be identified by a central bank.

The information contained in these reports may or may not be shared with commercial banks given this is a BPA management decision.

Attached **Appendix ‘F’** is a listing of some of the best practice reports that have been developed. They should receive consideration from the BPA for inclusion in their credit registry. These reports can be used to create graphs, charts or other vehicles that will allow for monitoring and recognition of trends and problem areas.

1.4.5.2 Language of database reports

In discussions with commercial banks and Moris Rasik MFI, they have requested that credit reports be made available in four different languages. The two that all agree is Portuguese (Timor official language) and English. Tutun and Indonesian are the other two languages requested.

The BPA needs to decide which, if not all, of the requested languages should be utilized in providing detailed information in a BPA credit report. The technical report discusses this subject in some detail.

1.4.5.3 Web based access

There are a number of options by which users of a credit registry are able to access information. These are: phone request; fax request; using proprietary software to access the registry database; web based access; computer to computer.

The BPA has a website and in accordance with best practice it is recommended that the website be enhanced to allow for access, via the site, to the registry database to request credit files. Via the web is the most efficient, and cost effective, medium to use. All banks, and the MFI, have the ability to use this access method and have indicated their preference for this solution.

The BPA website is being redesigned to become an on line, real time site and this will allow for the proposed web based access.

In simple terms, an icon would be created on the web page that, when activated, would take the user to the registry database site. An input screen would appear and the user would input identification information of the user (user name and password) and required and optional information

Recommend that Web Based Access be the only method used for requesting and returning credit reports.

1.4.5.4 Reporting of loan provisions

The amount of loan provisions, by commercial banks on credits, is critical to the health of banks supervised by a central bank. The higher the provisions, as measured against a commercial bank's assets, the greater the risk for possible failure.

Best practice is for commercial banks to report this information, to a central bank registry, attached to each individual credit that is reported to a registry. It is also reported with each monthly update of these credits.

Central banks capture this information, in monthly reports, as they conduct risk based supervision of commercial banks. They match the information, on a monthly basis, against assets and compared to previous periods (monthly, quarterly and year over year).

The information is used as an 'early warning system' of potential bank problems and by bank inspection teams to verify the information is accurately reported.

This information can be broken down by sector, region, industry, type of borrower etc. or utilized as BPA regulators may determine.

Recommend that commercial banks be required to report individual provisions in their regular submission of credit data to a BPA registry.

1.4.5.5 Penalties and fines

The integrity of any public or private credit registry, and the trust afforded to it by users, is based on information being complete, comprehensive and factual. In order to ensure that is the case it is critical that all data suppliers provide information on all credits and with full and accurate detail. In some jurisdictions meeting this objective has been a serious problem and, as a result, a central bank credit registry best practice has been to establish a level of penalties, in the form of fines, to be levied when commercial banks fail to report required credit information to a credit registry or reported information is inaccurate.

A review of Regulation No. 2000/8 ‘On Bank Licensing and Supervision’ has determined that Section 36, ‘Infractions, penalties and remedial measures’ (as noted below) provides for fines and penalties for violations.

Recommend that Section 36 of Regulation No. 2000/8 be applied to required data contributions, and usage of the registry, by financial institutions under the supervision umbrella of the BPA.

1.4.5.6 Reporting threshold

In Timor-Leste, banks have agreed that there will be no reporting threshold and only Moris Rasik, the propose MFI contributor in phase one, has indicated a concern. Their issue is the amount of work necessary to prepare monthly credit data submissions to a BPA registry. Until such time as Rasik have updated their software, they are proposing that they provide only accounts with balances greater than \$800. This seems a reasonable request and when the registry is able to accept credits, Rasik may already have upgraded their software and their request will be moot. During the roundtable discussion, the proposed number was lowered to \$500, by the MFI, while discussion suggested the threshold could be as high as \$1000. There was consensus, though, that for the present, a threshold was reasonable for the MFI.

Recommend that all credits be reported to the registry, regardless of balance. Consideration should be given to Moris Rasik for a temporary limit until their software is upgraded to allow for all credits to be reported.

1.4.5.7 Linking of businesses with individual owners

There are some borrowers who obtain personal credit for funds to be used towards a struggling business that is fully extended in business credit. As well, there are some business borrowers who may need personal credit yet lenders may not be aware of these borrowings, which may be a factor in credit decisions. Best practice is for data providers to include names of business principals in data submission to a credit registry.

Recommend that information on business principals be provided to the BPA credit registry, on each business credit being reported.

1.4.5.8 Frequency of reporting data to registry

Best practice is for the details of newly funded credits to be reported within two business days of the funding. For credits currently existing in a credit registry, those credits should be updated on a thirty day basis and normally within the first ten days of each month. Reporting should be completed by electronic means.

Recommend that existing credits be updated monthly and new credits reported within two business days of funding.

1.4.5.9 Charge for inquiry searches of registry

The BPA will be incurring significant expense from both a hardware/software acquisition perspective and from a personnel commitment, in order to construct the registry, assuming no donor support for the initiative. They will incur significant expenses until such time as the registry is available for search inquiries.

In order to recover most, or all, of these costs it may be appropriate for the registry to charge a fee for search inquiries, of the registry database, once the registry is operational. This is the method which private and public registries use to generate revenue and the (name of central bank) should consider following the same policy.

Once the registry is operational there will be normal operating costs to be recovered in the expectation the registry will be operated on a 'break even' concept.

Once capital investment is returned, search fees would be adjusted to relate to operating costs only.

In order for this to work banks should be required to complete inquiry searches on all credit applications. This would serve two purposes: the first would be to ensure that banks have a complete picture of the applicant's debt structure and payment history and second to generate sufficient revenues for the registry to cover their operating costs.

The fee amount would also have to make allowance for the value of information that would be utilized by the BPA in conducting its supervisory activities. That is to say that the initial fee should be adjusted downward to make the search fee more reasonable for users of the BPA system.

A fee structure would normally require that an accounting system be developed, at the same time as the registry. The accounting system would include a detailed billing feature and normally monthly invoices, with this detail, would be sent to each bank branch that conducted search inquiries. As an alternative, once the registry is operational, a quarterly report of all inquiries made, by bank and by branch, could be created and an appropriate fee attached to each inquiry and monies requested from each bank's head office.

Recommend the BPA adopt two policies. The first is that inquiry searches be conducted on all completed credit applications and, second, that a reasonable fee be adopted to cover any initial costs of the registry and ongoing operational costs of the registry.

1.4.5.10 Payment Pattern

Payment pattern is a **best practice** and provides the user with the history of the actual manner of credit payment on individual trade lines (record of payment of an individual credit) for a period of up to twenty four months, by month.

Recommend including payment pattern in design of registry database.

1.4.5.11 Marketplace Education

Timor-Leste is a primarily a 'cash society' operating within an informal market. This situation is changing by virtue of the fact that some Government agencies are now directly depositing individual's salaries into banks. With this change, several banks have indicated they wish to pursue growth in their retail credit portfolios which means Timor-Leste is slowly moving in the direction of a credit society. The number of current borrowers, through the banking sector, is less than 3% of the country's population.

The initial mission identified the fact that individuals have little discipline when it comes to taking responsibility of voluntary debt repayment.

Understanding and promotion of credit is generally left to credit grantors while Government focuses on educating consumers relative to their rights in regards to credit bureaus what they are entitled to obtain from credit bureaus in terms of personal files and opportunities to challenge what the consumer believes to be incorrect information in their credit files.

With these new borrowers entering the marketplace it is vital to educate them regarding the value of credit and the benefits of responsibly borrowing and repayment and the impact their actions will have on their credit registry report.

1.4.6 OTHER ACTIVITIES AND RELATED OBSERVATIONS

1.4.6.1 Central Bank Law

As noted in Section 1.4.4.1 the draft Central Bank Law was submitted to the Government's Council of Ministers, on February 19th, 2007. The Government has indicated they wish to have the draft Central Bank Law, and a number of other organic (for the establishment and functioning of public institutions) draft laws, passed prior to the upcoming elections in April 2007.

The law coming into force will allow for the establishment of the BPA credit registry.

1.4.6.2 Workshop

A workshop was held on Wednesday afternoon, February 21st at the BPA offices a Power Point presentation was made by the credit registry consultant: 'Timor-Leste Credit Registry Mission 2' was the subject and covered past activities, activities this mission and the future. An outline of the roundtable is included as **Appendix 'C'**. Queries, from the group, were answered to their satisfaction.

Twelve individuals attended. The attendees represented Banks, non Banks, the WB and the BPA. The workshop was chaired by BPA General Manager Abraao de Vasconselos

1.4.6.3 Training

During the mission, the credit registry consultant ensured both the Deputy Director of the BPA, and the newly appointed Manager of the BPA registry, were present during meetings and at the workshop. The purpose was to assist them in continuing to gain an understanding relative to some of the basics of a CR. They had the opportunity to hear questions and answers as it related to a CR.

On Monday, February 12, a meeting was conducted with the newly appointed manager of the credit registry, the off site manager of banking supervision and the Deputy Director of the BPA. The meeting was to outline the process of creation of a credit registry and how the data from a registry will assist the BPA as it conducts its supervision of the banking sector. There was also discussion of how the registry would assist banks in the completion of their credit adjudication process.

Periodic discussions, with General Manager Abraao de Vasconselos occurred throughout the mission.

This type of 'in field' training can only serve to assist the BPA in gaining a greater understanding of the key elements of a CR and to witness the reaction of potential data providers/users of a CR.

This type of approach should continue in any future missions.

1.4.6.4 Regulatory and legislative options for the BPA:

- **The short term:** The BPA has included a section on credit registry in the draft Central Bank Law that is expected to be passed by mid-year. This is being followed by regulations that will provide framework and operational details for the functioning of the registry. Given this is a Central Bank registry, these initiatives represent best practice and there is no need for any further activities in this area, for the short term. What is necessary, upon completion of the construction of a registry database, is the revision of regulations to provide consumer rights and protections and instructions for the handling of these rights and protections.
- **The mid to long term:** Looking to the future, the creation and passage of a credit reporting law, that will frame a robust credit reporting industry beyond banks and MFI, would be in order. This is a best practice, and necessary, given various types of non bank data would be included in a database (telecom and retail credit as examples) and the likelihood of the information being moved to a private ‘for profit’ credit registry. A law would provide comfort to potential private investors who might consider establishing a registry and would be secure in knowing the legislated rules and whether those rules would allow them to conduct a profitable business. A law would allow the registry to operate independently from the BPA.

During this mission, two meetings were held with the BPA legal advisor, A. H. Sagan. The first meeting was held on February 16 in order to provide documentation on the principles of credit registry regulations, along with some recently completed regulations, from two other central banks. An explanation was provided relative to the documents. The second meeting, on February 21, was held to review questions from the advisor, provide examples of four consent clauses, and the need for TA to assist him in completing the regulations. The BPA Deputy Manager also attended the first meeting.

1.4.6.5 Licensing

In the near term, with the BPA owning, housing internally and managing the registry, there would be no need for any type of licensing, with itself. Should a private operator choose to enter the market then the BPA should set up licensing standards that would require the private operator to ensure that BPA regulations are followed and enforced amongst data providers.

Currently the potential for a private operator to commence a registry business is extremely limited. The potential business activity, that generates revenue, would not come close to allowing a private company to recoup their capital investment nor to cover annual operating costs while anticipating a profit. It would be far less risky for a private operator to take their capital investment and place it in secure deposits than to take a chance in a fledgling credit market, such as Timor-Leste. It has been empirically proven that if there is no hope of capital investment return and a break even on operational costs, within two to three years, a private operator will not invest in a credit registry.

In addition to the cost recovery factor, no private operator will enter a market until there is certainty with laws and regulations. A credit reporting law would have to be passed in order to create this certainty and this process would normally take approx. two years, based on recent examples in Ukraine and Kazakhstan. So the likelihood of a private operator entering the Timor-Leste market would not be considered until a credit reporting law is in place.

1.4.6.6 Phase Two of data contribution

It has been agreed that, in the first phase of database construction that the four commercial banks and Moris Rasik MFI will be the contributors. They have automated databases and in order for the registry to have maximum efficiency, data providers must contribute data in automated format.

Many MFI do not have automated databases and, until they do, they are not good candidates for data contribution. USAID have indicated, in principle, they have funding to assist these MFI with hardware and software purchases, that will allow them to establish databases, and functionality, that could provide automated data transmission. TA could also be provided for training purposes.

Once data automation is confirmed, the BPA would have to satisfy itself of the readiness of the MFI, or other non bank entity, to contribute data prior to any approval for phase two entry.

Phase two could see the contribution of Timor Telecom's credit data to the BPA CR.

With the entry of non bank entities agreements would have to be signed that would link credit registry regulations with a data sharing agreement.

1.4.6.7 Donor Activity

It is clear that the BPA does not have the necessary funds and/or the expertise, to handle creation of credit registry regulations; the purchase of hardware and software for the credit registry; technical assistance for an RFP for the creation of the registry; oversight of the database creation process.

Three potential donor groups – USAID, IMF and World Bank – were contacted and ‘in person’ meetings held to review the status of the project and the need for additional funding. Reaction from all groups was positive. It is now up to the Managing Director of the BPA to provide follow up, to address specific needs as identified in the update Road Map.

1.4.6.8 Draft Service Level Agreement

In the first mission, a ‘best practice’ draft service level agreement was provided that would outline relationship between banks and the BPA relative to elements of a BPA registry. It has been determined that many of the points in this agreement would be included in the regulations for the BPA registry with relevant sections being drawn from this agreement for placement in regulations. There is no need for a service level agreement once regulations are in place. The regulations would be enforceable once the Central Bank Law is passed by Parliament and made effective.

Commercial banks have been made aware of the future creation of BPA registry regulations, what would be included and their responsibilities.

1.4.7 NEXT STEPS

With the introduction of the draft Central Bank Law, to the Council of Ministers, the first priority is to ensure passage of this legislation to allow for the creation of a BPA credit registry.

In tandem with the passage of the legislation, two primary issues need to be addressed. First is the creation of CR regulations and the second is commencement of activity for the creation of a BPA registry.

1 – **Regulations need to be created.** The creation of regulations would normally take approximately **four weeks of TA**, by a consultant experienced with credit registries and credit registry regulation. The consultant activity would include off site work and a mission to finalize the regulations. The time period for the creation of draft regulations would take from two to three months, or more, depending on the work commitments of the BPA registry department which is currently staffed with only one lawyer. There would be perhaps three or four drafts before finalization. The local BPA lawyer would need to ensure that any relevant local issues are addressed in the regulations.

2 – **Activity towards creation of a registry should commence.** Steps should be undertaken, in the following order:

- a. Decision to be made on which model will be approved from the report of the technical consultant;

- b. A consultant should be engaged to assist with the first step, which is an RFP. The steps of the RFP process would include: agreement on scope; technical study; preparation of RFP defining process of selection; issuing of RFP; selection; contract negotiations. The consultant would work on all steps. The required **TA would be approximately eight weeks.**
- c. Successful bidder, of the RFP, would commence activity towards construction of the registry would commence in include: defining high level requirements, system design (five components), database design (two components); test mode; live system.
- d. During the process, following engagement of a contractor to construct the database, TA is required for quarterly visits, by a registry expert, to monitor the creation of the registry. The TA would be for one or two week increments, for approximately one year. It would also allow for 'off site' assistance, as may be required. **TA would be at least eight weeks.**

3 – **TA needs to be obtained in #1 and # 2.** Donor groups have been approached for assistance and the BPA will continue follow up efforts.

4 – **Resolve funding for purchase of hardware and software for credit registry.** Once a solution is selected, for the registry, BPA management needs to determine how the purchases will be paid for. This could be from donor funding, from the BPA, from the government or a combination of them.

5 – **Follow up on 'Additional recommendations and action items' from section 1.4.5.** A summary of these recommendations follows section 1.4.8.

APPENDIX B: MEETINGS

Meetings were conducted by the Credit Registry Consultant, Jim Aziz.

Subject: Meeting with BPA Managing Director Abraao de Vasconcelos

Meeting Date: February 12, 2007

Attendees: Maria Jose Sarmiento (Deputy GM BPA), Brian Smith (Technical Consultant) and Jim Aziz (Credit Registry Consultant).

The purpose of this meeting was to brief the General Manager on proposed activities during the mission and to address any issues he had. The SOW for both the Credit Registry Consultant and the technical consultant were reviewed.

Subject: Meeting with Banking Supervision Department

Meeting Date: February 12, 2007

Attendees: Maria Jose Sarmiento (Deputy GM BPA), Rafael Borges (BPA Supervision Officer and Registry Manager), Pasceoela M. R. da Silva (BPA Off Site Inspector), Brian Smith (Technical Consultant) and Jim Aziz (Credit Registry Consultant).

The **purpose** of this meeting was for the consultant, Jim Aziz, to review the value of a credit registry system from both a banking supervision view and from a commercial bank view and to discuss the past, present and future of a BPA registry. Primary to this group was how they would use the information that would populate a credit registry database - for statistical purposes; credit monitoring purposes and as an aid as they move towards risk based supervision.

Rafael, as the new manager of the registry, accompanied the consultant on all field contacts to gain a greater understanding of the issues surround the creation of a credit registry

Subject: Meeting with BPA Deputy Managing Director Maria Jose Sarmiento

Meeting Date: February 12, 2007

The **purpose** of this meeting was to obtain an update on all activities since the February 2006 mission, status of the various Future Road Map items and other issues arising out of the discussion.

Subject: Meeting with BPA Managing Director Abraao de Vasconcelos

Meeting Date: February 19, 2007

Attendees: Maria Jose Sarmiento (Deputy GM BPA), Brian Smith (Technical Consultant) and Jim Aziz (Credit Registry Consultant).

The purpose of this meeting was to brief the General Manager on findings to date, items for discussion at the roundtable to be held on Wednesday, February 21st, priorities for the immediate future. There was amplification discussion and clarification on several issues.

Subject: Meeting and luncheon with Donors – IMF and World Bank

Meeting Date: February 20, 2007

Attendees: Tobias Rasmussen (IMF Resident Representative for Timor), Enrique Aldaz-Carroll (World Bank Economist Finance, Private Sector Development & Trade), Managing Director Abraao de Vasconcelos, Maria Jose Sarmiento (Deputy GM BPA), Nur Aini Djafar Alkatiri (Deputy GM BPA) Brian Smith (Technical Consultant) and Jim Aziz (Credit Registry Consultant).

Highlights: Meeting organized by MD of the BPA to provide potential donors with current activity on project and outline need for funding.

- Reviewed history and status of project and future plans for the creation of a BPA public credit registry;
- Outlined specific needs – TA for creation of regulations and funding for purchase of hardware

and software for registry database, funding for consultants to construct build registry database and funding for follow up TA as registry is being constructed;

- Discussion ensured on many areas of the project.

APPENDIX C: FEBRUARY 21, 2007 ROUNDTABLE MEETING OUTLINE

1. Current status:
 - a. Mandatory reporting – will be in regulations;
 - b. First phase – Commercial banks and one MFI;
 - c. Positive and negative data;
 - d. Credit data to be provided – 6 points, substitute asset classification for Manner of Payment; credit by sector; credit grantor name is masked;
 - e. Demographic data to be provided – name, address, Electoral Card/Registration card for consumers and Tax ID # for business; optional DOB, City of birth, marital status, employment, phone – the more data the greater likelihood of comprehensive data;
 - f. Consumer rights and protections – when database built;
 - g. Consent clause – four examples in regulations – other requires BPA ok. Start now;
 - h. Registry – owned, housed and managed by BPA.

2. Action items:
 - a. Regulations – guidelines for operation of registry, data contribution, protection of data, cleansing of data at both ends, consumer rights and protections, consent clause, details of data contribution etc;
 - b. Threshold;
 - c. Language – decide on number;
 - d. Web based access;
 - e. Loan provisions;
 - f. Link individuals to businesses;
 - g. Electronic medium to report data;
 - h. Report update credit every 30 days, new credits in 2 business days;
 - i. Tape data – clean up at source and further edits at BPA;
 - j. Payment pattern;
 - k. Phase 2 data contribution.

3. Technical – Technical Consultant

4. Time Lines:
 - a. Establish sources of funding for two primary initiatives – regulation creation and funding of registry. Possible sources – donors, BPA, Government, banks etc.
 - b. Regulation – consultant working with BPA legal department – take 2 to 3 months depending on workload of BPA legal.
 - c. Registry – define hardware and software needs;
 - i. Consultant to assist with RFP – agree on scope; technical study; prep of RFP including defining process; RFP; selection; contract negotiations.
 - ii. Commence construction process

Time period 9 to 12 months.

- d. define high level requirements
- e. construction begins
- f. data loaded
- g. test phase
- h. live

Time period of up to 12 months.

5. TA – assistance on RFP prep., selection, contract negotiation, high level requirements and quarterly visits, by an expert, during construction stage. Retainer for remote assistance.

All of the above is predicated on passage of Central Bank Law that was presented to Council of Ministers on February 19, 2007.

APPENDIX E: SURVEY OF FINANCIAL SERVICE PROVIDERS

Summary of Outreach and Performance of Selected Financial Service Providers adjusted as reported September 2005

Lene Hansen, Independent Consultant, DSP and UNDP

	# Borrowers	\$ loans outstanding	# Savers	\$ savings	Par(30)	Caseload	OSS %	FSS %	As at:
Banks									
CGD	10,182	63,667,000	43,039	75,000,000	10%	442			Sep-05
Bank Mandiri	104	6,300,000							Jun-05
ANZ	44	642,000	3,837	2,546,300	3%	15			Jun-05
Subtotal, Banks	10,330	70,609,000	46,876	77,546,300	6.5%	228			
AMFITIL member MFI									
IMFTL	3,748*	2,048,086	11,317	986,003	4%	423	153%	103%	Sep-05
MR	7,267	541,258	7,690	218,704	3.8%	196	58%	53%	Sep-05
OTL	3,603	212,342	2,855	101,432	32%	140	68%	64%	Sep-05
TRM	2,081	78,321	2,081	18,345	6.7%	301	53%	38%	Sep-05
Subtotal, MFI	16,699	2,880,007	23,943	1,324,484	11.63%	265	83%	65%	
Credit Cooperatives									
Fini Sorumutu	476	354,481	662	167,695	n/c	n/c	n/c	n/c	Nov-05
Naroman	400	12,000	1,075	80,000	25.00%	80	n/c	n/c	Sep-04
Fitun Naroman	191	n/c	381	n/c	n/c	n/c	n/c	n/c	Sep-05
Subtotal Coop's	1,067		2,118						
NGOs – AMFITIL members									
CCF (MEDI)	4,241	329,967	4,241	94,302	0.0%	336	131%	121%	Sep-05
Hotflima	1,731	113,047	1,731	130,234	7.7%	165	50%	40%	Sep-05
TimorAid (tot. Portf.)	445	71,201	0	0	91%	148	27%	24%	Sep-05
Lana Mona	364	15,562	604	11,896	0.0%	121	n/c	n/c	Sep-05
Subtotal NGOs	6,781	529,777	6,576	236,522		193	69%	62%	
TOTAL:	34,877	74,385,265	79,513	91,355,000					
AVERAGE:					20.3%	192			

* This number was incorrectly stated on the original report and has been restated. The bank information is less than has been identified in January 2006, in Section 1.4.2 of this report.

APPENDIX 'G' AGREED FEATURES OF BPA CREDIT REGISTRY

The following features have been agreed to, as components of a BPA Credit Registry:

- In the near term the registry will be owned and managed by the BPA;
- The registry database will be located on BPA premises;
- It will be classed as a 'public registry'
- Primary purpose of the registry will be for banking supervision and a secondary purpose will be to assist banks in obtaining more relevant information, on borrower's paying habits and debt structure, allowing for more precise and accurate credit decisions;
- In the first phase of data contribution, the contributors will be the four commercial banks and Moris Rasik MIF;
- Both positive and negative information will be provided for the database;
- With the exception of one MFI, all active credits are to be reported for the registry database;
- Reporting of credits will be mandatory;
- Data will only be accepted in an automated medium;
- A BPA 'Asset Classification' code will be attached to each credit that is reported to the registry;
- Demographic information to be reported is as follows:

Demographic Information (* = Mandatory)

<i>*Name</i>
<i>*Electoral Card# an/or Registration # for individuals and the <u>Taxpayer ID # for businesses</u></i>
<i>*Address</i>
<i>Birth date</i>
<i>City of birth</i>
<i>Marital Status – Spouse's name</i>
<i>Employment History</i>
<i>Telephone or cellular #</i>

- There will be normal best practice disclosure of information to users of the registry;
- Consumer rights and protections will be in place at such time as the registry is fully operational;
- All credit applications will require a 'consent clause' signed by credit applicant;
- Individuals will be identified with either, or both, of the electoral card and registration card and, for business, the Taxpayer ID #;

- Regulations, for the operation of the credit registry, will be developed for the credit registry and, when approved, will come into practice under the new Central Bank Law (which is expected to be passed and brought into effect by mid 2007);
- Based on the lending activity of the ‘phase one’ data contributors, there is the potential for 70,000 inquiry searches into the registry on an annual basis;
- Credit information to be reported as follows:

Credit Information (all data mandatory)

<i>Name of credit grantor will be <u>Masked</u></i>
<i>Date account opened</i>
<i>Original balance</i>
<i>Monthly payment</i>
<i>Date of last payment activity</i>
<i>Balance</i>
<i>Credit by sector</i>
<i>BPA Asset Classification (1 to 5)</i>
<i>Security</i>