

Using credit registry data to assess the risks in the financial system – the *Banco de Cabo Verde* experience

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The current economic and financial crisis, now labelled “the Great Recession” by the IMF, started in 2007, largely as a result of increasing sophistication of the financial sector, which was not matched by improvements in regulatory and supervisory mechanisms.

Since then, and in order to cope with the dire consequences of a major financial crisis, such as the related huge social costs, world authorities have devoted greater attention to strengthening financial sector soundness. Further, authorities have gone to great lengths to prevent and mitigate systemic crises – often, as in the case of Cyprus, with devastating consequences in terms of economic agents’ confidence.

Due to its strong dependence on the Euro Zone, the Cape Verdean economy has been severely affected by the European crisis, with FDI dropping (since 2009) and, in more recent years, lower levels of exports of goods, emigrant remittances and foreign aid. The reduction in these important external flows has hampered economic growth, which has been sluggish since 2009. The combined effect of low growth and counter-cyclical budget policies has been a surge in domestic and external debt.²

Bank asset quality has been hurt to a certain extent by the adverse external environment and by the deteriorating local economic context. Nonperforming loans (NPL) almost doubled in the last three years, and currently stand at 14 percent of total bank portfolio. Credit concentration risk with regards to both economic sectors and borrowers is also high, thus increasing the vulnerability of both banks and non-banks.

Considering the devastating consequences of a banking crisis, in a context of limited fiscal space for the public sector to assume the role of lender of last resort, as well as the need to develop the financial sector in line with the country’s potential for economic development, Banco de Cabo Verde moved to set up a task force to study the reasons behind the recent surge in NPL in the banking sector.³

The task force was given a mandate to:

- a. Identify the causes behind the increase in NPL by analyzing to which extent the deterioration in the local and/or international context, public policies, social causes (divorce, for instance) and failures in risk appraisal and moral hazard, ... have contributed to bank asset deterioration;

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² Budget policy from 2009 onwards also aimed at taking advantage of available concessional financing for infrastructure.

³ The focus on the banking sector owes to the fact that the securities market is incipient. In addition, banks are major holders of corporate bonds.

- b. Forecast future trends in terms of NPL based on the causes and the risks identified;
- c. Assess bank provisions and capital adequacy relatively to existing risks and provide recommendations for strengthening financial and macroeconomic stability.

The task force's mandate inspired this presentation because it was necessary to use (or at least attempt to use) information from BCV's Credit Information Registry (*Central de Riscos de Crédito – CRC*) to undertake the first of the three tasks assigned to the group.

The first step was to define information needs related to the assigned task. With regards to the corporate sector, the task force agreed on a number of issues pertaining to the company – name, location, domestic and foreign ownership, public ownership, and area of operation. Information from the banking side was also addressed, namely amount of financing to defaulting borrowers, loan dates, maturity and purpose (i.e., working capital, short term financing or capital investment) for each loan, guarantees, amount of NPL, date of last repayment and number of past due instalments.

With regards to individuals, the group aimed to collect information on fiscal status, address, birth date, gender, marital status, monthly/annual income, employer, whether emigrant or not, as well as information on loans on a per bank basis. In terms of loan purpose the group sought to identify cases of loans for housing purchase and construction, construction for rent/sale, vehicle acquisition and student loans.⁴ The group further sought to identify risks related to the different financial instruments used in each case, namely promissory notes, credit cards, salary advances, etc.

The task was hindered by a number of constraints faced by the CRC in collecting information from the banks. Current bank reporting does not meet information needs identified by the group. For instance, with regards to borrower identification, the CRC only collects data on name, area of activity and municipality where the company's headquarters or the individual is located.⁵

The group also faced constraints relating to loan classification. CRC data only includes information on whether the loan was given to a single or to multiple borrowers, on loan instrument and maturity, guarantees, and status (performing, nonperforming, under litigation or written off).

To deal with the above constraints, the group sent the banks a questionnaire to collect data on the 100 largest defaulting borrowers, corporate and individuals.

The Task Force strongly believes that a CRC should meet the supervisory needs in an economically, financially and socially more complex and demanding environment, as well as provide a database with information to allow studies to improve knowledge about the country's economic and financial context, thus facilitating policymaking for economic development. To achieve these objectives, the Task Forces recommends:

⁴ The perception is that most cases of nonperformance arose out of one of these circumstances.

⁵ For individuals, CRC data also includes birth date and parents' names.

- a. An assessment of CRC data collection, validation and analysis process, to be performed by a team of bank supervision, statistics and research experts;
- b. Design and implementation of an Action Plan to maximize the usefulness of the CRC in terms of bank risk assessment and statistical needs;
- c. Improved dissemination of the upgraded CRC to the banks so they may improve their risk appraisal framework, in line with a risk-based supervisory approach.

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