Restriction on Credits Granted to Individuals

RIA Excersise Group 2

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Background

- Norm NR.10
- Standard indebtedness levels

  30 % ,35% income

Down payment- mortgage loans

25 %

Market – 1.consumer loans

2.loans on residential property

Stakeholders

Consumers (low, medium/high income)	Regulators – National bank	Sellers – banks, non-banking financial institutions, real estate agency, retailers

Problem identification

- Market distortion
  - Restriction of credit activities:
    - banks complain they cannot lend more
    - High income borrowers cannot borrow for shorter time horizon
  - Asset-Liability Mismatch:
    - interest rate risk
    - liquidity risk
  - Increased used of Black Market financing

Regulatory Failure !!!

Policy objectives

General	Specific	Operational
Financial Stability	1. Efficient use of financial resources 2. Sound financial management 3. Adequate risk management in banks	1. Sketch risk profiles for clients 2. Develop a comprehensive risk management framework ▪ assess quality of collateral; ▪ estimated cash flows; ▪ risk provisioning rules
Access to finance	1. Access to short-term financing for high-medium income persons 2. Fulfill demand for financing for some clients	1. Abolish quantitative limits for lending activities

Alternative Options

- Option 1: Do Nothing
- Option 2: Increase limits /decrease down-payment
- Option 3: Introduce new methodology

Option 1: “Do Nothing”

- Cost for the customers
  - Unmet demand
  - Higher interest rates
- Cost for regulated firms
  - Not able to lend more /lower profits
  - Un-hedged exposure
  - Liquidity drain
- Cost for regulator
  - ???

- Benefit for customers
  - Some protection from indebtedness
- Benefit for regulated firms
  - Simple to apply / control
- Benefit for regulator
  - Simple to supervise
  - Cheap control of inflation

Option 2: Increase limits /decrease down-payment

- Cost for the customers
  - Still, some unfulfilled demand
  - Higher indebtedness
- Benefit for customers
  - Increased access to finance
- Cost for regulated firms
  - Increased default risk
  - Some AL mismatch
- Benefit for regulated firms
  - Improved use of resources
  - Improved ALM
- Cost for regulator
  - Harder to tackle inflation
- Benefit for regulator
  - Still simple to supervise
  - Better alignment to policy objective

Option 3: Introduce new methodology

- Cost for the customers
  - Maybe some transfer of costs in the short term
  - Longer application procedures
- Cost for regulated firms
  - Compliance (IT, training, control, personnel)
- Cost for regulator
  - Training of supervisors
  - Inspection costs (more time needed)

- Benefit for customers
  - Access to finance
  - Lower costs in long term
- Benefit for regulated firms
  - More business/increased profits;
  - Better risk / liquidity management
- Benefit for regulator
  - More stability in the financial system

Impact Assessment

	Do Nothing	Option 2	Option 3
Cost	++	+	++
Compliance			+
Benefits		+	+++
Quantity		+	++
Quality			+
Competition		+	++

Consultation process

- **Prepare a questionnaire**
- **I part – Credit institutions**
- Problem identification,
- assessments (variety of products, developing of competition)
- **II part – Consumers**
- Access to lending
- Lending costs
- Unfair treatment (low and medium/high income consumers)

Policy Recommendation

- Recommend Option 3:
  - Abolish old regulation
  - Adopt new regulation in a way as to give more discretion to the financial institutions with regard to the appropriate risk managements systems;
  - Train personnel (regulator and regulated firms)
  - Inspect and supervise proper implementation of risk management systems
  - Evaluate the regulatory impact
- Expected outcome (benefits from increased turnover will outperform the costs)