

# The Regulation of Consumer Credit Information Systems: is the EU Missing a Chance?

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## Abstract

This article examines the legal framework of consumer credit information systems in the EU in view of a single retail credit market. It puts forward the proposition that positive law is inadequate to strike a balance between legitimate concerns over consumers' civil liberties, institutional guarantees, and the needs of the credit industry. It suggests that the EU should enact industry-specific legislation, and the new consumer credit directive should represent the appropriate forum for its regulation. So far, however, the proposed directive maintains the status quo and is far from satisfactory, leading to the conclusion that the EU is missing a chance to re-think a regulatory model to support a healthy single consumer credit market in which consumers receive adequate protection.

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## **I. Introduction**

In virtually all the EC Member States, consumer credit reporting has become the most extensively used instrument employed by lenders to underwrite decisions on borrowing or the supply of goods and/or services to customers. Lenders, in fact, access credit reference databases managed by third party providers (the so-called ‘Credit Reference Agencies’) in order to evaluate a consumer’s credit application and his or her creditworthiness.

Credit Reference Agencies (CRAs) are independent, commercial organisations that are deemed to represent an institutional response to the service of the credit industry for the problem of asymmetric information in financial markets. They maintain a full data sharing mechanism based on the collection of data from the various lenders of information about their customers and, at the same time, provide those same lenders with consumer credit reports along with other information services and decision making tools, which make consumers' personal data and reputations accessible to other (potential) creditors.<sup>2</sup>

Another reason for the credit industry's interest in CRAs is that with their extensive, detailed collection of and their ability to share personal data, they are considered to provide useful services in the fight against the growth of over-indebtedness of borrowing individuals.

One of the most important and distinctive features is that lenders’ consultation of CRAs databases, prior to the underwriting of credit, is voluntary and not mandatory by law.

Against this background, the creation of an efficient EC single market in consumer credit in an environment in which consumers receive adequate protection is a present concern on top of the agenda for the completion of the Internal Market. So far, however, the existing Consumer Credit Directive 87/102/EEC has proven to be ineffective in reaching this goal.<sup>3</sup>

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<sup>2</sup> CRAs usually integrate their databases with data from other public sources, such as, for example, electoral rolls, Court judgements, bankruptcies and voluntary arrangements, and other private information provided by other organisations, which compile additional information referring to an individual thus forming a single file. Such files are then made available in the form of a Credit Report, which is provided to the (potential) lenders for a fee paid to the one or more CRAs, which they have decided to interrogate each time someone applies for credit or hire purchase.

<sup>3</sup> Directive 87/102/EC for the approximation of the laws, regulations and administrative provisions of the member states concerning consumer credit, OJ L 042, 12/02/1987 p. 0048-0053.

Thus, the European Commission and the European Parliament have recently presented new proposals for a directive on the harmonisation of the laws, regulations and administrative provisions concerning credit for consumers.<sup>4</sup>

However, despite all the efforts, so far, the Member States have shown few signs of agreement, and discussions and counterproposals have lasted for years.

In this context, existing studies identify the urge for a European single market in consumer credit and the creation of cross-border credit opportunities as the main factors behind the need for the cross-border exchange of information among information systems.

At the same time, however, so far there has been scant debate, especially amongst lawyers and legislators, concerning the legal framework of such information systems and the uses of credit reporting data. In particular, little attention has been paid either to privacy concerns or to the discriminatory consequences of credit reporting. Such concerns seem particularly relevant today because of the growing type and amount of personal data collected and disclosed to third parties, coupled with the sophistication and advances in computer technology and information systems.

These aspects are exacerbated by the fragmented market structure and industrial organisation of consumer credit reporting across the Community, with special reference to the lack, in most Member States, of a form of proper institutionalisation and all the consequences that follow.

Thus, the aim of this work is to assess whether the legal framework in place is adequate to strike a balance between legitimate concerns over civil liberties, institutional guarantees, and the needs of the credit industry. Conversely, questions of whether the EC should re-think a

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<sup>4</sup> Proposal for a Directive of the European Parliament and of the Council on the harmonisation of the laws, regulations and administrative provisions of the Member States concerning credit for consumers, COM (2002) 443 final 2002/0222 (COD); Modified proposal for a directive of the European Parliament and of the Council on credit agreements for consumers amending Council Directive 93/13/EC, COM(2005) 483 final 2002/0222(COD).

harmonised, if not uniform, regulatory model for consumer credit reporting seem particularly relevant.

In an attempt to provide such analysis, this article examines the advancements of the legislative proposals in place for the harmonisation of consumer credit laws, investigating to what extent these are also representing the forum for the regulation of the underlying information systems to support an European single market in retail credit in which consumers receive adequate protection.

## **II. Credit Reference Agencies and their role in the economy**

Economic theory has long stressed the importance of information in credit markets. Theorists have devoted a large body of theoretical studies aimed at demonstrating that asymmetric information between borrowers and lenders poses problems of bad debts, moral hazard, and adverse selection. They suggest that the lack of information on borrowers can prevent the efficient allocation of credit in a market and that one way that lenders can improve their knowledge of borrowers is through their observation of clients over time.<sup>5</sup>

As the theory goes, CRAs play a pivotal role as a borrower discipline device since borrowers know that a default in re-payment compromises his or her reputation with all the other potential lenders on the market, resulting in credit with more costly terms or by cutting him or her off from credit entirely. Information sharing would make it easier to predict with a certain degree of confidence the future payment behaviour of applicants allowing lenders to attract good borrowers and offering them better terms and conditions, thus promoting market competition that could ultimately result in benefits to consumers.<sup>6</sup>

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<sup>5</sup> J.E. Stiglitz and A. Weiss, 'Credit Rationing in Markets with Imperfect Information' (1981) 71(3) *American Economic Review* 393-410; A.N. Berger and G.F. Udell, 'Relationship Lending and Lines of Credit in Small Firm Finance' (1995) 68 *Journal of Business* 351-381.

<sup>6</sup> T. Jappelli and M. Pagano, 'Information Sharing, Lending and Defaults: Cross-Country Evidence' (2002) 26(10) *Journal of Banking and Finance* 2017-2045; D.W. Diamond, 'Monitoring and Reputation: The Choice between Bank Loans and Directly Placed Debt' (1991) 99(4) *Journal of Political Economy* 689-721; A.A. Admati and P.C. Pfleiderer, 'Forcing Firms to Talk: Financial Disclosure Regulation and Externalities' (2000) 13 *Review of Financial Studies* 479-519.

In addition, credit reporting systems are valued as instrumental tools in expanding the breadth and depth of financial markets and in strengthening the financial system. They reportedly reduce transaction and loan processing costs, the time required to process applications, improve the lenders' client portfolio quality by monitoring it and identifying potential problems, provide cost-efficient standardised and objective criteria for credit analysis, facilitate distant transactions (for instance, e-finance or internet transactions and banking), provide opportunities for new financial products to consumers and enable lenders to serve consumers who would be otherwise underserved or ignored (for example low-income consumers). All these aspects, in turn, result in the development and sale of new products, and accurate tailored pricing, targeting and marketing, which ultimately would contribute to the lenders' profitability.<sup>7</sup>

Finally, another reason for the industry's interest in CRAs is that through extensive detailed collection and sharing of personal data, they provide useful services in the fight against the growth of over-indebtedness for borrowing individuals. In policy terms, this would confer on the credit industry the tools for responsible lending practices, protecting individuals from borrowing beyond their means.<sup>8</sup>

It should be noted, however, that CRAs take decisive advantage of their ability to provide first-hand information and knowledge by offering additional services to the industry that involve the use of consumer credit data as the basis for their provision. Such additional services include, among others, credit scoring, consulting, application processing, small business information reports, market and consumer research, debt collection, marketing, fraud prevention, identity verification of credit applicants (including identity theft detection and verification for money laundering), and other private transactions, such as, commercial

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<sup>7</sup> C. Calari, Vice President, Financial Sector Network, World Bank, 'Foreword', in M.J. Miller (ed.), *Reporting Systems and the International Economy* (MIT Press, 2003), vii; M.J. Miller, 'Introduction', in M.J. Miller (ed.), *op. cit.* note 6 *supra*, 1-2.

<sup>8</sup> For example in the UK, see House of Commons Treasury Committee, 'Credit Card Charges and Marketing', Second Report of Session 2004-05 (London, 4 February 2005).

transactions, property rentals, telecom subscriptions, insurance contracts, and employment screening.<sup>9</sup>

### III. Institutional framework

As extensive economic research has recently demonstrated, European credit markets are far from being integrated, a conclusion derived from the existence of a number of legal barriers among the Member States, as well as several integration indicators such as real price and interest differentials, absence of cross-border lending, poor market penetration by foreign lenders, the existence of large differences from country to country in the extension of consumer loans, differentials in demand, business models, language, consumers' cultural and psychological factors in the use of credit.<sup>10</sup>

Overall, therefore, it is not surprising that these differences are reflected noticeably in the consumer credit reporting sector, which has mirrored the development of the underlying credit markets and has concentrated domestically, neglecting either a European dimension or the cross-border exchange of data.

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<sup>9</sup> See Experian Official Website, available via <<http://www.experian.co.uk>>; Equifax Official Website, available via <<http://www.equifax.co.uk>>; CallCredit Official Website, available via <<http://www.callcredit.co.uk>>. For literature in business studies, see McNab H. and Wynn A., *Principles and practice of Consumer Credit Risk Management* (CIB Publishing, 2000).

<sup>10</sup> On the fragmentation of consumer credit markets within the EC, see Mercer Oliver Wyman, *Consumer credit in Europe: riding the wave* Research Report, European Credit Research Institute, Brussels, Nov. 2005; N. Jentzsch and A. San José Riestra, *Information Sharing and Its Implications for Consumer Credit Markets: United States v. Europe* Working Paper, European University Institute Workshop 'The Economics of Consumer Credit: European Experience and Lessons from the U.S.', Florence, May 2003, 15; L. Weill, *Efficiency of Consumer Credit Companies in the European Union – A Cross-Country Frontier Analysis* ECRl Research Report No. 7, European Credit Research Institute, Brussels, 2004, 3-6; J. Crook, *The Demand and Supply of Household Debt: A Cross-Country Comparison*, Working Paper, European University Institute Workshop 'The Economics of Consumer Credit: European Experience and Lessons from the U.S.', Florence, May 2003; L. Guiso *Consumer Credit and Household Loan Markets Across Italian Regions*, Working Paper, European University Institute Workshop 'The Economics of Consumer Credit: European Experience and Lessons from the U.S.', Florence, May 2003; S. Lea, P. Webley, and C.M. Walker, 'Psychological Factors in Consumer Debt: Money Management, Economic Socialisation, and Credit Use' (1995) 16(4) *Journal of Economic Psychology* 681-701; N. Diez Guardia, *Consumer Credit in the European Union* ECRl Research Report No. 1, European Credit Research Institute, Brussels, 2002, 7; K. Lanoo and A. de la Mata Muñoz, *Integration of the EU Consumer Credit Market – Proposal for a More Efficient Regulatory Model*, CEPS Working Document No. 213, Centre for European Policy Studies, Brussels, Nov. 2004, 3-4; Buch C.M., *Information or Regulation: What is Driving the International Activities of Commercial Banks?* Kiel Working Paper No. 1011, Kiel Institut of World Economics, Kiel, November 2000.

Alongside this uneven development of consumer credit, however, the information distribution industry seems to present peculiarities of its own in relation to the institutional structure serving the markets and the industrial organisation.

From an institutional point of view, the main differentiating factor on how credit registries operate across Europe could be grouped under two main categories based on ownership: (i) privately owned CRAs; and (ii) Public Credit Bureaus (PCB) generally managed by central banks or other national supervisory authorities.<sup>11</sup>

The state of affairs in the EU appears to be a mixed one: while in certain markets only PCBs operate, in the majority of them the consumer credit reporting business has been left to free market forces. In some Member States, however, PCBs and CRAs coexist.<sup>12</sup> The role and activities of CRAs have been already dealt with above in this work.

By contrast, as far as PCBs are concerned, the Committee of Governors of the European Central Bank defines them as information systems “designed to provide commercial banks, central banks, and other regulatory bodies with information about the indebtedness of firms and individuals vis-à-vis the whole banking system”.<sup>13</sup>

PCBs are institutions typical of continental Europe, where they first originated and developed with the objective of providing an information system for supervisors to analyse financial

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<sup>11</sup> See M.J. Miller (ed.), *op. cit.* note 6 *supra*.

<sup>12</sup> CRAs operate alone in The Czech Republic, Denmark, Estonia, Hungary, Ireland, Malta, Poland, Sweden, The Netherlands, and the United Kingdom. CRAs and PCBs coexist in Germany, Greece, Italy (where a consortium of credit providers also operates), Portugal, and Spain. In Austria and Belgium, a consortium of credit providers and a PCB coexist. PCBs operate alone in Finland (but the operation of the PCB has been contracted out to a private company), France, Latvia, Lithuania, Slovakia, and Slovenia. No credit registries exist in Cyprus (where there is only a bad-cheque list operated by a PCB), and Luxembourg. Information assembled from the following sources: T. Jappelli and M. Pagano, ‘Public Credit Information: A European Perspective’, in M.J. Miller (ed.), *op. cit.* note 6 *supra*, 81-114; M.J. Miller, ‘Credit Reporting Systems around the Globe: the State of the Art in Public Credit Registries and Private Credit Reporting Firms’, in M.J. Miller (ed.), *op. cit.* note 6 *supra*, 25-80; Mercer Oliver Wyman, *op. cit.* note 9 *supra*, 22; A. San José Riestra, *Credit Bureaus in Today’s Credit Markets*, ECRI Research Report No. 4, European Credit Research Institute, Brussels, 2002; Data obtained by the author directly from the World Bank; CreditInfo Group, Official Website, <<http://www.creditinfo.com/>>; Tiresias Official Website, <<http://www.tiresias.gr/>>.

<sup>13</sup> Cited in T. Jappelli and M. Pagano, ‘Public Credit Information: A European Perspective’, in M.J. Miller (ed.), *op. cit.* note 6 *supra*, 82.

institutions' (banks) portfolios. Reportedly, Germany established the first PCB in 1934, followed by France in 1946, Italy and Spain in 1962, and Belgium in 1967.<sup>14</sup>

Although PCBs operate in many respects like the privately owned CRAs, substantial differences exist between the two.

As in the case of private CRAs, there is a two-way flow of customers' credit data between the credit grantors and the PCB. However, the key difference between PCBs and CRAs is that the former are generally managed by central banks or other states' regulatory authorities. Crucially, financial institutions that are under the supervision of a country's central bank are required to report certain credit data on a regular basis to the PCB by law or other regulation. Thus, as participation in a PCB is compulsory, its rules are imposed by law or regulation, not under contract as occurs with CRAs.<sup>15</sup>

Equally, PCBs have a legal basis for demanding that reporting lenders remedy eventual inaccuracies or make available missing data. Failure to comply results in sanctions that, by law, PCBs may impose (generally, penalty fees followed by supervisory actions).<sup>16</sup>

Indeed, as it will be shown later, such mandatory reporting and rules of participation represent a fundamental difference between a PCB and a CRA and have a decisive impact on the legal standing of consumer credit reporting.

From the concise description provided hitherto, it appears clear that the information collected by PCBs serves mainly two purposes: (a) to conduct the prudential supervision of banks, monitoring the health and soundness of the overall financial system of a country; and (b) to assess and monitor the indebtedness of borrowers, both legal and natural persons.

The first purpose means that PCBs exercise a public function by furthering the general stability of the banking and payment system. As such, only banks participate in the system

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<sup>14</sup> M.J. Miller, 'Credit Reporting Systems around the Globe: the State of the Art in Public Credit Registries and Private Credit Reporting Firms, in M.J. Miller (ed.), *op. cit.* note 6 *supra*, 25-80.

<sup>15</sup> T. Jappelli and M. Pagano, *Information Sharing in Credit Markets: The European Experience* CSEF Working Paper No. 35, University of Salerno, Salerno, 2005.

<sup>16</sup> M.J. Miller, 'Credit Reporting Systems around the Globe: the State of the Art in Public Credit Registries and Private Credit Reporting Firms, in M.J. Miller (ed.), *op. cit.* note 6 *supra*, 25-80.



and are subject to the underlying rules, unlike CRAs that also take in non-bank lenders as client members. This public function is alien to the information sharing systems of CRAs that are designed to provide services in the interest of the profitability of a larger variety of lenders that includes, but is not limited to, banks. In this respect, CRAs databases are accessible by an indefinite number of potential client members, as they are conceived as open systems with the additional incentive of bringing an increasing number of subscribers into play to respond to competition pressures.

In a different way, the element above marked as (b) leads to another important difference between PCBs and CRAs, namely, that PCBs have universal coverage of all loans above a threshold amount determined by law or regulation (such threshold varies from country to country), and the information consists of credit data disseminated in consolidated form. This means that, unlike CRAs, lenders have access to the total loan exposure of each borrower, there is no detail on individual loans, and no merger with other personal data nor data mining occurs.<sup>17</sup>

Evidently, legislators did not consider information about credit operations below a certain threshold (i.e. small loans and other credit that constitute what today is referred to as ‘consumer credit’) either a threat for the prudential supervision of a sound national financial system or a concern in relation to indebtedness, ‘since small loans have little impact on system solvency or risk’.<sup>18</sup>

In those countries where PCBs and CRAs coexist, the threshold also demarcates the market segment below which CRAs operate without the lenders having the opportunity to turn to PCBs, while the same cannot be said as far as it concerns the provision of information above such threshold.<sup>19</sup> This segmentation, in fact, also enables CRAs to collect and store information about operations above the threshold (in detail, rather than in the consolidated

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<sup>17</sup> Jappelli and Pagano, *op. cit.* note 14 *supra*.

<sup>18</sup> M.J. Miller, ‘Credit Reporting Systems around the Globe: the State of the Art in Public Credit Registries and Private Credit Reporting Firms’, in M.J. Miller (ed.), *op. cit.* note 6 *supra*, 39.

<sup>19</sup> This, of course, unless a specific law prevents them to do so.

form as PCBs). This is possible because the law, which makes their communication compulsory to the competent PCB, says nothing about their collection by others, i.e. it is not forbidden. Distinctively, in this upper market segment, CRAs are able to collect and provide their member clients with information with a precise degree of detail (for example, particulars of each line of credit a borrower has with reporting lenders) as opposed to the consolidated form that PCBs provide by rule of law or regulation. Again, this advantage is possible, as CRAs are not bound by the same rules that fix the functioning of PCBs.<sup>20</sup>

Within the context of the described institutional organisation, while most countries have just one large credit registry dominating the market, some Member States have two or (exceptionally) three companies competing on the same national market.

It should be observed that a common trait shared by credit information systems is that, in economic terms, they are natural monopolies in that the extension of a system's coverage itself enhances its effectiveness. In fact, they are dependent on network structures within which information is traded, where the participants that share the information constitute such a network.<sup>21</sup>

Economic research describes networks as a form of industrial organisation and market governance. Jentzsch extensively explains their functioning:

‘The architecture of the network is constituted of the number of participants as well as the symmetry (or asymmetry) of data flows between them and the system of information flows. (...) Information diffusion and its efficiency are influenced by the network architecture and the channels; hence architecture influences economic outcomes. In this context, information is at the same time integrated in vertical networks (as part of the value chain) as well as in horizontal networks (exchanges

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<sup>20</sup> See Jappelli and Pagano, *op. cit.* note 14 *supra*.

<sup>21</sup> M. Pagano and T. Jappelli, 'Information Sharing in Credit Markets' (1993) 48(5) *The Journal of Finance* 1693-1718.

among different firms of the same industry). (...) In credit reporting markets, the information flows among agencies, information suppliers and consumers constitute such a network of information which reveals strong feedback effects: its value increases as more creditors are connected to it'.<sup>22</sup>

As the author ultimately clarifies, thus, 'scale and scope effects also affect coverage, which has the propensity to universality. The more sources are connected to the network, the more detailed becomes the credit report and the more precise may become the risk prediction'.<sup>23</sup>

In sum, the very nature of the credit reporting business demands that the success of the system depends on its broad extension, otherwise, it is of no or little use otherwise.

When looking at the combination of all the factors described in the above survey, though, it is noteworthy at this early stage of the discussion that, in most cases, appropriate institutional arrangements are absent, having been left to commercial organisations that are monopolistic in nature and scope. This and many other issues, which are exemplified below, cause unease over basic consumer freedoms and civil society guarantees.

#### **IV. Concerns**

Intuitively, consumer credit reporting systems represent a threat to the privacy of individuals. In fact, there are sophisticated and highly technological mechanisms in place, where data from different sources are easily and quickly aggregated, new data are automatically created, and data are disclosed to a potentially unlimited number of third parties for a growing number of expanding purposes.

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<sup>22</sup> N. Jentzsch, *The Regulation of Financial Privacy: The United States v Europe* ECRI Research Report No. 5, European Credit Research Institute, Brussels, 2003, 30-31. According to the author, an increasing number of data sources produces a more precise profile of the credit applicant which in turn enhances the risk prediction capabilities of the interconnected participants. Thus, the contributions of an increasing number of data providers almost inevitably increases the flow of information among the agents. The more the network of a CRA increases, the more attractive it will be for potential participating lenders leading to considerable 'bandwagon effects' and network externalities.

<sup>23</sup> *Ibid.*, 36

Previous research has already stressed that further consideration should be given to what constitutes the ‘essential information’ which allows the credit assessment process by lenders.<sup>24</sup>

In this respect, it would certainly be a useful exercise to assess the necessity and scope of all the information collected and disseminated by CRAs for the purpose of predicting the future behaviour of a borrower, and matching them with the relation of cause and effect about the likelihood of repayments with the contracted interests.

For example, in an analysis of what constitutes ‘essential information’, one of the main questions refers to the distinction between positive and negative data.<sup>25</sup> Whereas most people may accept the value of sharing negative data as a disciplinary instrument, at least where customers are informed and where they provide consent, the issue of sharing positive information proves more difficult.<sup>26</sup>

More important, however, seems the question of how far a consumer should be forced to sacrifice his or her own (not only financial) privacy in the interest of the credit industry (the general interest?), bearing in mind that the ‘utilitarian’ concerns of the credit industry cannot necessarily prevail over civil liberty and fundamental human rights concerns. To these ends, in fact, it should be taken into account that all privacy rights now benefit from, and should be interpreted in light of, Art. 8 of the European Convention for the Protection of Human Rights and Fundamental Freedoms.<sup>27</sup>

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<sup>24</sup> San José Riestra, *op. cit.* note 11 *supra*, 17; G.G. Howells 'Data Protection, Confidentiality, Unfair Contract Terms, Consumer Protection and Credit Reference Agencies' (1995) *Journal of Business Law* 343-359.

<sup>25</sup> An important distinction to be drawn when referring to the type of data collected and distributed by CRAs is the one between negative and positive consumer data. Negative data refer to information about defaults on payments, delays, delinquencies, bankruptcies etc. That is, information with a negative connotation on the payment history and the financial behaviour of the data subject. Positive consumer data, by contrast, refer to information about financial standing, payment history and other details, which do not indicate a default or a late payment.

<sup>26</sup> San José Riestra, *op. cit.* note 11 *supra*; Howells, *op. cit.* note 23 *supra*.

<sup>27</sup> C 364 (2000), 0001-0022.

Article 8 - Protection of personal data – states:

‘1. Everyone has the right to the protection of personal data concerning him or her.

2. Such data must be processed fairly for specified purposes and on the basis of the consent of the person concerned or some other legitimate basis laid down by law. Everyone has the right of access to data which has been collected concerning him or her, and the right to have it rectified.

Moreover, the profiling and standardisation of the behaviours of individuals not only appear hazardous for the civil rights involved, but also conceited and artificial. Very often, contrary to the very foundations of credit reporting, human behaviours are heterogeneous and unpredictable. As recent research has stressed, in fact, the major factors behind the creditworthiness or over-indebtedness of individuals were found to be unforeseen life events, such as sudden illness, loss of job, death of someone close, etc. rather than a mismanagement of resources.<sup>28</sup>

From a different angle, it could be also argued that someone who has had problems in the past does not necessarily have problems at present or in the future. Or, an individual also may have a low profile credit record from failing to make payments, which are either not due or are in conflict with the service provider's claims.<sup>29</sup>

Last, but not least, the mechanisms in place bear important consequences in terms of social justice, either by way of absence of equal treatment in the access (or, else, exclusion) to credit, or in any event selection, hence discrimination.

This also seems particularly relevant today in the perspective of the free movement of people and the effective mobility of Europeans from a Member State to another. They should not face barriers caused by the lack of information provided by CRAs (or the result of different national practices and cultures) and selection different from nationals of the hosting Member State, which is discrimination based on nationality.

Arguably, moreover, when people (particularly, though not exclusively, those at a social disadvantage) are refused credit, they should not become more vulnerable to credit at more expensive rates and unfavourable contract terms (sometimes to the point of extortionate credit deals) or, even worse, to being the victims of usury in the black market.

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3. Compliance with these rules shall be subject to control by an independent authority'.

<sup>28</sup> Such consideration has also been expressly stated by the director of data protection and regulatory affairs at Credit Reference Agency Experian UK, see M. Bradford M., 'Full data-sharing could stem over-indebtedness concerns' (2004) 11 *Credit Risk International*, 11. See also San José Riestra, *op. cit.* note 11 *supra*.

<sup>29</sup> Examples of such incidents are reported in M. Brignall M., 'Total History of Your Dealings', *The Guardian, Jobs & Money*, Saturday 30 October 2004, London.

What is striking is that information about defaults is passed on to CRAs (and then, in turn, disseminated) simply by the lenders so affirming, regardless of any judicial hearing having taken place, thus raising questions as to whether there is any respect for the certainty and rule of law.

It is useful to remember once more that all the above concerns are exacerbated by the consideration that there is no conclusive or at least empirical evidence - nor a certain relation of cause and effect - as to the connection between credit reporting and the predictability of human behaviour. What's more, when considering all such issues, one should not forget that the use of CRAs databases is not mandatory by law.

When it comes to a closer look at the existing institutional arrangements, it may appear worrying to many that, at least in the majority of the Member States, profit-seeking privately owned companies that have a natural tendency to be monopolies are allowed to be the repository of all such powers. Such lack of proper institutional organisation increases the concern about the arbitrary positioning of CRAs in the modern society. One may be tempted to think that as civil liberties and social factors are involved, there would be a need for some institutional guarantees and/or, as a minimum, accountability measures. Obviously, this raises the difficult question of whether these types of activities should be left to free market forces or, on the contrary, should there should be a form of institutionalisation with definite and specific rules in place, following the example of PCBs.

In such a confused situation, how has the law reacted to the many concerns and complex issues that arise with credit information reporting? Is there a case for policy makers to re-think the institutional and legal framework?

## **V. The legal standing**

As seen, in many ways, in almost every European country, the development of the credit industry has reflected the intuitions developed in the economic theoretical literature, with the

addition of the industry's substantial investments in technologies that were not in place when data sharing was initially considered.

At the same time, legislators have not responded with the same speed to the new concerns brought by such mechanisms, leaving them under the regulatory umbrella of general principles of existing legislation.

At present, there is no industry-specific law at Community level that regulates credit-reporting activities. Legislators across Europe, by contrast, mainly rely on one law that has a significant impact on data sharing, namely, the EU Data Protection Directive as transposed in national law.<sup>30</sup>

However, it is open to discussion, and would require a more detailed country by country legal analysis, if data protection legislation is adequate and relevant to the sophisticated and highly technological mechanisms of credit reporting, where data are disclosed to a potentially unlimited number of third parties for a growing number of expanding purposes. When looking at the compliance, however, it is worthy to stress that it seems that consumers do not have much choice if they do not want to be refused credit. The consumer's consent with regard to the searches to be carried out in the CRAs' databases, in fact, seems to be viewed both mandatory and/or assumed, i.e. implied consent. Lenders say that the lack of such consent would impede them from taking the credit application any further. Thus, no consent equals no credit, so, essentially it is an enforced consent.

Moreover, lenders make it a condition of the credit contract that, at a later stage, they have the right to pass the information concerning such specific credit line to CRAs, which, in turn, have the right to disseminate the same to their client members; such clause seems to be non-negotiable although alien to the decision of the granting of credit (that has already been taken

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<sup>30</sup> Directive 95/46/EC, OJ 1995 L 281 p 0031-0050.

Other laws, regulations, or codes of practices at national level may have an impact on consumer credit reporting, although they do not regulate it neither directly nor comprehensively. In Great Britain, for example, the 1974 Consumer Credit Act does not address the issue of data collection, processing, and dissemination.

positively). Again, it seems that no agreement to such clause means that there will be no contract.

Moreover, there is the issue mentioned above about what constitutes the 'essential information' (if any), which allows the credit assessment process by lenders, as no rule exists and potentially all information could be claimed as 'useful'. In this respect, it would be crucial to assess the necessity and scope of all the types of information collected and disseminated by CRAs for the purpose of predicting the future behaviour of a borrower, and matching them with the causal nexus about the likelihood of repayments with the contracted interests.

In sum, the number of actors involved, the nature of the data processed and disseminated, the complex technologies of credit information systems, and the consequences of the use of credit reporting, coupled with the many different activities that CRAs carry on, may legitimately induce the conclusion that data protection legislation is inadequate, and specific regulation of this market is necessary to avoid the arbitrary processing and dissemination of consumer credit information.

At any rate, the data protection legislation cannot solve, or at least balance, the other concerns that are not privacy-related, such as, those about the absence of guarantees and accountability measures that institutionalisation would bring to the sector.

## **VI. Proposals for a new Consumer Credit Directive: a solution in sight?**

Against the background provided above, one may be tempted to think that laws relating to consumer credit, by their nature, should include the regulation of the underlying information sharing arrangements. Unexpectedly, however, until now, these have been excluded from the provisions.

Adopted in 1987, the Consumer Credit Directive 87/102/EEC established a legal framework for consumer credit throughout the EU with the aim of promoting a common market for



credit and creating an environment in which consumers receive adequate protection.<sup>31</sup> Significantly, no provision or mention of consumer information sharing was made.

Directive 87/102/EEC has been amended twice, in 1990 and in 1998, but again no action in relation to consumers' data was taken on these occasions.

Driven by the failure of Directive 87/102/EEC to integrate European markets effectively, the European Commission presented on 11/09/2002 a proposal for a new Directive on the harmonisation of the laws, regulations and administrative provisions concerning credit for consumers (the 'Proposal').<sup>32</sup>

The Proposal aimed 'to pave the way for a more transparent market, a more effective market and to offer such a degree of protection for consumers that the free movement of offers of credit can occur under the best possible conditions both for those who offer credit and those who require it'.<sup>33</sup>

The text spelled out a comprehensive set of provisions that would have affected the way the consumer credit industry and market function, including consumer credit reporting.

In particular, in Chapter III of the Proposal titling 'Protection of Privacy', Article 7 (Collection and Processing of Data) stated:

'Personal data obtained from consumers, guarantors or any other person in connection with the conclusion and management of agreements covered by this directive, and in particular by Article 6 (1), may be processed only for the purpose of assessing the financial situation of those persons and their ability to repay'.<sup>34</sup>

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<sup>31</sup> Directive 87/102/EC for the approximation of the laws, regulations and administrative provisions of the member states concerning consumer credit, OJ L 042, 12/02/1987, 0048-0053.

<sup>32</sup> Proposal for a Directive of the European Parliament and of the Council on the harmonisation of the laws, regulations and administrative provisions of the Member States concerning credit for consumers, COM (2002) 443 final 2002/0222 (COD).

<sup>33</sup> *Ibid*, Explanatory Memorandum, 4.

<sup>34</sup> *Ibid*. In turn, Article 6(1) – Exchange of Information in Advance and duty to provide advice - of the Proposal provided: 'Without prejudice to the application of Directive 95/46/EC, and in particular Article 6 thereof, the creditor and, where applicable, the credit intermediary may request of a consumer seeking a credit agreement, and any guarantor, only such information as is adequate, relevant and not excessive, with a view to assessing their financial situation and their ability to repay. The consumer and guarantor shall reply accurately and in full to any such request for information'.

The following Article 8 (Central Database), innovatively bringing into play either CRAs or PCBs depending on the various institutional arrangements of each Member State, specified:

‘1. Without prejudice to the application of Directive 95/46/EC, Member States shall ensure the operation on their territory of a central database for the purpose of registration of consumers and guarantors who have defaulted. This database may take the form of a network of databases.

Creditors must consult the database prior to any commitment on the part of the consumer or guarantor, subject to the restrictions referred to in Article 9. The consumer and, where appropriate, the guarantor shall, if they so request, be informed of the result of any consultation immediately and without charge.

2. Access to the central database in another Member State shall be ensured under the same conditions as for firms and individuals in that Member State, either directly or via the central database of the home Member State’.<sup>35</sup>

The Proposal, finally, introduced in Article 9 the principle of responsible lending, based on the requirement that a lender has ‘previously assessed, by any means at his disposal, whether the consumer and, where appropriate, the guarantor can reasonably be expected to discharge their obligations under the agreement’.<sup>36</sup>

In practice, the introduction of the rather difficult – and controversial - concept of ‘responsible lending’ would have represented an obligation for the ‘good lender’ to consult centralised credit databases and to examine the responses provided by the consumer and eventually the guarantor.

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<sup>35</sup> *Ibid.* Importantly, Article 8 further specifies in its third limb that ‘personal data received under paragraph 1 may be processed only for the purpose of assessing the financial situation of the consumer and guarantor and their ability to repay. The data shall be destroyed immediately after the conclusion of the credit or surety agreement or the refusal by the creditor of the application for credit or the proposed surety’. Article 8 then concludes by clarifying that ‘the central database referred to in paragraph 1 may include the registration of credit agreements and surety agreements’.

<sup>36</sup> *Ibid.*

The above three provisions of the Proposal would have been interesting grounds for a discussion and detailed analysis for this work and its subject matter, but for the fact they were suppressed in the modified version presented after rejection of the Proposal on 11/09/2003 by the Legal Affairs Committee of the European Parliament and its consequent withdrawal by the Commission.<sup>37</sup>

On 10/10/2005, in fact, the Commission presented, pursuant to Article 250(2) of the EC Treaty, a modified proposal for a Directive of the European Parliament and of the Council on credit agreements for consumers, amending Council Directive 93/13/EC (the ‘Amended Proposal’).<sup>38</sup>

As a whole, the Amended Proposal has revolutionised the original Proposal. As far as consumer information sharing is concerned, the former Article 7 has been completely erased and the former Article 6 has been incorporated with substantial modifications in the new Article 5(1):

‘The creditor and, where applicable, the credit intermediary shall adhere to the principle of responsible lending. Therefore, the creditor and, where applicable, the credit intermediary, shall comply with their obligations concerning the provision of pre-contractual information and the requirement for the creditor to assess the consumer’s creditworthiness on the basis of accurate information provided by the latter, *and, where appropriate, on the basis of a consultation of the relevant database.* (Emphasis added.)

Where the credit agreement allows the creditor to change the total amount of credit after the date of conclusion of the credit agreement, the creditor shall update the

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<sup>37</sup> Committee on Legal Affairs and the Internal Market, P5\_TA-PROV(2004)0297, (A5-0224/2004 - Rapporteur: Joachim Wuermeling) PE 338.483, ‘European Parliament legislative resolution on the proposal for a European Parliament and Council directive on the harmonisation of the laws, regulations and administrative provisions of the Member States concerning credit for consumers (COM(2002) 0443 – C5-0420/2002 – 2002/0222(COD)).

<sup>38</sup> Modified proposal for a directive of the European Parliament and of the Council on credit agreements for consumers amending Council Directive 93/13/EC, COM(2005) 483 final 2002/0222(COD)

financial information at his disposal concerning the consumer and shall assess the consumer's creditworthiness before any significant increase in the total amount of credit'.<sup>39</sup>

As was made clear in the Explanatory Memorandum of the Amended Proposal, the obligation to set up national credit reference databases has been deleted, 'since this would go beyond the purpose of this Directive. Issues relating to data protection are already dealt with in the Data Protection Directive 95/46/EC. Therefore, the Commission proposes to guarantee only a mutual access to existing private and public databases on a non-discriminatory basis'.<sup>40</sup>

In the intention of the legislator, this simply means that the Amended Proposal requires all existing consumer credit databases to be opened up to EU credit providers on a non-discriminatory basis, instead of requiring the setting up of new consumer credit databases at national levels.<sup>41</sup>

Finally, as regards the controversial concept of 'responsible lending', the Amended Proposal has modified the initial formulation requiring lenders to give standardised information about important elements, such as annual percentage interest rate, fees and monthly repayments when advertising consumer credit products. It also obliges lenders to give consumers comprehensive information about credit agreements expeditiously before they sign the contract, document the agreement properly and keep the consumers properly informed about their respective rights and obligations under the agreement throughout their credit relationship. These information requirements, coupled with the right to cancel a credit agreement within fourteen days of signing it, are intended to help consumers avoid taking on more debt than they can afford. In addition to these core requirements, the revised law

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<sup>39</sup> *Ibid.*, Article 5(1).

<sup>40</sup> *Ibid.*, Explanatory Memorandum, 6; See also *Ibid.*, Article 8(1) Database Access.

<sup>41</sup> European Commission MEMO/05/361 Date 10/10/2005 available at <http://europa.eu.int/rapid/pressReleasesAction.do?reference=MEMO/05/361&format=HTML&aged=0&language=EN&guiLanguage=fr>

demands that lenders check a consumer's creditworthiness before concluding a credit agreement with him or her, without imposing any specific means among the many that could be used (CRAs, indeed, are just one possibility).<sup>42</sup>

## **VII. Concluding Remarks: missing a chance?**

What strikes a commentator's attention straightaway is that, throughout the discussions that have taken place at EU level over consumer credit information systems, there was no mention at all of the institutional side and the problems concerned that this - or, better, the absence of it - raises. It seems like that no consideration was given to the function that the organisations serving the market carry out. A basic question should be asked: do CRAs exercise a public function for the benefit of all, the industry and consumers alike, or rather do they not simply provide services for the benefit of the profitability of lenders? In the former circumstance, in fact, debates over a form of institutional governance, at a minimum, should have occurred. If, however, this is not the case, it poses the serious problem of what role CRAs really have in the consumer credit sector. Do they exercise a function similar to that of private investigators at the service of the industry? Should the latter be the case, then there could be grounds for propositions ranging from the extremist ones to outlaw CRAs to more moderate ones to introduce industry-specific laws covering the many aspects that consumer credit reporting entails.

Whatever the case may be, surprisingly, it emerged from the discussions over the Proposal and the following Amended Proposal that the position of the relevant European institutions, after consultation with the industry, was to voluntarily omit the regulation of consumer credit reporting from the context of a consumer credit law for the single market, with the result that it would substantially leave the *status quo* in the sector.

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<sup>42</sup> *Ibid.*

As this work has stressed, however, it is doubtful that consumer credit reporting complies with the requirements of data protection legislation, and in any event such law seems inadequate to bring a balance to the sector, solving the number of concerns that affect individuals and the larger European society alike.

Thus, is the EU missing a chance to re-think a new regulatory model to support a healthy single market in retail credit in which consumers receive adequate protection?

Certainly, the new consumer credit directive should represent the appropriate forum for a public debate. And, subsequently, legislative intervention should occur that will not only require lenders to be placed in a condition to operate in the whole Community without being subject to extraneous legal requirements and/or natural barriers, but that will also necessitate legal certainty, legitimisation, and appropriate institutional guarantees for all the actors involved, *in primis* consumers.

For these reasons, the results of the Amended Proposals are far from satisfactory. This is provided, of course, that consumer credit information sharing is really the answer to responsible lending practices in an efficient and thriving consumer credit market, a circumstance that should be still demonstrated by way of conclusive evidence of a relation of cause and effect or, at least, empirically.