

A HISTORICAL PRIMER ON CONSUMER CREDIT REPORTING SYSTEMS: A LESSON FOR EU POLICY MAKERS?

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Abstract

This work investigates the cultural framework through the lens of history of consumer credit reporting in the lender-borrower relationship in order to inform European legislators when setting a future legal framework. It provides an historical primer of consumer credit reporting in the US where it first originated and how the system was transplanted in Europe without following that process of legitimisation and legislative procedure that was so crucial over more than 100 years of American history. This brings concerns that European countries need to contend with, especially in view of a future integrated single market in consumer credit in which consumers receive an adequate protection.

I. INTRODUCTION

This work explores the cultural framework of consumer credit information systems as tools used by lenders to manage credit risk. This arguably has important consequences for the legal context in which they operate and aims at informing policy makers for future legislation.

Consumer credit information systems consist of databases containing information on consumers' financial transactions, borrowings, payment behaviour and other aspects of household finances.

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This information, together with information from other sources, is disseminated by the Credit Reference Agencies (CRAs) to their member clients, i.e. third party lender organisations, to help them to assess the creditworthiness of borrowers and monitor the risk of lending.

Recent scholarship has located credit information systems as risk-management tools to solve problems of bad debts, moral hazard and adverse selection, a framework that largely focuses its attention on the economic efficiency of credit markets.²

Another framework that has been too often neglected, but nevertheless should not be underestimated, is the legal one. This, in turn, should take into account the cultural framework, intended as the set of societal norms that influence the success, promotion, and most importantly the legitimisation of a business in the context in which it operates.

The cultural dimension is certainly one difficult to measure. But one suggestive way to approach the problem is that of taking a historical perspective as a description of a social process.³

Thus, similarly to what has been already questioned about business credit reporting⁴, one may be tempted to address the same type of questions for the system implemented for consumers: why and how consumer credit reporting emerged and evolved to the present system? What led to the development of powerful organisations such as CRAs that crucially affect the way credit is allocated and, ultimately, the lives of individuals? Why did this solution to the problem of information asymmetry in the consumer credit market was implemented in Europe instead of other models? What cultural baggage does consumer credit reporting carry with it and how does this may affect its operation elsewhere other than where it first developed?

² Stiglitz J.E. and Weiss A., *Credit Rationing in Markets with Imperfect Information*, 71(3) AMERICAN ECONOMIC REVIEW 393-410 (1981); Berger A.N. and Udell G.F., *Relationship Lending and Lines of Credit in Small Firm Finance*, 68 JOURNAL OF BUSINESS 351-381 (1995); Jappelli T. and Pagano M., *Information Sharing, Lending and Defaults: Cross-Country Evidence*, 26 (10) JOURNAL OF BANKING AND FINANCE 2017-2045 (2002); Diamond D.W., *Monitoring and Reputation: The Choice between Bank Loans and Directly Placed Debt*, 99(4) JOURNAL OF POLITICAL ECONOMY 689-721 (1991); Admati A.A. and Pfleiderer P.C., *Forcing Firms to Talk: Financial Disclosure Regulation and Externalities*, 13 REVIEW OF FINANCIAL STUDIES 479-519 (2000); Barron M. and Staten M., *The Value of Comprehensive Credit Reports: Lesson from the US Experience*, in REPORTING SYSTEMS AND THE INTERNATIONAL ECONOMY 273-310 (Miller M.J. ed. 2003).

³ Olegario R., *Credit Reporting Agencies: A Historical Perspective*, in REPORTING SYSTEMS AND THE INTERNATIONAL ECONOMY 115-159 (Miller M.J. ed. 2003); Strasser S., *The Alien Past: Consumer Culture in Historical Perspective*. 26 JOURNAL OF CONSUMER POLICY 375-393 (2003).

Already at this early stage, one may suspect that the modelling of a system that was developed in the context of a different culture, timeframe, and pace of establishment may cause problems of adaptation and legitimisation if transplanted in jurisdictions with different traditions. Thus, tracing the origins of consumer credit reporting within a specific historical time and place proves useful as:

- (i) it carries an interest on its own in business and legal history;
- (ii) it helps to better understand the pillars upon which the credit information business is based;
- (iii) it provides a cultural perspective that could clarify to what extent the transplantation from a jurisdiction to others of systems capable of affecting significantly the lives of people may lack legitimacy and could hardly fit into pre-existing legal frameworks;
- (iv) it may contribute to the policy debate that authorities in the EU will need to face when setting a legal framework.

In order to attempt to answer to the questions that it asks, this work will try to identify those informal mechanisms that are considered the ancestors of credit reporting.

Following, an investigation of the commercial area of credit reporting in the US – the country where it first originated – will follow. Such scrutiny appears necessary as reporting about consumers seems to owe its development precisely to the model which was implemented long before for the business sector.

Once outlined the process of legitimisation that consumer credit reporting had to go through in the US, then an analysis of the European context will be carried out.

Any thorough account of the detailed history or ideologies behind consumer credit would require a book-length study in itself and, for certain aspects, still needs to be written. For instance, debates among economists or historians about the exact causes of the development of a certain form of

⁴ Olegario, *supra* note 3.

credit or another, though significant in their own right, are of little interest to this study in so far as they do not have an impact on information sharing mechanisms.

The source of information and materials about the origins of the phenomenon of credit reporting are scarce. Until now, only few scholars have investigated the historical background of the industry (although mainly business credit reporting) and those who examined it acknowledge that most of the early agencies' records have not survived, so a number of aspects concerning their evolution can only be a matter of conjecture⁵.

II. CONSUMER CREDIT INFORMATION SYSTEMS

Consumer credit reporting has become the most extensively used instrument to underwrite decisions on borrowings 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.

CRA's are deemed to represent an institutional response at the service of the credit industry to the problem of asymmetric information in financial markets. They maintain a full data sharing mechanism based on the collection from the various lenders of information about their customers. At the same time, they provide those same lenders with consumer credit reports along with other information services and decision making tools, making consumers' reputations accessible to other (potential) creditors.

Another reason for the industry's interest in CRA's is that through an extensive collection and sharing of personal data they are considered to provide services in the fight against the growth of over-indebtedness of borrowing individuals. In political terms, this would confer to the credit

⁵ *Id.*

industry the tools for responsible lending policies, protecting individuals from running up significant borrowings beyond their means.

Significantly, at least in Europe, consumer credit reporting is not mandated by law and the underlying sharing devices rely on the voluntary provision to CRAs of customers' data from an indefinite number of lenders, which in turn are the same CRAs' own clients.

The use of credit information sharing systems represents already the current practice in consumer credit and banking relationships in every European country. In many ways, in fact, the development of the credit industry has reflected the intuitions developed in the economic theoretical literature on information sharing arrangements, 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. To date, there is no industry-specific legislation that deals with credit reporting activities. Legislators across Europe, in fact, mainly rely on at least one law that have a significant impact on consumer credit reporting activities, the EU Data Protection Directive as transposed in national law.⁶

However, whether data protection legislation is adequate and relevant to the sophisticated and highly technological mechanisms of credit reporting, where data from different sources are easily and quickly aggregated, new data are automatically created, and are disclosed to a potentially unlimited number of third parties for a growing number of expanding purposes is doubtful.

In fact, the preservation of consumers' right to privacy of their financial transactions appears to be in jeopardy and an attentive legal analysis would be required.

At the same time the EU single market and the political desire for further integration in the consumer credit sector are likely to bring with them a number of important decisions for legislators. Insofar as there is a need for an European single market in consumer credit, the creation of cross-

border opportunities, and an effective mobility of Europeans from one member state to another, then Europe should start to re-think an harmonised legal framework, including an institutional organisation for an European exchange of information.

To assess the above legal dilemmas, it should not be underestimated the role of culture as a distinctive and consistent part of the legal mind. Arguably, looking at consumer credit reporting through the lens of history could provide a contribution to the debate.

III. HISTORICAL INFORMAL INFORMATION SHARING MECHANISMS

Locating the origins of credit reporting with a certain degree of historical precision may result in a difficult task. In fact, it seems that informal information sharing mechanisms have existed since the genesis of the notion of society itself.

To this extent, there appear to be both conceptual and historical connections between credit reporting and the practice of 'gossip', an informal information sharing method that has its roots in humankind living in communities.⁷

In particular, civilised societies, at least as they are known today according to Western world standards, would need to rely on accountability mechanisms to protect the social order and historically 'gossip' best served as a vital function of creating social reputation. As Klein reasons, this was particularly so when it came to trade and business practices because "when people interact, there is no referee overseeing the interaction. If one party fails to meet his or her obligations, the other party is the only person able to report it. Reporting the failure helps to form a reputation on the chiseller and creates accountability against chiselling".⁸

⁶ Directive 95/46/EC, OJ 1995 L 281, 0031-0050.

⁷ Klein D.B., *Promise keeping in the great society: a model of credit information sharing*, 4(2) ECONOMICS AND POLITICS 117-136 (1992); Klein D.B., *Credit Information Reporting: Why Free Speech is Vital to Social Accountability and Consumer Opportunity*, (2005) at <http://lsb.scu.edu/faculty/creditreporting.html>.

⁸ Klein (2005), supra note 7 at 7.

Thus, much longer before CRAs existed, merchants had to rely on word of the mouth, letters of reference, and other forms of gossip to assess the trustworthiness of those counterparties dealing with them.⁹

However, informal information flows such as 'gossip' are known to be efficient in small communities ensuring the diffusion of information about their members. By contrast, across all the members of a greater society 'gossip' would be impossible as with increasing social complexity informal social controls would necessarily diminish in significance and need to be replaced by formal mechanisms of social control.¹⁰

For these reasons, credit reporting is considered to represent an institutionalised transformation of 'gossip' originating from informal reputation mechanisms in the creditor-debtor relationship that could be traced over the centuries and are said to be nearly as old as credit itself.¹¹

Notably, such evolution is considered to be the most standardised and extensive reputational system humankind has ever known.¹²

This alone, however, does not explain the formal emergence of CRAs as the institutional response associated with the problem of asymmetric information and the risk of granting credit.

It is important to note that these mechanisms were initially appropriate only for trade related or small-scale business activities among a closed group of local merchants.¹³

An annual report of the World Bank identifies the emergence of embryonic formal institutions for credit information sharing already in the seventeenth century (*sic!*) Paris where notaries exchanged data on debtors' creditworthiness.¹⁴

This view, however, is isolated and appears somehow misleading.

⁹ *Id.* at 4-5.

¹⁰ Klein (1992), *supra* note 7 at 119-120.

¹¹ Olegario, *supra* note 3.

¹² Klein (1992), *supra* note 7 at 121.

¹³ Olegario, *supra* note 3; TransUnion LLC., *Credit Reporting - The Backbone of a Vibrant Market Economy* at <http://www.transunion.com>.

¹⁴ The World Bank Group, *Doing Business in 2004 - Understanding Regulation* (2004) at <http://www.doingbusiness.org/Main/DoingBusiness2004.aspx>.

Hoffman, Postel-Vinay, and Rosenthal used evidence from eighteenth century Paris to examine how financial intermediaries resolved problems of asymmetric information in the financial market. The intermediaries in Paris were indeed notaries, who were in high demand for all sort of inter-temporal contracts (for example debt, trade ventures, probate records, marriage contracts) and were required to keep a copy of the contracts they drew up. Their archives, thus, were a valuable source of information about the private wealth of individuals. It was from their archives that they acquired and used the information needed to match borrowers and lenders for specific transactions. However, that information was the notaries' property and the archives were closed to outsiders. Thus, they did not hand out the information to lenders to assess the creditworthiness of those borrowers that entered independently into business with the lenders themselves. On the contrary, such dealings practised by notaries rather evolved in what modern society today defines as 'brokers', i.e. intermediaries allocating persons to the various types of contracts.¹⁵

This distinction is important as it allows to draw a clear-cut separation between two types of third-party intermediaries that have established themselves to meet the problem of asymmetric information in credit markets. CRAs, in fact, are not brokers mainly because they lack independency from both the contracting parties. CRAs operate at the service of lenders notwithstanding the agreement or disagreement of borrowers. They provide information to lenders that they have not received directly from borrowers but from other lender clients. In this respect, CRAs are closer to private investigators gathering and disseminating information about borrowers through a peculiar mean that has the goal to inform their clients.

This distinction has crucial consequences when attempting to map the legal framework of credit reporting systems in the consumer sector. For example, it could be anticipated that the latter, other than been perceived by many as 'inquisitorial', has the potential to collide with privacy rights. In the case of brokers, on the contrary, this does not happen in so far as borrowers voluntarily seek them to

¹⁵ Hoffman T.P., Postel-Vinay G. and Rosenthal J.L., *What do notaries do? Overcoming asymmetric information in financial markets: the case of Paris, 1751*. 154(3) JOURNAL OF INSTITUTIONAL AND THEORETICAL ECONOMICS 499-530 (1994).

the same extent as lenders do, i.e. to be allocated to the best contractual solution corresponding to their needs (the rule of the matching between demand and supply).

By contrast, in an historic search about the formal emergence of CRAs there is agreement that they evolved in the US much later in time in the first half of the nineteenth century.

IV. THE ORIGINS OF CREDIT INFORMATION SHARING SYSTEMS: BUSINESS CREDIT REPORTING IN THE US

In the US business credit reporting preceded consumer credit reporting by several decades.

According to some, it developed from an agrarian need that generated a system of credit: during the spring and summer months farmers lacked a source of income and retailers provided them unsecured credit to be recovered later in the year upon sale of their products. While farmers traded their expectations of future income, creditors kept record of the transaction and on occasion shared the information.¹⁶

More commonly and in much larger scale, however, historians agree that credit reporting rather emerged as an attempt to manage the risk of mercantile credit, intended as the extension of goods to other merchants or businesses based on the promise that the receivers of the goods paid for them at a later date. This form of credit was - as it continues to be - a vital source of funding for small businesses. It functioned as short-term working capital allowing them full use of the goods before their payment. At that historical time, it was often - if not exclusively - the only type of credit available to small businesses, as opposed to today's forms, varieties, and availability of financing arrangements. At the same time, it represented a form of unsecured business to business lending

¹⁶ Trans Union, *supra* note 13; GUP B.E., (1976). FINANCIAL INTERMEDIARIES: AN INTRODUCTION 210 (1976).

whose repayment terms during the American colonial era extended to a year or more, as compared with the thirty to ninety days of today's commercial practices.¹⁷

Likewise, as it happens at present times, sellers did not charge any interest unless buyers incurred in late repayments in accordance with penalty clauses in the underlying contract, whilst discounts were granted for straightforward or early payment.¹⁸

Thus, good information became an essential element particularly in those trade relationships when the parties did not know each other personally.

The small scale of trade in the US until the early nineteenth century had allowed traders to rely on personal ties or, in the event the seller did not know a prospective buyer personally, on the experiences and opinions of other merchants. In this latter circumstance, merchants relied on letters of recommendation or word of mouth information exchanges with members of the same industry group. This is the reason why they developed networks of mutual cooperation taking the forms of roundtables, associations, and mutual protection industry organisations restricted to members only, sharing information about the trustworthiness of their customers in meeting their obligations. An important feature of such closed users' groups was that there was no attempt to profit from it as it exclusively served as a mean of making good business.¹⁹

A differential and decisive set of elements occurred in the US by the second decade of the 19th century: the growth of the population and the expansion of the American country, coupled with a considerable increase in the volume of transactions favoured by the construction of canals and railroads, opened the market to a growing number of potential new customers many of whom were unknown to merchants being located in distant states and territories.²⁰

¹⁷ NORRIS J.D., R.G. DUN & CO. 1841-1900: THE DEVELOPMENT OF CREDIT-REPORTING IN THE NINETEENTH CENTURY (1978).

¹⁸ Olegario, *supra* note 3.

¹⁹ Klein (2005), *supra* at : Olegario, *supra* note 3 at 118-120; Madison J.M., *The Evolution of Commercial Credit Reporting Agencies in Nineteenth-Century America*, 48(2) BUSINESS HISTORY REVIEW 164-186 (1974); Hidy R.W., *Credit Rating Before Dun and Bradstreet*, 13(6) BULLETIN OF THE BUSINESS HISTORICAL SOCIETY 81-88 (1939); Wyatt-Brown B., *God and Dun & Bradstreet, 1841-1851*, 40(4) BUSINESS HISTORY REVIEW 432-450 (1966).

²⁰ Norris, *supra* note 17: Olegario, *supra* note 3.

As a result, existing industry group systems and techniques became unreliable. As Olegario explains, it was because of the vast geographic scale of the US and the high mobility of its population that mutual protection society and other merchants' groups could not last as an effective response to credit risk.²¹

The need for knowledge about distant and unknown customers stimulated several larger business houses to develop more formal methods of acquiring credit information.²²

In order to cope with the changing needs of the market, during the 1830s groups of wholesalers attempted innovative solutions and hired private investigators or travelling salesman providing data about unknown customers.

However, some businesses like international banking houses such as Barings and Brown Brothers, preferred to use their own agents with specific responsibilities only for credit reporting as they didn't trust third parties data providers who were either unreliable (as they were themselves unknown) or subject to various form of bias or, in worst cases, collusion.²³

Such arrangements had a crucial downturn: the reports of these large banking houses, described to be high in quality and more reliable than other forms, were also high in cost and only few businesses could afford to hire a full-time credit agent or develop their own systems of reporting.²⁴

Because reasonable alternatives did not exist, most businesses had no choice but to continue to rely on their personal knowledge, the knowledge of others they knew, mutual protection groups hiring unreliable third parties investigators or travelling salespersons, or luck.

The inadequacy of such methods of gaining information for credit purposes became particularly evident during the economic crises of the late 1830s and the early 1840s when rapid changes in the financial condition of many demonstrated once even more the wide extent of the ill-founded trust in many new customers.

²¹ Olegario, *supra* note 3 at 118.

²² Madison, *supra* note 19 at 166; Norris, *supra* note 17.

²³ Hidy, *supra* note 19; Wyatt-Brown, *supra* note 19.

²⁴ *Id.*

In contrast to the industry groups, as a reaction to their inadequacy, enterprising individuals in New York set up a new type of organisation better suited to the peculiar needs of American society, where traders needed information about their (potential) customers whose business experienced where dispersed over a wide territory, at the same time being able to meet the costs of such expanded service. The first of this new type of organisations - the credit reporting agencies - opened its doors in New York in 1841 and was soon followed by others.

As Madison writes, CRAs "attempted to provide in a formal and institutional manner a service that earlier was almost exclusively a function of personal ties within the mercantile community".²⁵

To do so, they set up as third-party profit-seeking providers of information that turned information into a commodity accessible not only to the industry group members but by anyone willing to pay to the agencies a subscription price. In their operations, the new CRAs gathered information on a wide array of businesses, and did not limit to those of interest to a particular network.²⁶

Thus, it may be acceptably maintained that such added value provided at affordable costs, coupled with the financial robustness of earning fees from subscribers, were the most probable reasons why CRAs emerged over industry groups or other organisations in providing information services about (potential) trade partners or customers.

For the most part, above all, CRAs succeeded to emerge owing to the context and exploiting the momentum in which they set up. The country's growth in population and territories, the development of transportation, the new opportunities and consequent ever stronger commercial orientation, coupled with the absence of established interests in that particular market, were factors highly encouraging to institutional experimentation.

Furthermore, as many CRAs emerged rapidly with the entry of new competitors, the actors involved in such brand new sector needed to gain competitive advantage one over the other, thus being

²⁵ Madison, *supra* note 19 at 167.

²⁶ *Id.* See also Norris, *supra* note 17; Olegario, *supra* note 3.

forced to develop the largest possible territorial coverage as well as provide the greatest number of available information also reporting on even the smallest businesses.²⁷

These factors led the most successful CRAs to achieve scale and scope efficiencies by setting up a network of correspondents, local agencies, and branches all trading under a common name, soon becoming what some commentators defined as organisations being among the first US businesses to be truly national in scope.

Taking advantage of the local knowledge of their network structure and pursuing their perennial efforts to prevail over rival organisations, CRAs also began to offer a wide range of further services, such as debt collection and analyses of local market conditions.²⁸

In other words, as Olegario puts it, CRAs "helped to entrench the very conditions that gave rise to them, and which made their work possible".²⁹

As far as it concerns the type of information available to the American creditor of the 19th century, it is interesting to observe that it was very different from that used today.

There were no track records of early financial transactions, payment histories, and other quantitative data.

Norris and Olegario provide a comprehensive account of the information collected and used for credit purposes. Little or no information was provided on business revenues, profits, losses, and cash flow. Creditors, in addition, were reluctant to request them for fear of offending and losing existing or potential customers. In any event, as credit terms extended from six to twelve months, a customer's current liquidity was not of much interest as it could not be available at the time of the repayment. Creditors, by contrast, were more interested in the borrower's 'character' as an indication of past behaviour. To this purpose, not all character traits were considered relevant or equally important. Creditors, instead, focused their attention on those elements that they thought, according to the culture of the territory at that particular time, directly linked to the borrower's

²⁷ *Id.* See also Wyatt-Brown, *supra* note 19.

²⁸ Olegario, *supra* note 3; Wyatt-Brown, *supra* note 19.

²⁹ Olegario, *supra* note 3 at 9.

willingness or ability to repay the debt. These included, for example, honour and honesty, punctuality, extravagance, experience, energy, vices (drinking and gambling only), and few others. Accordingly, such methods of assessing creditworthiness, aided by the CRAs network structure, spread quickly in the US territory because they were relatively simple and congenial to the American values of that particular time. This is also the reason why such methods became a standard for the industry in managing situations of credit risk.³⁰

Credit reporting in the US not only became the activity it is today only through the application of those techniques that were determined by the needs of the market, but also was shaped by the subsequent regulatory environment that developed over time.

Early complaints and discontent about the services of CRAs centred on the pragmatic issue of the accuracy of the information. The CRAs unprecedented methods of collecting and disseminating information, some of it erroneous, outdated, or incomplete made them the target of lawsuits as the result of a number of circumstances in which subscribers were misled about potential customers and incurred in losses.

As a result, in the absence of legislation and clear legal precedent, Courts emerged as the sole and most active controllers of the credit reporting business, bearing also the merit to open its secret workings to public scrutiny.

The first cases all focused on the concepts of 'defamation' versus 'privileged communication'. According to the CRAs, the reports fell under the legal heading of 'privileged communication' between the CRAs and their subscribers (i.e. their clients), therefore they did not constitute libel or slander. As they fall within the rule of privileged communications of confidential nature in a client relationship - the argument run - the reported-on persons should have had no right of access to it. Judges, at first, rejected such view reasoning that credit reports could not benefit from the

³⁰ Norris, *supra* note 17; Olegario, *supra* note 3. See also Wyatt-Brown, *supra* note 19.

protection of privileged communication because the information was available to a large number of subscribers, potentially open to anyone willing to pay for the service.³¹

In later decades, however, the Courts broadened the definition of privileged communication accepting the CRAs arguments, provided that the communication must be in “good faith” and “made in a proper manner, without evil intent or malicious motive”.³²

At the same time, CRAs recognised that improvements in the quality of their services were not only possible but also necessary if they were to earn wider acceptance from American businesses and consolidate.

More importantly for their survival, they simultaneously refined their contracts with subscribers to include disclaimers regarding the accuracy of information they provided and formulating denials of liability to the fullest extent possible.³³

Such disclaimers, however, could have had little effect unless the courts were willing to accept a very limited definition of liability.

In the late nineteenth century, the major thrust of court decisions was favourable to CRAs as judges ruled that they only needed to carry out their activities using 'reasonable diligence' in order to be exempt from liability if their reports were inaccurate.³⁴

In unison, the courts went further by enlarging the obligation of the person about whom a report was made to provide truthful statements to the CRAs' reporters. In such circumstances, it was held that CRAs were not accountable for the losses suffered by their subscribers but rather the merchants who intentionally deceived CRAs reporters were the ones liable as if they had made the false representation directly to the party injured.³⁵

Thus, throughout and after the post Civil War period, as a result of the increased protection from the courts, improved quality of services, growing use and convenience of credit reporting services, as

³¹ *Beardsley v. Tappan*, 5 Blatchf, 498 (1867) cited in *Madison*, *supra* note 19 at 179 et seq.

³² *Ormsby v. Douglass*, 37 N.Y. 484 (1868) cited in *Madison*, *supra* note 19, 179 et seq.

³³ *Olegario*, *supra* note 3; *Wyatt-Brown*, *supra* note 19; *Madison*, *supra* note 19.

³⁴ *Madison*, *supra* note 19 at 179.

³⁵ *Eaton v. Avery*, 83 N.Y. 34 (1880) cited in *Madison*, *supra* note 19 at 179 et seq.

well as the utter prevalence of business practice, the resistance to CRAs slowly gave way not only to acceptance but also imposed the CRAs as permanent elements of the US commercial infrastructure and established business institutions.³⁶

As Olegario comments, "lawsuits were a constant source of concern to the agencies, but they functioned as an important check on an otherwise unregulated industry. (...) Equally important, the court decisions helped to legitimise the agencies' activities".³⁷

Once consolidated on the US market, large agencies began to establish foreign branches, particularly in those countries where American companies conducted sizeable trade.³⁸

Only later, other European countries followed the example of the US and started to develop mutual protection society operations.³⁹

V. CONSUMER CREDIT REPORTING IN THE US

The history of consumer credit reporting differs from that of business (or commercial) credit reporting in that the former developed much later and for long time operated on a non-profit basis.

Apart from that, the design of the system and the fundamental functions of the two types were not different: the provision to a party of information about another (stranger) party by an outsider so that the former may trust the latter party to engage in a contractual relationship prior to receiving a payment for goods or services, i.e. on the basis of credit.

Tracing the origins of consumer credit reporting would require, in first place, looking at the history of consumer credit in its modern form which took place - again in the US - much later in time than mercantile and business credit.

³⁶ Wyatt-Brown, *supra* note 19; Madison, *supra* note 19.

³⁷ Olegario, *supra* note 3 at 132.

³⁸ For example with countries such as Canada, Mexico and, in Europe, the UK and Paris.

³⁹ Creditreform 1879, a German company, prides itself to be the first one of this sort. See <http://www.creditreform.de>

Although credit for consumer goods is one of the oldest of all forms of credit, with a history stretching back to antiquity, the modern system of credit for consumption - the one properly known today as 'modern consumer credit' - has its roots only in the early decades of the 20th century.

The ongoing debate among economists and historians regarding the legitimacy of labelling the 1920s as a revolutionary period in consumer credit and spending, while significant in its own right, is of little consequence to the argument of this work. This work is concerned primarily on the origins of consumer credit reporting and its close relationship with the American culture and during the 1920s indeed occurred a dramatic change in consumption culture and standards, as well as selling techniques.⁴⁰

Accordingly, modern consumer credit differentiated from the original conception of credit for goods in that it was built on two institutional foundations:

- (a) a peculiar method of credit based on the instalment plan, where money is lent or a good is sold on the condition that the borrower or purchaser repays the loan with fixed payments to be made at regular times over a specified period;
- (b) an array of particular sources of credit other than the traditional historic pawnbrokers and/or illegal moneylenders.

Certainly, end of 19th/early 20th century Americans had more than their share of financial pressures and were indisputably involved in borrowing practices. However, it is the concept of debt that was different from modern consumer credit. Households rarely went into debt for things that were nonessential or frivolous. Borrowing, in fact, was acceptable and safe only when used to acquire goods that increased in value or had productive uses.⁴¹

A number of studies take seriously the role that culture and religion played in market development.

⁴⁰ CALDER L., FINANCING THE AMERICAN DREAM - A CULTURAL HISTORY OF CONSUMER CREDIT (1999); GELPI R.M. AND JULIEN-LABRUYÈRE F, THE HISTORY OF CONSUMER CREDIT. (2000); Gup, *supra* note 16; Kubik P.J., *Federal Reserve Policy During the Great Depression: The Impact of Interwar Attitudes Regarding Consumption and Consumer Credit*, 30(3) JOURNAL OF ECONOMIC ISSUES 829-842 (1996).

⁴¹ Calder, *supra* note 40 at 16-22; Gelpi and Julien-Labruyère, *supra* note 40.

Among them, Calder provides an extensive account of the cultural history of modern consumer credit that best explains the distinction between the different approaches of consumer debt as compared with that of business. Consumer credit was not invented during the years of the consumer revolution of the 1920s, although it is undisputed that household debt levels soared during that decade. Rather, the American Victorian era of the late 19th century is considered as the starting point in history to analyse, a period marked with attempts to solve a new major problem introduced by the rapidly industrialising economy of that time, i.e. the smoothing out of household cash flow. Money ethic literature of that age first began to distinguish between two types of credit: (a) the good 'productive credit' used to finance labour, business, and/or investments creating wealth; versus (b) the bad 'consumptive credit', exemplified by "shivering youths who pawned overcoats to pay gambling debts [and] sallow New York dandies with showy chains on their vest".⁴²

Yet, consumption retained an air of disreputability and, in economic terms, was suspected of having a negative effect on aggregate growth.⁴³

Crucially, these ideological barriers fell first in the United States.

As Calder explains, the economic history of consumer credit consisted of the sluggish and often insufficient adjustments made by lenders and households to the new forces of industrialisation and monetarisation. It was an uneven and ambivalent process of legitimisation that accelerated in the first decades of 20th century America that redirected the image and meaning of 'consumptive debt' into the morally neutral idea of consumer debt.⁴⁴

At the same time, the ancient religious legacy in obstructing the use of credit was reflected in the enactment of state usury laws (in the US as well as in Europe) that resisted over a long period of

⁴² Calder, *supra* note 40 at 103.

⁴³ Kubik, *supra* note 40.

⁴⁴ Calder, *supra* note 40 at 109 et seq.

time making it difficult - if not impossible - for lenders to earn profits on small loans lent at legal rates.⁴⁵

As a result of the above cultural and legal constraints, in the US as elsewhere, consumer credit was not easily available.

The first organisations to experiment successfully the use of a hidden form of credit for consumers were retailers, the only ones that were able to take advantage of the extension of payments in instalments (i.e. credit) to consumers for the purchase of goods that otherwise they could not sell, at least for the price that they asked for.

Merchants sold goods charging a credit price distinct from the cash price. The difference between the higher credit price and the cheaper cash price was not considered an interest rate which would have been subject to usury laws. In fact, according to the time-price doctrine established in England already in 1774, credit extended by merchants for the sale of goods was exempted from usury laws.⁴⁶

For the vast majority of retailers the market was limited to a town, a part of a city, or on some occasions, to a whole single city.⁴⁷

At the turn of the century, however, instalment selling was still largely socially identified with poor, female, or immigrant consumers.⁴⁸

As consumer credit itself was limited, the volume of consumer credit data was modest and there was no compelling need for a reporting system of the like of the one that emerged for the business sector. Following the example of the latter, nevertheless, an embryonic type of consumer credit reporting emerged: it was structured in the form of local non-profit associations or cooperatives established by those community retailers that were the primary source of consumer credit.

⁴⁵ *Id.* See also Gelpi and Julien-Labruyère, *supra* note 40.

⁴⁶ Gup, *supra* note 16 at 211.

⁴⁷ Hunt R.M., *A Century of Consumer Credit Reporting in America*, WORKING PAPER 05-13 FEDERAL RESERVE BANK OF PHILADELPHIA (2005); Furletti M., *An Overview and History of Credit Reporting*, DISCUSSION PAPER, PAYMENT CARDS CENTER, FEDERAL RESERVE BANK OF PHILADELPHIA (2002).

⁴⁸ Calder, *supra* note 40 at 111-123.

As it happened for business credit reporting, early operations of this type specialised in providing reports that described customers in a particular location for a single industry segment. As a result, hundreds of small cooperatives emerged throughout the American territory, each focusing on a particular business line in a particular geographic area.

These early local cooperatives were limited in scope and typically restricted their credit related reporting to negative or 'derogatory' information.⁴⁹

For example, as Furletti reports, "a group of retailers in a small town might have agreed to form a cooperative that kept track of customers who were considered delinquent by any member of the group. The individual merchants would then use this information in managing their own credit relationships with prospective and current customers".⁵⁰

This situation, however, gradually changed as the retail markets got bigger following the economic growth led by the expansion and consolidation of the country enhanced by the development of new transports. The larger stores expanded forming chains of stores located in various geographical areas thus moving their administrative and financial operations at single headquarters.⁵¹

Moreover, the social image of instalment selling changed with the booming of industrialisation and, in particular, with the development of a wide array of new consumer durable goods such as the radio, the sewing machine and the automobile, costly items that tested the ability of households of different social classes and income to pay for it or to save over a long period. Almost inevitably, the marketing of such new products was matched by the development and diffusion of innovative payment devices and selling techniques including, most prominently, instalment financing.⁵²

As a consequence of the changes carried out by the process of industrialisation, local sharing of information became less important, the next necessary step for such industry being the formation of a mechanism to share consumer credit information in different cities and regions of the country.

⁴⁹ Hunt, *supra* note 47 at 11-16; Furletti, *supra* note 47 at 3-6.

⁵⁰ Furletti, *supra* note 47 at 4.

⁵¹ Hunt, *supra* note 47; Furletti, *supra* note 47.

⁵² Calder, *supra* note 40 at 156-208; Gelpi and Labruyère, *supra* note 40 at 97-112; Kubik, *supra* note 40 at 830-836.

As a first reaction, thus, in the early decades of the 20th century the National Federation of Retail Credit Agencies was formed, a non-profit association whose task was to facilitate the nationwide sharing of consumer credit information between the cooperative agencies across industries.⁵³

Importantly, towards the second decade of the 20th century, many federal states abolished or relaxed their usury laws, a key factor that thereby encouraged businesses other than retailers to begin granting credit.

The US experienced an unprecedented expansion and diversification of the sources for credit and banks and finance companies - organisations that were already providing business credit - began to gain a primary role by providing open-end consumer credit, thus fostering a market for credit national in scope.⁵⁴

Therefore, the demand for credit reports became a consequential need of the explosion of consumer lending.

At the same time, new technologies were gradually beginning to make it possible to collect and store more data at less cost, making it faster and more efficient to share information. Hence, also in the case of consumer credit reporting, the same potential for scale economies started to be present.

After decades of development by cooperative associations and the rise of new technologies, the fragmented nature of consumer credit reporting began to change in the early 1950s as a number of new companies attempted to achieve scale efficiencies by taking over local non-profit operations.⁵⁵

What was important about scale efficiencies and new technologies was that these companies became able to operate on a commercial for-profit basis.

In the aftermath of World War II, economic recovery coupled with the expansion and increasing mobility of the population boosted consumers' consumption and, with it, consumer credit.

⁵³ Hunt, *supra* note 47 at 11; Staten M.E. and Cate F.H., *Does the Fair Credit Reporting Act Promote Accurate Credit Reporting?* WORKING PAPER SERIES, JOINT CENTER FOR HOUSING STUDIES, HARVARD UNIVERSITY 4-5 (2004). See also COLE R.H. AND MISHLER L., *CONSUMER AND COMMERCIAL CREDIT MANAGEMENT* (1998).

⁵⁴ Calder, *supra* note 40 at 156-208; Gelpi and Julien-Labruyère, *supra* note 40 at 97-112; Gup, *supra* note 16 at 210-226.

⁵⁵ Klein (2005), *supra* note 19; Trans Union, *supra* note 13.

Scholarship often points out that economic growth, together with increased household disposable income, affected significantly behaviour patterns. After the war the US was the first country where a majority of the population disposed of an income well above subsistence level. Consumers' aspirations rose and goods which once were a luxury or nonessential progressively became part of everyday life.⁵⁶

As previous studies emphasise, "the triumph of the industrial society, and the development of a consumer society, had a favourable effect on attitudes to consumer credit".⁵⁷

Over the same period of time, the next major innovation in consumer credit was the development of the credit card industry which presented both opportunities and challenges for credit reporting.

Not only the arrival of credit cards had a dramatic impact on the greater participation of banks in consumer lending fostering demand for credit reports. Also, credit cards made lenders realise the usefulness of the credit history about applicants, thus representing a source of new business for CRAs, particularly for the provision of pre-screening services to card issuers that were interested to know a set of characteristics of potential customer users. In addition, the increasing number of people applying for credit cards made it very difficult both in economic and manpower terms to do anything but automate lending decisions. As lenders began to automate their issuing systems, they obviously soon expected CRAs to do the same automation. Hence, to meet these changes, CRAs had to both automate and get larger, undergoing a process of mergers and/or acquisitions. In this respect, therefore, CRAs had to respond to those economic and technological changes that were occurring in the US, and that was exactly what they did. For this number of factors, business and consumers lending both faced increasing needs for credit data, especially for improved nationwide, multipurpose credit reports.⁵⁸

⁵⁶ Calder, *supra* note 40 at 156-208; Gelpi and Julien-Labruyère, *supra* note 40 at 97-112.

⁵⁷ Gelpi and Julien-Labruyère, *supra* note 40 at 105.

⁵⁸ Gup, *supra* note 16 at 212; Hunt, *supra* note 47 at 14-16; EVANS D.S. AND SCHMALENSEE R., PAYING WITH PLASTIC 61-84 (1999); Thomas L.C., *A survey of credit and behavioural scoring: forecasting financial risk of lending to consumers*, 16 INTERNATIONAL JOURNAL OF FORECASTING 149-172 151 (2000); Nocera J. (1994). A PIECE OF THE ACTION: HOW THE MIDDLE CLASS JOINED THE MONEY CLASS (1994).

As discussed above, however, while business credit reporting was already fairly developed, the same was not the case for the consumer sector.

Although the two types of credit were different in that the level of development of business credit reporting was far more advanced, nevertheless the idea behind the two was the same: to provide information to lenders about potential customers.

As a result, the optimal and ready solution available to the industry was probably that of transposing the model already effectively developed for business credit reporting into the consumers sector.

But consumer credit reporting was more diverse and proved far more controversial.

The type of information involved, in fact, was of personal nature: it had the potential to intrude significantly on personal privacy, it was highly impressionistic, and subject to inaccuracy.

In dealing with consumer information, moreover, the previously existing cooperative organisations aroused less suspicion and resentment than did a business operating for profit.⁵⁹

Considerably, also in the case of consumer credit reporting, until 1970 there was virtual no legal regulation throughout its evolution, and case law referred to business credit. In the absence of statutes, common law was of no help for consumers in large part because it recognised a privilege that protected CRAs from libel unless the plaintiff could provide evidence that CRAs intended to cause him or her harm.⁶⁰

The passage of the Fair Credit Reporting Act (FCRA) was one of the events that left an indelible mark on the industry.⁶¹

First passed by Congress in 1970, the FCRA took effect in 1971 and for the following 25 years regulated specifically credit reporting, with only minor amendments until the substantive changes adopted in 1996 and 2003 to further protect consumers.

⁵⁹ Staten and Cate, *supra* note 53 at 6.

⁶⁰ Olegario, *supra* note 3.

⁶¹ Furletti, *supra* note 47 at 16.

From its enactment, it applied only to individuals (not legal persons) and only to consumer credit (not the business or commercial one) setting forth the rules that govern the reporting activities of CRAs in the US and regulating the way they must interact with creditors and consumers.

Looking at the legislative history, the main impetus for its passage was to reduce the widely recognised problems in the content and accuracy of the reports.

According to Staten and Cate, in fact, "one of the FCRA's primary goals was to create a regulatory structure that would encourage the creation of credit history files that were factually correct and sufficiently descriptive of a consumer's credit usage so that businesses could rely upon the information to make products and services more readily available to consumers. Since implementation of the FCRA in 1971, accuracy in credit reporting has been a perennial issue".⁶²

Obviously, the FCRA represented an important piece of legislation for its substantive provisions and the way it regulated the sector.

More importantly, though, it began that process of legitimisation that is so crucial for the acceptance of a system by the larger society.

A peculiar feature of the credit reporting system as developed in the US consists of its reliance on the voluntary reporting from an indefinite number of lenders providing the credit data to CRAs. Arguably, such voluntary nature of reporting has made the industry particularly sensitive to the costs and limits imposed by legislation. Consequently, since the beginning of the legislative process and debate, the US Congress has been markedly cautious about imposing new requirements on either CRAs or information providers (i.e. lenders) without a clear indication of a problem that necessarily required legislative intervention.

The FCRA responded precisely to inaccuracy problems of reporting private consumer credit files within a voluntary system.⁶³

Ultimately, the law permitted CRAs to collect consumer credit data and assemble credit reports freely. At the same time, the three broad themes that dominated the legislative debate and

intervention were highlighted in the preamble of the FCRA: "to ensure that consumer reporting agencies exercise their grave responsibilities with fairness, accuracy, and a respect for the consumer's privacy".⁶⁴

In this regard, it is important to note that the FCRA has not been the only piece of legislation that has legitimised credit reporting in the US

In 1974, in fact, the enactment of the Equal Credit Opportunity Act (ECOA) ensured the complete acceptance of credit reporting outlawing discrimination in that all consumers were given an equal chance to obtain credit. What is relevant about the ECOA is that among the factors that contribute to the final decision to extend credit there is the explicit recognition of credit histories (together with amount of income, expenses, and debts).⁶⁵

In the end, therefore, the ECOA, together with the FCRA, contributed decisively in the legitimisation by law of the use of credit reports for credit granting purposes to consumers.

Not only legislation shaped the credit reporting industry in the US, but also the simple threat of new laws played an important part.

In fact, regulation has always been seen as imposing costs on credit reporting systems, not all of them being obvious: depending upon where the regulatory burden is placed, some of them could even endanger the provision itself of the services in consideration that the US system is reported to owe much of its alleged effectiveness to the reliance of voluntary reporting and competitive incentives.⁶⁶

Thus, it should be taken into account that despite the legislative framework in place, over history many other voluntary industry initiatives and arrangements dealing directly with consumer concerns have been accelerated by the threat of further regulation.

⁶² Staten and Cate, *supra* note 53 at 2.

⁶³ *Id.* at 3

⁶⁴ Fair Credit Reporting Act of 1970, Pub. L. No. 91-508, 84 Stat 1114, codified at 15 U.S.C. § 1681(a).

⁶⁵ Equal Credit Opportunity Act of 1975, 15 U.S.C. § 1691 et seq.

⁶⁶ Staten and Cate, *supra* note 53 at 52.

CRA's, moreover, have preferred to settle a considerable number of lawsuits brought against them by consumers which, together with the mentioned regulatory pressure, led to the adoption of standardised reporting formats and procedures specifically designed and suited for the American social relations and culture.⁶⁷

VI. CONSUMER CREDIT REPORTING IN EUROPE

Gelpi and Julien-Labruyère provide so far the only contribution of the history of consumer credit in Europe as well as an account of its different cultural approach, exemplified by the anxiety that indebtedness invokes in many middle-class Europeans and those who govern them.⁶⁸

The historical and cultural difference about the development of and approach to modern consumer credit - and, most of all, consumer credit reporting - between the US and Europe is best summarised by the authors own words: "new countries develop new techniques, whereas old countries adapt traditions to suit the times. The history of consumer credit in the United States is almost entirely free of historic influences, whereas Europe, it still suffers from a sort of mental hangover, the result of centuries of bans and taboo. Practices derive from and are explained by age-old traditions".⁶⁹

Certainly, the historical claim that the history of American consumer credit is free from historic influences may seem to many as "shaky".⁷⁰

Nevertheless, in Europe until more or less the mid of last century borrowing was largely morally condemned and stigmatised, although money lending through pawn-broking was a legal activity since 1572.

⁶⁷ The lawsuits mainly concerned errors in credit reports and other inaccuracies.

⁶⁸ Gelpi and Julien-Labruyère, *supra* note 40.

⁶⁹ *Id.* at 119.

⁷⁰ Calder L.G., *Review of Rosa-Maria Gelpi and François Julien-Labruyère 'The History of Consumer Credit: Doctrines and Practices*, ECONOMIC HISTORY SERVICES (2000) at <http://www.eh.net/bookreviews/library/0286.shtml>.

In this regard, pawn-broking represents the ancestor of consumer credit and took various forms alongside the culture and religious beliefs of each country, from the Catholic pious lender organisations fighting money lending (seen as usury) - the French *monts-de-piétés* or Italian *monte di pietà*, public pawnshops controlled by official bodies and designed to help the poor overcome temporary liquidity problems - to the British liberalist free market practice and approach.⁷¹

However, pawning differed from consumer credit significantly for at least an essential element: the function of the former is to advance small loans against the security of goods and chattels while, on the contrary, the latter is often a form of unsecured credit and relies on a planned repayment. This is an important feature in money lending (or else, hire purchase) in that secured credit entails no or little risk to lenders.

As anticipated, however, European countries have a very different history and cultural traditions in respect of modern consumer credit.

Gelpi and Julien-Labruyère account the diverging cultures and traditions in Europe in terms of different mentalities originating from religion: from the protestant reformist countries to the catholic ones.⁷²

Studies on household credit have generally concluded that there is a cultural division between on the one side the US and the UK which are historically open to credit, and on the other side continental European countries.⁷³

Thus, as far as Europe is concerned, Great Britain is often seen by continental Europeans as "a sort of United States within easy reach of Europe" where the role and development of consumer credit was just as strong as the American one, though at different periods but with the same techniques and the same broad liberal economic approach counterbalanced by strong influences of consumer protection movements. Accordingly, this latter feature of consumer protection covers essentials such as the morality of the offer and the right to privacy. In this latter sense, it can be maintained

⁷¹ Gelpi and Julien-Labruyère, *supra* note 40.

⁷² *Id.*

⁷³ Diez Guardia N., *Consumer Credit in the European Union*, ECRI RESEARCH REPORT NO.1 (2002).

that although Great Britain carries the above similarities with the US, at the same time it provides another clear example of the historical difference of 'European' consumer credit as compared with the American way.⁷⁴

In Great Britain pawning was the most important source of credit for the working class households at least until the 1920s and debts of consumers were already extensive since the 19th century when County Courts already dealt extensively with disputes over petty debts.

The development of hire purchase between the two world wars, a model taken from the American example, is explained in terms of being a driving force behind the mass sale of consumer items following industrialisation and by the fact that it did not come under the dominion of strict money lending legislation.⁷⁵

In legal terms, in fact, hire purchase agreements were considered as conditional sales agreement since the hirer had to complete payment of the full price before taking legal possession (Crowther, 1971).

According to Gelpi and Julien-Labruyère, “hire purchase was aimed at a cultured and well-to-do clientele who borrowed to improve their standard of living. There was practically no risk for lender or borrower. For this reason it was distinguished from money lending, and did not come to be regulated by law in Britain until 1938”.⁷⁶

As in the US, little by little modern consumer credit began to take shape and loans offered by traders, banks and financing companies increased spectacularly.

Consumer credit reporting pursued the same path: it followed the development of modern consumer credit and was a system imported from the US implemented much later in time.

⁷⁴ Gelpi and Julien-Labruyère, *supra* note 40 at 133.

⁷⁵ PARKER G., GETTING AND SPENDING - CREDIT AND DEBT IN BRITAIN 25-41 (1990); JOHNSON P., SAVING AND SPENDING - THE WORKING-CLASS ECONOMY IN BRITAIN 1870-1939 144-192 (1985); TEBBUT M., MAKING ENDS MEET, PAWNBROKING AND WORKING CLASS CREDIT (1984).

⁷⁶ Gelpi and Julien-Labruyère, *supra* note 40 at 129.

Like in the US, consumer credit attracted the attention of legislators and laws were enacted to protect consumers. Differently from the US, however, consumer credit reporting remained largely unregulated, at least as far as substantive provision were concerned.

No laws equivalent to the FCRA or the EOCA were enacted and credit reporting was left under the provision of existing or impacting regulations that were not expressly designed for consumer credit reporting systems.

In the UK, the 1974 Consumer Credit Act – considered as the culmination of intense legislative work encompassing the high development of the British consumer credit market⁷⁷ - indeed established an early regulation of the credit reporting industry but it did not address, for instance, neither issues of consumers' privacy rights nor discrimination. Nor did it deal with delicate issues such as social exclusion, equal opportunities, confidentiality, or accuracy, thus leaving its legitimacy still open to debate.

Carrying dissimilar views and traditions, continental European countries – particularly France and the Mediterranean ones – had a very different development of consumer credit both in terms of time of implementation and cultural and legislative approach.

Consumer credit remained for long time underdeveloped and stigmatised, bearing negative connotations inherited from catholic prejudicial visions of credit and interests (seen as usury), as well as the concept of 'consumption' intended as 'destruction by wasting'. Also, different mentalities about living on savings rather than on debit have often existed, rejecting American attitudes towards indebtedness and, in more general terms, American way of life.

⁷⁷ *Id.* at 133.

The 1974 Consumer Credit Act established the early regulation of the credit reporting industry. The Act contains a number of provisions available to consumers to remedy the main mischief that may occur. Under Section 25 of the Act all CRAs must be licensed by the Office of Fair Trading (OFT), the latter having the right to revoke such licence, *inter alia*, for deceitful or oppressive business practices, or unfair or improper conduct. These powers available to the OFT are commonly said to ensure that CRAs disclose credit information about individuals strictly for the purposes intended. Section 157 puts the lenders under a duty to disclose to the consumer at his/her request the name and address of any CRA to which the lender applied for information. Section 158 then goes on to oblige CRAs to provide the consumer with a copy of the file relating to him/her, together with a statement of his/her rights to have mistakes corrected under section 159.

Similarly, the countries of northern Europe, although influenced by various forms of Protestantism and all practised loans on interests from early times, culturally have rejected for long time money lending for consumerism as being harmful and ostentatious.⁷⁸

Notwithstanding the forgoing, it is not surprising to see how the European development of consumer credit mirrored the credit practices and business of the US, though with a considerable time lag.

In France, as well as in the Mediterranean and northern European countries, as elsewhere in what is today the European Union, modern consumer credit has followed the example of the US and its model has been imported spreading in every national market.

However, the use of consumer credit still differs deeply and varies widely across the member states of the EU. Differences in national practices and institutions exist in the marketplace notwithstanding the trend and move towards a European harmonisation of the laws, regulations and administrative provisions of the member states.⁷⁹

As this work is attempting to stress, this is arguably the result of diverse cultures: consumer credit, in fact, results from the interaction between household decisions on consumption and savings, two factors largely influenced by the people's traditions within countries.

Recent studies show that consumer credit is very limited in Greece, Italy, and the Netherlands, while consumer borrowing stands at comparatively high levels in Germany and the UK and at an intermediate level in France and Spain. They conclude that such differences in credit culture, use, and regulatory regimes hamper the development of an integrated credit market in Europe.⁸⁰

The same considerations could be considered applicable for the less studied phenomenon associated with consumer credit information systems.

⁷⁸ *Id.* at 133-150.

⁷⁹ Diez Guardia, *supra* note 73; Jentzsch N., *The Regulation of Financial Privacy: The United States vs. Europe*, ECRI RESEARCH REPORT N.5 (2003).

⁸⁰ *Id.* See also Lanoo K. and De la Mata Muñoz A., *Integration of the EU Consumer Credit Market – Proposal for a More Efficient Regulatory Model*, CEPS WORKING DOCUMENT N.213 (2004).

As modern consumer credit developed so late, consumer credit reporting systems are a relatively new phenomenon for most countries in the EU, especially when compared with the US.

As it has happened in the US, they inevitably developed years after the introduction and consolidation of consumer credit.

As for the case of consumer credit itself, also in this sector experiences vary greatly in history from country to country and information systems often developed for purposes other than the creditworthiness of consumers in small credit operations.

For example, from the 1950s German influenced markets (mainly Germany, Holland and Switzerland) designed obligatory debt filing systems managed by bodies related to professional associations as a counterbalance to abuses of market developments by independent credit brokers deliberately passing bad risk customers to lenders just to earn their fee.⁸¹

Equally, after World War II public credit registries were implemented in many continental European countries: they were usually managed, directly or indirectly, by the country's central banks for the prudential supervision of financial institutions (mainly, if not exclusively, banks) in order to control the soundness of the financial system of the country rather than for the assessment of the creditworthiness of credit applicants.⁸²

Notably, this is a key difference that allows to distinguish and keep such function separate from the implementation of a country credit reporting system for assessing the creditworthiness of consumers.

In addition, for the monitoring of the health and soundness of the financial system, public credit registries have an universal coverage of all loans above a threshold amount determined by law or regulation and the information consists of credit data disseminated in consolidated form. Evidently, legislators did not consider information about credit operations below a certain threshold neither a

⁸¹ Gelpi and Julien-Labruyère, *supra* note 40 at 145.

⁸² Jappelli and Pagano, *supra* note 2 at 2028; Jappelli T. and Pagano M., *Public Credit Information: A European Perspective*, in REPORTING SYSTEMS AND THE INTERNATIONAL ECONOMY 81-114 (Miller M.J. ed. 2003). With the exception of Germany, that established its public credit bureau already in 1934. France followed in 1946, Italy

threat for the prudential supervision of a sound financial system nor a concern in relation to indebtedness. In a large number of European countries this meant that with the gradual introduction and expansion of modern consumer credit the reporting of all information below the threshold required by law was left open to free market forces and, as a consequence, taken over by private organisations that developed a brand new consumer credit information sector on the American model.⁸³

For example, countries like Italy did not have CRAs until 1992 and started to implement consumer credit reporting systems only from then on. Significantly, others like France do not still have a consumer sharing information system in place.⁸⁴

Overall, as other research has concluded, the cultural differences of European countries affect the typology of existing credit reporting systems, either in terms of *modus operandi*, ownership structure, industrial organisation, or types of information.⁸⁵

Today, in the panorama of the EU, private CRAs operate alone in the Czech Republic, Denmark, Estonia, Hungary, Ireland, Malta, Poland, Sweden, The Netherlands, and the United Kingdom. Private CRAs and public credit registries 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 public credit bureau coexist. Public credit registries operate alone in Finland (but the operation of the database 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 public authority), and Luxembourg.

Certainly, each country is a different experience and its own cultural, institutional, and legal features explain this diversity.

and Spain in 1962, and Belgium in 1967. Consumer credit, moreover, is often neglected from the reporting of public credit registries as not having a significant impact on the balance sheet of banks.

⁸³ This was so because the law usually makes the reporting of information above a certain threshold compulsory to public registries saying nothing about the collection of information below such threshold by others, i.e. it did not forbid it.

⁸⁴ Djankov S.D., McLiesh C. and Shleifer A., *Private Credit in 129 Countries*, NBER WORKING PAPER N.W11078 (2005).

⁸⁵ San José Riestra A., *Credit Bureaus in Today's Credit Markets*, ECRI RESEARCH REPORT N.4 (2002).

Yet, all such consumer credit information systems share a crucial common feature: the rationale, scope, structure, and design were imported and transposed in whole from the system originated and developed in the US, although the culture, history, market integration, past and present legislative history and case law of the latter are unique and differ from those of each one of the member states of the EU (that, in turn, differ one from the other).

VII. CONCERNS FOR THE EU

The transplantation of American-style CRAs in the social, cultural and legal context of Europe's welfare states brings concerns about possible violations or abuse of human rights and civil liberties, either in terms of privacy or the discriminatory consequences of consumer credit reporting.

The development of Europe's approach to privacy stems from specific historical and political experiences that led to the enactment of data protection legislation. This measure shaped the divide between the EU and the US to the point that the EU considers the US privacy regime unacceptable. The rupture is particularly strong as far as it concerns European's stringent application of the regulation of privacy to the private sector. This circumstance reflects an European cultural vision about the diffidence towards the private sector vis-à-vis the welfare state.

The basic ground rules for the 25 member states of the EU are laid down in Directive 95/46/EC which explicitly aims at protecting the fundamental rights and freedoms of natural persons, and in particular their right to privacy.⁸⁶ The law is built on the principles of legitimate processing, requiring the data subject's unambiguous consent and/or the necessity of the processing (for compliance with legal obligation, to protect the vital interest of the data subject, in the public interest or in the exercise of official authority, for the purposes of the legitimate interests of the data

⁸⁶ Directive 95/46/EC, OJ 1995 L 281, P. 0031-0050, at Art. 1.

controller or third parties except where such interests are overridden by the interests for fundamental rights and freedoms of the data subject such as privacy).⁸⁷

As far as consumer credit reporting is concerned, however, it seems the case that consumers do not have much choice if they do not want to be refused credit. The consumer's consent seems to be viewed both mandatory and assumed (i.e. implied consent). Lenders say that the lack of such consent would impede them from taking the credit application any further. No consent, no credit (i.e. enforced consent).

Moreover, lenders make it a condition of the credit contract that 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 seeming to be not negotiable although alien to the decision of the granting of credit (that has already been taken positively). Again, it seems that no agreement to such clause means that there will be no contract.

Significantly, this kind of clause also releases bank secrecy duties (in those many jurisdictions where they exist) from the lender whether the customer likes it or not.

Moreover, previous research has already cautioned that further consideration should be given to what constitutes the 'essential information' which allows the credit assessment process by lenders.⁸⁸ In this regard, it is crucial to assess the necessity and scope of all the types of information provided by CRAs for the purpose of predicting the future behaviour of a borrower, matching them with the causal nexus about the likelihood of repayments with the contracted interests.

For instance, in an analysis of what constitutes 'essential information' one of the main questions refers to the distinction between 'negative' and 'positive' data. Whereas most people may accept the value of sharing negative data as a disciplinary instrument, at least where customers are

⁸⁷ *Id.*, at Art. 7.

⁸⁸ San José Riestra, *supra* note 85. See also Howells G.G., *Data Protection, Confidentiality, Unfair Contract Terms, Consumer Protection and Credit Reference Agencies*, 7 JOURNAL OF BUSINESS LAW 343-359 (1995).

informed and where they provide consent, the issue of sharing positive information proves more difficult.⁸⁹

Most importantly, there are no fixed rules as to what constitutes a good credit risk. Very often, contrary to the 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.⁹⁰

In the end, when balancing the interest of lenders vis-à-vis the right to privacy of consumers, there is no conclusive or at least empirical evidence as to the connection between credit reporting and the predictability of human behaviour.

Moreover, someone who has had problems in the past does not necessarily have problems at present or in the future. Or else, an individual may have a low credit profile from failing to make payments which are either undue or in conflict with the claims of the service provider. What strikes someone attention is that information about defaults are passed on to CRAs (and then, in turn, disseminated) simply by the lenders so affirming, regardless of any judicial hearing having taken place, thus rising questions as to whether is there any respect for the rule of law.

Last but not least, the mechanisms in place bear important consequences in terms of social justice, either by way of absence of equality in the access to credit (or exclusion from it), or in any event selection - hence discrimination. Arguably, this bears consequences in terms of poverty, as people with low and/or unstable incomes are categorised and face inequality. When people (particularly those at social disadvantage) are refused credit they should not become more vulnerable to either getting 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.

⁸⁹ Negative data refer to information about defaults on payments, delays, delinquencies, bankruptcies, etc. Positive consumer data, by contrast, refer to information about the financial standing, payments and other details which do not indicate a default or late payment.

⁹⁰ San José Riestra, *supra* note 85.

At a different level of discrimination, moreover, such a system impacts on the EU fundamental rule of the free movement of people and the effective mobility of Europeans from a Member State to another. EU nationals should not face barriers caused by the lack of information provided by CRAs (or the result of different national practices and cultures) or different selection criteria used in the hosting Member State. This would equate to discrimination based on nationality.⁹¹

All the above concerns are exacerbated by the existing institutional arrangements. It seems worrying that, at least in the majority of the member states, profit-seeking companies (modelled on the types that long before developed in the US) that have a natural tendency to be monopolies are allowed to be the repository of all such powers.⁹² This adds alarms about the arbitrary positioning of CRAs in the modern European society. As civil liberties and social factors with a long recognition are involved, there would be a need for some institutional guarantees and/or accountability measures. This raises the difficult question whether this type of activities should be left to free market forces or, on the contrary, there should be a form of institutionalisation with definite and specific rules in place.

It is worth repeating that, when considering all such issues, the use of CRAs databases is not mandatory by law.

Whatever the answer may to all the questions above, the heart of the debate about credit reporting is how far consumers should be forced to sacrifice their privacy in the interest of the credit industry (the general interest?), bearing in mind that the ‘utilitarian’ concerns of the latter cannot necessarily prevail over civil liberties and fundamental human rights. To this end, it should be taken into account that in Europe 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.

⁹¹ Free movement of workers – Articles 39 (ex Article 48) to 42 (ex Article 51) Treaty Establishing the European Community. Right of Establishment – Articles 43 (ex Article 52) to 48 (ex Article 58) Treaty Establishing the European Community.

⁹² The economy of CRAS is characterised by scale and scope effects that also affect coverage, which has the propensity to universality. On CRAs being natural monopolies see Jentzsch, *supra* note 79.

Whether all such considerations are relevant or rather could be contested, what seems in any case crucial is that the legal community and policy makers alike should debate openly to what extent the mechanisms of consumer credit reporting comply with the positive law or this is adequate to cover the many questions and complex legal and institutional issues involved, bearing in mind Europe's unique tradition, history and political experiences.

In this context, could there be any lesson for Europe from the history of consumer credit reporting?

VII. LESSONS FOR EUROPE FROM HISTORY

The history of credit reporting shows that a strong connection exists between the one developed for the business sector and the one for the consumer credit market.

They both developed in the US as a response to its own economic and market changes, reflecting closely the values of its society as it gradually developed into the present one.

Business credit reporting originated first: it was an institutionalised evolution of 'gossip' to manage the risk of mercantile credit.

Consumer credit reporting followed much later, as modern consumer credit evolved in the US in the wake of industrialisation of durable goods. Nevertheless, it incorporated the same logic, structure, and design of the system developed for managing the risks of credit in business transactions.

The transfer and adaptation of such a model from one business sector (the business one) to another (the consumer one) not only rely on different dynamics but also insist on different foundations and interfere with different rights.

Businesses and consumers borrow for diverging reasons and use the money differently: the formers use credit to invest (i.e. to create more wealth) while consumers borrow to expend (i.e. to consume wealth).

As Olegario maintains, in fact, in contrast to a banking relationship involving consumers, the trade relationship is more akin to a partnership wherein contracts are flexible and open to compromise. This factor is extremely important, in that trade creditors have historically been willing to postpone payments when debtors are struggling (say for difficult economic times, tough selling environment, other factual situation, etc.), a flexibility that normally avoids negative credit reporting and that does not usually exist in consumer lending, a sector that is typically targeted at a very broad customer base.⁹³

Such leeway could arguably be helpful for new businesses to get established or, sometimes, prevent established ones from going bankrupt straightaway. In any event, businesses do not necessarily have to carry with them the stigma of being bad or late payers when factual situations occur, a concession or help that cannot be easily offered to a consumer in reporting his or her behaviour.

Also, businesses normally have wider powers in negotiating terms and conditions of credit agreements (big companies being treated as better clients than others), something that consumers are not allowed to do.

Many other substantial differences are likely to exist between the two types of credit, the ones mentioned above not pretending to represent an exhaustive list.

Above all, however, what seems to be the most important difference between dealing with legal and natural persons is the most obvious one: consumers are human beings that, as such, benefit from civil liberties and human rights alien to business entities.

Therefore, all the differences between commercial and consumer credit suggest that the transplantation of one system to the other brings not only doubts about the fitness for its purpose, but also concerns on its own right.

Although the same transfer from one sector to the other took place in the US, what is noteworthy about the European context is that there it did not follow that process of legitimisation that it went through in almost a century of US history.

⁹³ Olegario, *supra* note 3.

The existing inherent tension between the US historical focus on freedom of expression on one side, and the strong emphasis placed on data protection in the EU, as well as the latter's attitude towards a tighter consumer protection regime, on the other side, are the best example of a radically different cultural approach towards the problem. In the broadest terms, the US favours a liberal understanding towards the collection and dissemination of personal information by the business community, a vision according to which the general economic good prevails. In Europe, by contrast, privacy intends to exemplify not only an aspect of individual self-determinism but also the individual's right to exist in and be accepted by the community where he or she expresses his or her own personality.⁹⁴

It appears clear, therefore, that consumer credit reporting brings with it concerns that European countries need to contend with, specially in view of an integrated EU single market in consumer credit.

This is not, however, all what history may teach about adaptation and legitimisation.

In the US, the courts rather than legislatures or official policy makers functioned as instruments by which the larger society exerted control over business credit reporting. By contrast, in the case of consumers the American legislator intervened with tailored laws that resulted from and offered a solution to the concerns of the larger society.

Regardless of the American experience, none of the like happened in Europe where the system has been incorporated into the lending practice of credit markets, without absorbing the cultural drive and industry-specific laws that left an indelible mark on the American industry.

As yet, however, no research has been conducted nor there is literature on the implications of these reporting systems in the jeopardised credit cultures of the EU member states.

Thus, although some considerations could be seen as a matter of supposition, looking at the history of consumer credit reporting one may well reach - at the very least - the same conclusions that

⁹⁴ MacDonalD D.A., *Myths in the Privacy Debate*, in THE FUTURE OF FINANCIAL PRIVACY 54-75 (CEI Staff ed. 2000); Singleton S., *Privacy and Human Rights: Comparing the United States to Europe*, in THE FUTURE OF

Olegario offered in her research about an historical account of the business type of credit reporting, bearing in mind the differences in dates and times between the two.

Meaningfully, the scholar writes:

"Locating the origins of CRAs within a specific time (...) and place (...) demonstrates that the business assumptions upon which CRAs were originally founded were not necessarily natural or universal; they merely happened to have been good innovative solutions to the peculiar conditions that existed in the United States (...). In the intervening time, these assumptions have become naturalized.

(...) CRAs (...) evolved alongside other important institutions, including the country's [own] commercial and bankruptcy laws. The agencies had ample time not only to experiment but also to accommodate the demands of the larger culture, which in turn had the opportunity to adjust to the new agencies. A long process of give-and-take occurred among the agencies, the courts, legislatures, the press, and the public before CRAs became deeply embedded in US business culture.

A historical perspective makes clear that efforts to transplant CRAs (...) involve risks. An institution whose underlying assumptions were forged in the frontier United States may not be compatible with the institutions and cultures of countries that have different historical traditions. Transplanted institutions are often not given the time to adjust because both policymakers and entrepreneurs feel pressure to demonstrate their effectiveness as quickly as possible".⁹⁵

All the more, the author's cautions provoke a greater degree of unease if consumers are involved, specially in the context of the EU with its own cultural values and legal traditions.

In the attempt to balance the practice that has developed from the US vis-à-vis the rights to privacy and non-discrimination in its double facet, it would be hard to accept to sacrifice established civil

FINANCIAL PRIVACY 186-202 (CEI Staff ed. 2000); JAY R. AND HAMILTON A., DATA PROTECTION – LAW AND PRACTICE (2003).

⁹⁵ Olegario, *supra* note 3 at 117-118.

liberties over a business whose history demonstrates that it was originally founded on assumptions that are not necessarily natural or universal.

US-style CRAs evolved alongside the American institutional structure, court decisions, and legal framework, important circumstances that shaped the business and people's acceptance through history. Did the same happen in Europe where the driving traditional values are the privacy of personal financial transactions and the corresponding laws (for example, bank secrecy and data protection), often exacerbated by the cultural stigma associated with borrowing, indebtedness, and difficulties in re-payments?

In sum, the history of credit reporting provides a vivid example of how a country's own societal, behavioural, and regulatory norms may shape a business and its serving institutions.

In either the business or the consumer type of reporting, CRAs had their origins at a time and in a place whose unique circumstances have long since ceased to exist. Arguably, all such experiences have been denied to the European transplanted institutions - the extent of which surely depending on the particular country where they operate.

In many circumstances, CRAs are hardly compatible with the cultures of countries that have different institutional traditions. In a large number of member states operate credit registries in the form of public credit bureaus. However, these public institutions managed by central banks or other state's regulatory authorities provide a public service in the prudential supervision of the whole banking system of a country. Such public function is alien to CRAs that are designed to provide services in the interest of a large variety of lenders that includes, but it is not limited to, banks. Thus, public credit bureaus have a legal basis for demanding the collection of information, providing an exception to data protection legislation and bank secrecy obligations. In fact, the sacrifice of personal privacy for the public interest is embedded in European culture and law, a circumstance that could not be transferred to the activities of private CRAs that operate for the profitability of lenders.

On a different level, the US experience shows how consumer credit reporting transformed from not-for-profit to profit-seeking organisations. This process was facilitated by the gradual social acceptance of the reporting of personal information to access credit. Profit-seeking CRAs turned private financial information into a commodity that could be potentially accessed by anyone willing to pay for it. Arguably, this causes no or little harm in a society that has legitimised and entrenched in its culture such system over a long period of time. By contrast, in a society that places a strong emphasis on data protection, the secrecy over banking transactions, and the stigma for debt this may be harder to accept *sic et simpliciter*. Rather, one would expect that even assuming that CRAs do really provide an essential service to the whole financial system, this should occur without making money over the privacy of individuals, as it happens with the reporting of information to state's authorities for the prudential supervision of the banking system.

VIII. CONCLUSION

Building on existing studies, this paper has attempted to offer an original contribution to research by providing an understanding of the evolution of the consumer side of credit reporting in the EU together with its cultural baggage, informing policy makers of the threats that are likely to be associated with it. Ultimately, the goal is to suggest that in Europe consumer credit reporting should go through legislative and institutional legitimisation not only to adapt to its social context (either in terms of social justice or with reference to its more recent rights of free movement of workers and establishment), but also to adjust to the strong value placed on data protection. The EU should start to re-think its legal and institutional framework to stem privacy and discriminatory concerns.

Understanding a foreign system developed within a foreign culture and legal process is very useful and, at the same time, would not be possible without respecting it. At the same time, debates as to

the rightfulness and efficiency of a particular system and the legal context in which it operates should be promoted in order to understand and create awareness of the relative value of the solutions adopted as well as the reactions of the law.

By contrast, in Europe the promotion and adoption of the consumer reporting model took place disregarding the existing socio-cultural diversities and legal traditions. This work has attempted to demonstrate that in Europe CRAs weren't given the time and public debate to adapt to the cultural environment, circumstances, and process of legitimisation that local conditions would require in order to deal with concerns over the lawfulness of their activities, as well as issues of social and political disruption. Rather, they were forced to prove straightaway their effectiveness and success in the same way as it happens when a model that is successful in a given jurisdiction is imported elsewhere. They lacked the same recognition and legitimisation that proved so vital in the US and that allowed them to gain acceptance by the American society, becoming embedded in today's culture of the country. The lesson that American history provides is that consumer credit reporting was the result of its culture and it cannot be easily reproduced elsewhere, specially without taking into account the complexities and problems that may arise from the mismatch between legal and social cultures. Different cultures and traditions should be at least respected.

Therefore, the cultural argument may prove a useful one to induce the competent European authorities to pay attention to the problems that may take place when institutions are transplanted but fail recognition. This is particularly so when transplanted systems interfere with the everyday life of individuals and their established rights.

In this respect, the US has thought another important lesson: that the regulatory environment of credit reporting through industry-specific legislation could stem consumer concerns and promote legitimacy, accuracy, fairness, and acceptance.

Obviously, this does not mean that the EU should reproduce the same laws and institutional arrangements of the US. It should shape its own credit reporting model taking into account its cultural baggage made of institutional and legal features, without neglecting the contemporary

needs posed by an EU integrated market in consumer credit where consumers receive an adequate protection.