TOWARDS BETTER USE OF CREDIT REPORTING IN EUROPE

CEPS-ECRI TASK FORCE REPORT

SEPTEMBER 2013

CHAIR: **DIETER STEINBAUER**
Professor

RAPPORTEUR: **ELINA PYYKKÖ**
Research Fellow, CEPS/ECRI

CENTRE FOR EUROPEAN POLICY STUDIES
EUROPEAN CREDIT RESEARCH INSTITUTE
BRUSSELS

This report is based on discussions in the CEPS-ECRI Task Force on the future of credit reporting in Europe. The group met four times over a concentrated period from June 2012 to April 2013. The policy recommendations offered at the beginning of this report reflect a general consensus reached by Task Force members, although not every member agrees with every aspect of each recommendation. A list of members, observers and invited guests of the Task Force can be found in Annex 3. The members were given the opportunity to comment on the draft final report, but its contents may only be attributed to the rapporteurs and do not necessarily represent the views of the institutions to which the members belong.

ISBN 978-94-6138-333-4

© Copyright 2013,

Centre for European Policy Studies and European Credit Research Institute.

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system or transmitted in any form or by any means – electronic, mechanical, photocopying, recording or otherwise – without the prior permission of the Centre for European Policy Studies.

Centre for European Policy Studies
European Credit Research Institute
Place du Congrès 1, B-1000 Brussels
Tel: (32.2) 229.39.11 Fax: (32.2) 219.41.51
E-mail: info@ceps.eu
Website: http://www.ceps.eu

CONTENTS

Preface i

Executive Summary and Key Recommendations 1

Introduction 8

1. Credit Reporting as a Building Block for Sustainable growth 10
   - 1.1 Introduction to the credit reporting cycle 10
   - 1.2 From over-indebtedness to sustainable financial inclusion 12
   - 1.3 Responsible lending 15
   - 1.4 Benefits for society as a whole 17
   - 1.5 Risks arising from credit reporting 20

2. Credit Reporting in Europe 23
   - 2.1 The structure of credit reporting in the EU 23
   - 2.2 The regulatory framework 29
   - 2.3 Post-crisis environment for credit data sharing 33

3. Facilitating Accurate and Efficient Credit Reporting 37
   - 3.1 Ensuring data quality 37
     - 3.1.1 Access to credit data 39
     - 3.1.2 Extending the reporting networks 41
   - 3.2 How should the credit data be used? 43
   - 3.3 Cross-border exchange for the single market 44

4. The Role of the Legislative Framework 47
   - 4.1 Network of different legislative frameworks 47
   - 4.2 Data protection legislation 49
   - 4.3 Regulation of credit to consumers 51

5. Conclusions 53

References 55

Appendix 1. Glossary of Abbreviations 58

Appendix 2. Task Force Members and Invited Guests and Speakers 59

List of Tables

Table 1. Segmentation of Credit registers 26

List of Figures

Figure 1. A typical credit reporting cycle... 12
Figure 2. Percentage of adults covered in credit databases in 2012............. 24
Figure 3. Breadth of data in credit registers.. 28

List of Boxes

Box 1. Potential benefits of credit reporting for consumers.......................... 15
Box 2. Potential benefits of credit reporting for lenders 17
Box 3. Potential benefits of credit reporting for legislators and supervisors 20
Box 4. Lawfulness of data processing in Europe.. 30

PREFACE

The title "Towards Better Use of Credit Reporting in Europe" implies some theories and questions. First, does the expression "better use" imply that the current use is not good? Better for what purpose – for the lender, for the borrower, or for both? The key to answering these questions is to assess how the requirements of the regulator, the credit industry and the consumer could be brought into balance, and the role of the credit registers in such an environment. In general, credit reporting is an important way to help predict the future financial behaviour of an individual. However, it should not be over-interpreted as reflecting individuals' overall behaviour.

Second, "credit reporting" uses information about persons' financial obligations. Is the right of privacy of the citizen in conflict with the responsibility between contractors? What information is necessary to implement responsible lending and prevention of over-indebtedness? How can we ensure that credit reporting contributes to financial inclusion?

Third, "in Europe" refers to the differences in the structure and usage of credit reporting within the member states of the EU. What level of harmonisation should or could be achieved among the member states, and would that help in achieving more market integration? Are some national approaches more conducive to competition and do they provide benefits to citizens?

In this Task Force, representatives from the credit industry, consumer associations, data protection experts, economic scientists, legal advisers, public authorities and, last but not least, credit reporting industry representatives discussed these topics. The Task Force discussions did not point to one solution, but rather to a range of suggestions for better credit reporting in the EU. The key arguments from these discussions are summarised in this report together with an analysis of the relevant empirical evidence and data. These recommendations are offered as a tool for improving the EU landscape of credit reporting systems so that they can help support responsible lending, sustainable financial inclusion and economic growth.

Professor Dieter Steinbauer
Chairman of the CEPS/ECRI Task Force

EXECUTIVE SUMMARY AND KEY RECOMMENDATIONS

Credit reporting can be characterised as a system for collecting, sharing and using relevant data for the purposes of making decisions related to credit agreements and/or managing these agreements. This system consists of individuals (acting on their own behalf or sometimes as sole traders) as data subjects, creditors as data providers and users, and credit register operators as collectors, processors and suppliers of data. The data providers can be creditors themselves, private credit reference agencies, public credit registers, public authorities, or some other official or licensed data controller in a sole or joint capacity.

The purpose of these systems is to create a mechanism for the secure and accurate sharing of information. An efficiently functioning credit reporting system can provide creditors with access to sufficient relevant information to make risk assessments and well-informed credit decisions and in this way, can help open up the market by promoting a level playing field for creditors, providing individuals with more credit choice and contributing to customer mobility. This enables individuals to get credit with terms that reflect their financial capacity. Moreover, these systems can help facilitate monitoring and control of lenders and markets by regulators through providing reliable and consistent information.

Empirical evidence, as set out in this report, has generally found support for the functioning of credit reporting systems for these purposes. They have been shown to increase lending as well to improve safer lending and loan performance. In the period following the outbreak of the global financial crisis, the role of credit reporting in also fighting consumer over-indebtedness has gained more support, as accurate and up-to-date knowledge of the financial obligations of customers can make the creditors' assessments of their creditworthiness more robust. Well designed and operated credit data registers can therefore have a crucial role in retail financial markets.

Credit reporting systems are not without risks, and a number of concerns about privacy, security, and the coverage and quality of the data and its processing can be identified. Use of inaccurate data or misinterpretation of data for credit decisions, data usage for unauthorised purposes, financial or even social exclusion resulting from defaulting on a

loan, identity theft, and the inability of credit data to adequately reflect each individual situation have all been raised as major concerns related to credit reporting. As a result, credit reporting is standing in the cross-fire of data protection and responsible lending and borrowing. From the perspective of data protection and privacy, some commentators are calling for new privacy principles to restrict the data to be used in credit decisions on the grounds of individual privacy. On the other hand, financial authorities and supervisors are demanding that creditors take more responsibility in the assessment of credit risk, including better assessments of the credit worthiness of their borrowers. As the amount and depth of collected and processed data increases, it is therefore becoming increasingly important to balance the costs and benefits of credit reporting systems to ensure their efficient contribution for both consumers and creditors, as well as for society as a whole.

The content and functioning of credit reporting systems differs among EU member states, largely resulting from their differing stages of financial development and differences in legislations. The Consumer Credit Directive (2008/48/EC)[1] (CCD) requires creditors to 'assess the customer's creditworthiness on the basis of sufficient information, where appropriate obtained from the customer and, where necessary, on the basis of a consultation of the relevant database'. In parallel, the EU Data Protection Directive 1995/46/EC[2] (DPD) provides the framework for any processing of personal data by any sector, thus including credit data reporting. As a minimum harmonisation law, some countries have interpreted the Data Protection Directive more restrictively than others, limiting the type and extent of information creditors can acquire from credit data systems and the framework under which they may do so.

The differing interpretations and implementations of the DPD by EU member states has partly resulted in credit reporting systems that are not consistent across the member states. However, the EU data protection legislative framework is currently under consideration by the EU legislators following the European Commission's proposal for a General Data Protection Regulation, which would replace the DPD. The proposal is still under discussion in the European Parliament and Council. This changing policy environment may therefore present some opportunities to

---

[1] Official Journal L 133 22.5.2008.

[2] Official Journal L 281, 23.11.1995.

improve the credit reporting systems in the EU. A more efficient and proportional regulatory framework might help to facilitate equal access to data for the purpose of credit decisions for all creditors, thereby promoting a level playing field and competition in the credit industry and increasing consumer confidence, choice and mobility.

This report discusses how the current EU credit reporting systems meet the demands of the different stakeholders in the credit granting and management process, and what is needed to improve these systems. As credit reporting is a tool for responsible lending and for ensuring financial inclusion of consumers, the needs of EU credit markets and consumers should be the basis for assessing the current regulation and its functionality. How a creditor assesses the risk and the creditworthiness of a customer is at the core of successful and safe crediting. Facilitating this assessment process, within the boundaries of data protection laws, is a key building block for making well-informed credit decisions. To assess creditworthiness, creditors may use different parts of the credit reporting 'ecosystem'. This ecosystem may include a credit register, combined with other data sources such as the creditor's own internal data, direct information from the customer or data from public authorities. These different sources of data are important as creditors need access to a comprehensive pool of data that is accurate, sufficient and consistent. Creditors also need to understand the data and how to use it effectively. Therefore, the definitions used for classifying and processing data, as well as the purposes for which it may be used, should be unambiguous and clear.

The high quality of data is also a prerequisite for consumers to benefit from credit reporting through generally improved access to financial services at better terms. To promote the transparency, comprehensiveness and high quality of the processing of the individual data, consumers need to understand and have access to their own data. To this end, consumer groups should be engaged in the development of credit reporting systems by promoting a dialogue about the opportunities and challenges of such systems.

The report argues that the role of legislation should be realised on the one hand through credit legislation, which allows creditors to use the credit reporting ecosystem to assess of the creditworthiness of their customers and, on the other hand, through data protection legislation to authorise the purposes and users of this data. Membership criteria, such as reciprocity rules, have a key role in making sure that these systems balance the

interests of the different stakeholders by ensuring that only those organisations that share data may receive it, further promoting the fair use of credit reporting systems and creditors' incentives to share data in a controlled way.

Key recommendations

The underlying objective of this report is to contribute to ensuring more efficient and secure retail credit markets where all stakeholders have equal confidence. The report therefore aims to identify the problems in credit reporting systems and the concrete steps to help achieve this objective. These analyses are undertaken to identify room for policy recommendations, where appropriate, but also to point out the issues that still call for further discussion and clarification. These key recommendations provide a platform for working towards more inclusive, comprehensive, efficient and secure credit reporting in the EU, in line with consumer credit and data protection laws.

Benefits of functioning credit reporting systems

- **Credit reporting can help facilitate a more level playing field among creditors as more creditors can make more accurate assessments of their (potential) customers' creditworthiness, thereby resulting in more consumer choice and higher customer mobility.**
  Better functioning credit reporting systems can attract more players to enter the market, thereby increasing competition and consumer choice.

- **Credit reporting can provide a tool for empowering consumers, as they can build credit reports (or a financial CVs) that help them to manage their own finances.**
  Credit reporting can empower consumers to better control their finances. However, the data gathered on consumers should be accessible and understandable to them to ensure the quality of the data.

- **Credit reporting can help lenders make more informed credit decisions, thereby reducing bad debt.**
  Sharing this data can provide lenders with access to more reliable information about customers' current obligations and how they are managing them.

- **Credit reporting using current and recent full payment and loan instalment history (which includes moderate delinquencies) can help the lender to monitor its customers' current financial situations.**
  It may allow creditors to monitor how consumers are managing their obligations and identify early signs of financial stress that might have resulted from an unpredictable economic shock. This can help creditors in monitoring the overall financial burdens of their customers and to intervene before unmanageable financial difficulties occur.

- **Credit reporting including data on all relevant debt obligations can contribute to financial inclusion.**
  In some circumstances, sharing this data can provide previously financially excluded consumers with a credit history, making it easier for them to obtain financial services and other services. This is, however, dependent on the stage of development of the market and the credit reporting system in question.

- **Consistent and effective credit reporting can help regulators in monitoring both individual lenders and the credit market as a whole.**
  Sharing this data on an anonymous basis can provide regulators with signals warning of impending problems and systemic failures of organisations or the market as a whole.

Use of credit reporting systems

- **All credit providers should be able to access a sufficient range of financial data on their existing or proposed customers to assist them in making credit-granting decisions.**
  When effective, credit reporting can help creditors in assessing the risk and creditworthiness of customers. Access to a sufficient pool of data also allows for the accurate verification of the identity of an applicant borrower, therefore also providing a tool for preventing fraud.

- **The credit data that the creditor deems sufficient for an individual credit decision can be retrieved from different sources within the whole ecosystem of credit reporting.**
  The creditor has to collect data in the context of a credit application, which it may store in its own database, or it may additionally retrieve data from private credit reference agencies, public credit registers, public authorities, or some other official or licensed data controllers.

- **The decision as to what information should be used for the credit decision should be left to the creditor.**
  Assessment of the customer's creditworthiness is at the core of the business of crediting. The type and extent of information used for a specific credit decision depends on various factors, such as the financial product in question and the creditor's prior relationship with and experience with the customer.

- **The standards for reporting and gathering data should be transparent and well understood by all stakeholders, and the main definitions should be aligned at a national level to achieve comparability.**
  The credit data should be used in the authorised way, and for this purpose the definition of reported data must be made clear so that it is comparable and usable for the range of financial products. Terms and definitions for data should, if feasible, be harmonised within individual EU member states before assessing whether to harmonise across borders.

The legislative framework

- **The rules and conditions for access to and for sharing credit databases should be based on the reciprocity principle or on creditors' legal obligations to report data to credit registers.**
  Reciprocity is the fundamental guideline and should be embedded in all credit reporting systems to ensure that data is accessed only by those creditors that report the same type of data to the credit register, save a few exceptions.

- **Legislation should facilitate the right of creditors to share, access and use all credit data relevant to the assessment of their customer's creditworthiness.**
  Because of the regulatory obligations that many creditors face, their authorised sharing, use of and access to the relevant information should be guaranteed under reciprocity conditions. The legitimate interest, authorised purposes and authorised uses in the data protection legislation are key facilitators.

- **As a horizontal inter-industry law, data protection legislation should not direct the use of data but focus on balancing the protection of privacy, mitigation of risks and free movement of data by outlining the legal conditions for data sharing and access.**
  Data protection legislation should not restrict or specify which data should be used in particular kinds of decisions, but rather should ensure that the relevant information can be gathered and retained under legitimate conditions for a sufficient period, and that the users and subjects of the data have the legitimate right to access and process this data.

- **The legislative framework should facilitate the development of credit databases by authorising data providers to gather and process the credit data under data protection law.**
  Legislation has a role in ensuring that data can be gathered and processed by credit data registers as third parties to the credit decision process, as they have a significant role in facilitating a level playing field among creditors.

INTRODUCTION

The Centre for European Policy Studies (CEPS) and the European Credit Research Institute (ECRI) initiated a Task Force in mid 2012 to analyse and identify the next steps in the development of credit reporting to support more efficient and reliable retail financial services markets in Europe. The EU is currently undergoing several reviews of the existing legal framework to better cope with the post-financial crisis world of ever-growing technical and financial development and flows of data and to better facilitate sustainable economic growth. The Task Force was formed to outline the role of credit reporting in this development by summarising its impacts on the provision of financial services to consumers and analysing the role of legislation in this relationship.

The role of credit reporting is to help facilitate responsible lending and responsible borrowing by making data available to prospective creditors to help them assess the creditworthiness of their borrower applicants. Efficient and properly functioning credit reporting can lead to a system where consumers enjoy wider choice and more transparent pricing of credit products.

The extension of credit reporting systems, however, does not come without concerns. As the amount and depth of collected and processed data increases, it is becoming increasingly important to ensure the quality of reported data and that only authorised users can access it and only for authorised purposes. Furthermore, the collection and processing of this data by authorised users should follow certain guidelines that facilitate the free flow of relevant information within the boundaries of privacy.

Credit reporting functions differently across EU member states, which means that not every EU citizen and business experiences the same functionalities of credit reporting systems. These differences are also reflected in hindrances to cross-border financial flows and can hamper the free movement of people across the EU, as they can find it difficult to access financial services when they move from one state to another. The lack of data sharing in some member states also restricts the ability for new players to enter the market and provide consumers with more choice in products.

This report aims to analyse society's expectations towards credit reporting and to assess how this should be reflected in market practices and in the future legislative framework. For this purpose, the report addresses the following four questions:

1. What do we need and expect from credit reporting?
2. What is the current landscape of credit reporting in the EU?
3. How should we use credit reporting to achieve what we need?
4. How can regulation help in this?

Throughout the report, we will discuss all matters from the perspective of data users, data providers and data subjects, as well as from the perspective of a level playing field and competition. To follow the above-mentioned narrative, the report is structured in the following way.

Chapter 1 **Credit reporting as a building block for sustainable growth**

Introduces the functioning of credit reporting systems and their significance in meeting the needs of the main stakeholders.

Chapter 2 **Credit reporting in Europe**

Provides an overview of credit reporting systems and related regulation in Europe today.

Chapter 3 **Facilitating accurate and efficient credit reporting**

Analyses what steps in the context of credit reporting systems would be likely to better support sustainable retail financial services in a post-financial crisis Europe.

Chapter 4 **Role of legislative framework**

Discusses how, at the EU level, the legal framework can help achieve the requisite efficiency of the credit reporting systems.

1. Credit Reporting as a Building Block for Sustainable growth

Credit markets are characterised by asymmetric information between borrowers and lenders, which leads to adverse selection and moral hazard. Credit reporting has an important role in minimising these effects by providing creditors and borrowers with access to reliable and consistent information about borrowers and thereby helping to provide consumers with responsible and sustainable access to credit. Accurate credit information makes credit provisioning more fair and efficient, making it possible for more enterprises and individuals to obtain credit. This increases the circulation of capital in the economy, creating jobs and growth as well as reducing the potential imbalances leading to overheating and recessions. Therefore, credit reporting has an important role for both consumers and creditors, as well as for the economy as a whole as it contributes to responsible lending decisions of creditors, responsible borrowing by consumers, financial inclusion, and overall financial stability[3]. A well adjusted and properly functioning credit reporting system should balance between all the above-mentioned three parties, all of whom should benefit from the system. This section will describe the overall credit reporting cycle from the perspective of its main stakeholders and discuss the potential benefits from each perspective.

1.1 Introduction to the credit reporting cycle

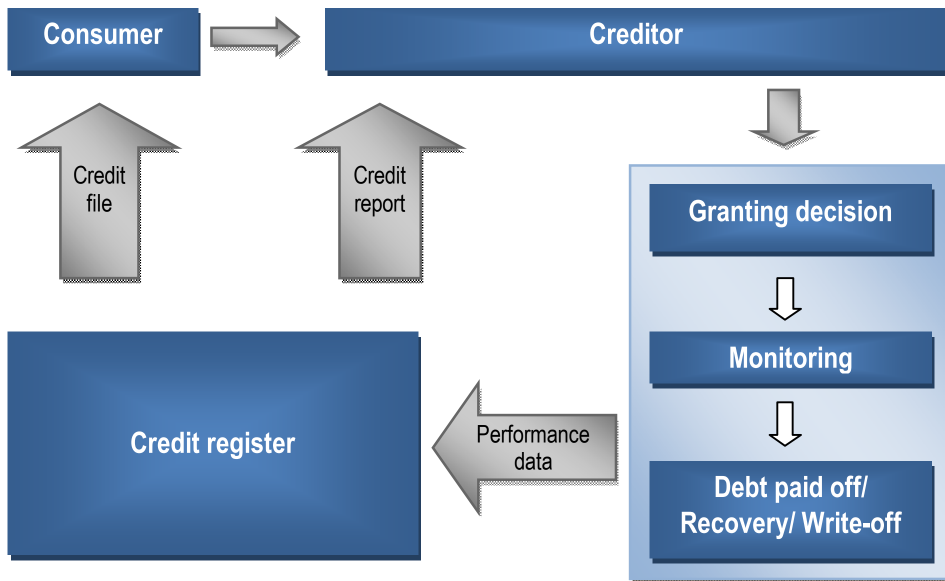
The overall credit reporting cycle begins when a customer approaches a creditor to apply for credit (

[3] Although the creditworthiness of individual borrowers does not impact the financial stability of economies, the ratio of the volume of credit to individuals to GDP in the EU is high enough to comprise significant exposures to large borrowers, which poses a systemic risk to the overall economy, affecting its financial stability.

Figure 1). Once the customer has made a formal credit application, as part of the condition of the application the creditor, if subscribing to a credit register, will advise the customer that they will access data, or will seek their permission to do so, from a credit register to supplement or to verify information provided by the applicant. The creditor may also use its own internal databases and/or, in some countries, a public authority to provide credit information regarding the customer in order to assess his or her creditworthiness. Based on this information, the creditor makes the decision of whether to grant credit to the customer. If the credit application is rejected on the basis of consultation of a credit register, Article 9 of the CCD requires the creditor to inform the customer of this fact and of the details of the database consulted. The creditor must also inform the applicant how they can access and potentially rectify their data in the credit register, as set out in Article 11 of the DPD.

The scope for using credit reporting further, after the assessment of creditworthiness has been conducted, depends on the legislative framework and the functioning of the credit reporting system in the particular member state. For example, the outcome of the credit decision may be reported to the credit register by the creditor. Depending on the member state's credit reporting system and the credit product being used, the creditor may also retrieve updated data to help monitor the agreement in order to intervene at an early stage if the customer starts to encounter payment problems, as well as report these delinquencies back to the credit register to update the customer's credit files. If the customer can no longer pay his or her instalments, the data retrieved from the credit register can potentially also help the creditor to better assess the suitability of possible forbearance measures. In the most advanced credit reporting systems, the forbearance scheme can also be reported to the credit register.

Figure 1. A typical credit reporting cycle



The type and extent of information the creditor requests from the credit data register depend on how much data the creditor already has about the customer. For example, some creditors base their crediting procedures on strong face-to-face contact and relationships that enable them to retrieve and rely on a significant part of relevant information directly from the customer. The necessary information sufficient for a credit decision may depend on the type of product offered to the customer.

Nevertheless, the general ability to use all relevant information and retain it for a sufficient period of time is of general importance to all creditors, whether or not they derive the required data from a credit data register.

1.2 From over-indebtedness to sustainable financial inclusion

As consumers, we all want convenient and affordable access to credit. An efficiently functioning credit reporting system can help consumers in achieving this. The competition among creditors resulting from efficient credit reporting is an important factor in providing consumers with more choice of service providers and better conditions of credit (Dell'Ariccia and Marquez, 2004). Therefore credit data sharing is in the interest of the

consumer as it promotes competition among creditors and reduces adverse selection. When the relevant information is not shared, the creditor has a monopoly power attached to exclusive information about a customer, which reduces consumer choice. The exchange of information between banks reduces the informational rents that banks can extract from their clients within lending relationships, which again reduces the interest rates being charged as well as the probability of default of each borrower (Padilla and Pagano, 1997; Jappelli and Pagano, 2002; Dell'Ariccia and Marquez, 2004).

The level of data shared about the consumer also plays a role. While a disciplinary effect arises from the exchange of default information (negative information), sharing information about borrowers' characteristics can reduce this effect as a high quality borrower is not affected by default reporting and, instead, the information about his or her high quality is spread (Padilla and Pagano, 1997; Jappelli and Pagano, 2002). Borrowers who have defaulted or gone bankrupt in the past can be practically excluded from access to credit for the years that the information remains in their credit file, but if further information is recorded, positive payment data can counterbalance the past negative data (Turner et al., 2012). Therefore, while data sharing on defaults directly reduces the probability of defaults through its disciplinary effect, exchanging further information about the borrower's financial status and payment history can reduce adverse selection by the creditors, giving potentially better credit terms for the borrower, which can again reduce default rates. Default information alone may have a disciplinary effect on borrowers, but the availability of qualitative information enhances the creditor's ability to assess the financial status of a customer. It further enables earlier intervention by creditors, reducing the likelihood of default in the first place.

As the lender has reported both the successes and failures in the customer's instalment payment history to the credit register, the customer has gained relevant and significant information placed on their credit file, again making it easier for a new lender to assess their creditworthiness and price the credit more accurately if the customer decides to enter a new credit agreement in the future. Credit reporting therefore also provides an incentive for consumers to pay their debt instalments promptly in order to avoid any negative entries in their credit file and to maintain it as an asset, thereby functioning as a mechanism for borrower discipline (Padilla and Pagano, 2000). Even a solvent borrower may try to avoid repayment if the

lender cannot observe or sanction their actions (Jappelli and Pagano, 2002). When consumers have access to and understand their credit files from the beginning, they can use these files as an asset helping them to obtain credit with better conditions.

From the consumer perspective, the question of which data is a fair and suitable reflection of a borrower's current financial situation is often raised as a concern. The transparency of the assessment process, as well as third-party access, is therefore considered to be one of the key challenges. Transparency is a key factor for consumer confidence. Consumers generally have access to information recorded about them by credit registers, but their awareness of how to access this information, their rights and responsibilities in the context of their credit data collected, and how they can correct erroneous data on their credit file, should be increased.

When the consumer understands how they can access and use their credit data, credit files can provide them with a significant financial asset as well as a useful tool for financial planning. Credit data will always be used for credit decisions, and having a transparent credit file can give the consumer the control over their financial details they, as a data subject, deserve and make it easier for them to see how their financial choices affect their profile. This contributes directly to consumer empowerment and financial literacy that are on the current EU policy agenda to prevent consumer over-indebtedness. When consumers understand how their financial performance is reflected in their credit files, they are better able to use these files as an asset helping them to obtain credit on better terms. The data can be used to demonstrate to service providers how they honour a commitment and meet obligations. This way, credit reporting also gives consumers a greater ability to rely on their credit and repayment history rather than assets as collateral, contributing to greater fairness in lending (Turner et al., 2012).

Even if consumers do their best to meet all of their financial liabilities, unexpected life events that have significant economic implications can force them to face financial difficulties. Most studies have reported that unpredicted income shocks, such as unemployment, death of spouse or a divorce, are the most common causes of over-indebtedness (Disney et al., 2008; Kempson et al., 2004; Ramsay, 2011). If only minimal data about delinquencies and bankruptcies is gathered in the credit reporting systems, consumers cannot be helped before it is too late, unless they voluntarily turn to the debtor when the early signs of financial distress are starting to show. However, research has found that a large number of borrowers

choose to make minimum payments they actually cannot afford, rather than seeking help with their debt. Using interviews with debt counsellors, Disney et al. (2008) show that consumers typically self-report their financial situation to be of concern only when entering arrears. This is because people are worried that they will be penalised for asking for help. In these cases, more comprehensive credit data can be of help as the creditor can notice early signs of financial distress before it is too late and provide workable solutions for debt management.

Box 1. Potential benefits of credit reporting for consumers

- Provide the consumer with evidence of their financial behaviour by assembling all relevant information together in a financial CV.
- Enable consumers to access more credit on terms that better meet their risk profiles (financial inclusion).
- Give consumers more choice of credit products, as they benefit from the competition enabled by better access to credit information.
- Reduce the likelihood of becoming the victim of fraud through the provision of monitoring and alert systems.
- To prevent consumers from getting more credit than they can support (prevention of over-indebtedness).
- More tailored and sustainable forbearance measures in case of financial difficulties.
- Help in better managing their finances by providing an easy tool to assess their overall level of financial obligations and what it means and translates to.
- Provide cross-border credit data to help consumers as they move from one country to another.
- Offer consumers more secure and efficient electronic payment services as credit register data better enables identifications.

1.3 Responsible lending

Because of the underlying information asymmetry present in credit markets, creditors have an implicit motive and an obligation to thoroughly assess the risk of granting a credit to an individual. Information sharing improves creditors' knowledge of their (potential) customers'

characteristics, allowing them to make more accurate predictions of their repayment ability and thereby allowing them to price their loans more accurately and monitor customers' loan performance more effectively (Jappelli and Pagano, 2002). The more complete and accurate the information the creditor has access to, the better they are able to assess the risk of their portfolios. Empirical research provides evidence consistent with this. For instance, Turner et al. (2012) found, using New Zealand and Australian experimental data[4], that more extensive data sharing decreased the proportion of bad loans by 45%.

Sufficient, adequate and accurate credit data also allows the use of credit decision systems, such as statistical scoring models. These systems allow creditors not only to speed up credit decisions, thereby lowering the costs of issuing a loan, but also to base their decisions on a consistent and statistically proven model. Statistical models also standardise credit decisions, minimising the risk of manual errors in creditworthiness assessments. With statistical facilities, the composition of borrowers reflects more closely the general population, contributing to fairer lending (Turner et al., 2012).

As described in Section 1.1, in some countries, the creditors also use credit information after the initial credit decision to monitor customers' instalment payments to prevent over-indebtedness. Credit reporting is useful for lenders to obtain information alerting them to customers who may be getting into financial difficulties. This contributes to avoiding further borrowing and to finding appropriate debt management and collection strategies.

In addition to obtaining credit information to enable a credit risk assessment of a new applicant or to facilitate the monitoring of existing credits, there are also other authorised and/or obligatory purposes for using credit data, such as fraud prevention[5], supervision of credit institutions, Basel II compliance, meeting anti-money laundering

---

[4] The experimental data was gathered from a number of major lenders in Australia and a telecommunications firm, including one and a half to two years of positive information on individuals who had applied for credit between March 2008 and August 2009. This data was then merged on individual level with the traditional negative-only data. This resulted to a final sample of 1.8 individuals that submitted a credit application during the period.

[5] See Eurofinas (2011) for a review of data protection and prevention of fraud in consumer lending.

requirements and authentication. Credit data is also of importance to the security of electronic payments. Electronic payment service providers have a legal obligation to verify the control of the funding instrument in order to prevent fraud or insufficient funds. Payment service providers need identity data for this, which can be obtained through the credit reporting system.

Box 2. Potential benefits of credit reporting for lenders

- Help in making credit decisions by providing fast access to reliable, consistent and verifiable information about the credit applicant and in particular, those they have no prior engagement with.
- Help in prevention and detection of fraud by providing the data electronically from a trusted third party.
- Help in the management of existing credit contracts and in identifying customers' financial difficulties at an early stage, where they can be better managed in cooperation with the customer.
- Help in assessing the correct tools for debt management that suit the customer.
- Assessment of risk on a portfolio and company level, including provisioning and write-off of bad debts, therefore contributing to financial stability.
- Adequate and consistent information allows automated decision systems, which lowers costs of issuing a loan and makes lending fairer as decisions are based on statistically proven models based on a composition of borrowers that reflects more closely the general population.

1.4 Benefits for society as a whole

There is a significant body of empirical evidence of the positive impact of effective credit reporting on economies. The findings generally indicate that credit information sharing is positively associated with an increase in bank lending and credit availability (Pagano and Jappelli, 1993; Padilla and Pagano, 1997; Djankov et al., 2007; Brown et al., 2009; Houston et al., 2010), lower cost of credit (Brown et al., 2009), reduced default rates (Jappelli and Pagano, 2002), and lower corruption in lending (Barth et al., 2009). Houston

et al. (2010) have further found that greater information sharing can lead to a reduced likelihood of financial crisis and greater economic growth.

Availability of credit information also leads to most of the above-mentioned effects through its ability to support a level playing field and competition in the credit markets. Both the theoretical and empirical research shows that the organisation of the credit reporting industry impacts competition in the retail financial services industry. In the adverse selection model developed by Pagano and Jappelli (1993), information sharing improves the pool of borrowers and increases competition, which in turn leads to greater lending. Dell'Ariccia and Marquez (2004) show that the average quality of borrowers obtaining financing from the creditor decreases with information asymmetries in the market because this allows the informed creditors to effectively finance borrowers that are less creditworthy in these markets.

The efficiency of credit reporting systems also has implications for the attractiveness of countries from the perspective of foreign investors. If there is more quality credit information available for risk assessment, financial institutions are more likely to enter the market, which is likely to increase choice and availability of financial services for the private sector, boosting economic growth.

Credit reporting is also beneficial for the economy because of its contribution to macro-prudential supervision. Accurate, timely and comparable credit data enables the monitoring of macro-level economic activity as well as micro-level surveillance. Complete and accurate information about borrowers and their credit allows authorities to assess banks' credit risk exposures and to optimise prudential regulation to ensure that capital requirements are properly calibrated to cover these risks. It is also an important tool for supporting bank stress tests and macro-prudential surveillance.

Individuals' over-indebtedness has been cited as one of the side-effects of the financial crisis as well as a factor slowing down the economic recovery. Therefore economies need a system that facilitates sustainable credit for consumers. An over-emphasis on real estate prices has also been criticised in the aftermath of the crisis, and sharing information provides a partial solution as it prompts creditors to shift from collateral-based lending policies to more information-based policies. Wider credit reporting provides creditors with a greater ability to rely on credit exposure, repayment history and potential rather than assets as collateral (Turner et al., 2012).

The fight against over-indebtedness should not be associated only with financial debt, as over-indebtedness can result from obligations other than traditional financial debt. Studies in the UK in 2004 showed that 50% of individuals in difficulty had no traditional credit at all (DTI, 2004). Comprehensive consumer credit data sharing provides a tool for the prevention of this over-indebtedness. If the creditor has a comprehensive view of all the financial burdens of its customers, it can better assess their creditworthiness. Also, if a utility service provider knows the payment history of customers, it can seek to adjust their payment mechanism to fit better with their financial profile. Credit reporting systems can therefore potentially help in preventing over-indebtedness in a proactive way.

As previously mentioned, many studies have shown that changes in employment status and other unpredictable changes in economic circumstances are the most common factors causing financial difficulties (Del-Rio and Young, 2006; Disney et al., 2008; Kempson, 2002; Kempson et al., 2004; Ramsay, 2011). While reporting only bankruptcies and defaults does not capture these economic shocks in the consumer profile, more comprehensive data allows service providers to identify these changes early in the cycle and intervene to help in repayment planning. Furthermore, as discussed in Section 1.2, many consumers may try to avoid turning to debt counselling until the last minute, during which time the financial difficulties can exacerbate. Consumers also stop paying their debt instalments in a hierarchical way according to their personal priorities, depending on their individual preferences. They might already be facing serious financial problems and be over-indebted by the time they stop paying their consumer or mortgage credit. Debtors and service providers with a thorough overview of all of the financial obligations of customers can intervene in these problems before they exacerbate.

On the other hand, the better functioning credit reporting systems extend credit to a larger pool of consumers that are proven to be able to afford to take credit. This is an important benefit from the perspective of economies that are struggling with the systemic impacts of consumers taking illegal and expensive credit. Consumers that are denied credit because of a lack of data or a poor credit file can always turn to credit providers that are not regulated in the same way as traditional providers, and offer credit with more expensive terms. Therefore, sharing all relevant and accurate data about the consumer can help to extend traditional credit to all consumers with the ability to bear credit instalments, thereby reducing the number of consumers turning to high-cost credit.

Box 3. Potential benefits of credit reporting for legislators and supervisors

- Provides supervisors with anonymous data on market, lender and product level, allowing supervision at micro and macro levels.
- Better ability to monitor the stability of the financial system on both national and EU level and support the macro-prudential policy to prevent financial crisis and promote sustainable credit growth.
- Reduces over-reliance on assets as collateral.
- Facilitating the efficient prevention of identity theft and fraud.
- Encourages competition among incumbent players and attracts foreign investments as the access to information lower entry barriers.
- Reduces the reliance on illegal more expensive credit through lowering financial exclusion.

1.5 Risks arising from credit reporting

Reporting and maintaining private data about individuals logically leads to concerns about the security of collecting, maintaining and processing this data. A major concern generally linked with credit reporting is the potential violation of an individual's privacy via the transmission of sensitive information among unauthorised third parties, possibly even for identity theft. The ability of credit data to address all causes of over-indebtedness and to adequately reflect all individual situations has also been questioned. Some stakeholders have also expressed their concern about information sharing across industry segments, which might potentially lead to exclusion from some services.

The usability of the data collected and processed in credit reporting systems is an issue requiring controls on several levels. The quality of data is of key importance, as inaccuracies can result in unjustified loan denials or indeed agreements, higher borrowing costs, and other unwanted consequences for borrowers, creditors and credit reporting service providers (World Bank, 2011). The DPD requires that data is accurate and up to date, and any lender supplying data to the credit register should already have processes in place to ensure data accuracy within their own systems. However, extending credit reporting access to providers of non-financial credit, such as telecommunications and energy providers, may raise special concerns of data quality as not all actors in different industry sectors are regulated in the same way.

Similarly, the complexity of the credit reporting systems can also lead to difficulties in ensuring that the data is consistent and not fragmented among different credit data controllers. If a data item about a product differs depending on which lender provides it or which product it relates to, borrowers may be treated differently, potentially leading to unfair outcomes. A situation where a creditor requests credit data from a credit register that holds no data on a particular customer should not lead to a negative creditworthiness assessment.

When credit reporting grows in breadth and depth, it also becomes a concern to ensure that the data collected and processed only covers the 'relevant' and 'right' products. Over-burdening credit reporting systems with too much information raises the risk of inefficiency and over-complexity. The data in credit reporting systems should cover only products that are provided on credit, so for example pre-pay energy services or so called 'pay as you go' mobile telephony products should not be included as they do not use credit. However, more advanced payment products, such as so-called "pay as you go" mobile telephony products should not be included as they do not use credit.

At the same time, who can access the system and why are key issues. The registers are there for certain purposes but as they contain significant amounts of valuable information, there will always be parties that want to access or use the data inappropriately and even illegally. Even those that are entitled to access the data may seek to use it in inappropriate ways, such as for 'fishing' for marketing targets.

Another inappropriate use of data may arise from a falsely applied motive to monitor and manage existing customers. While this monitoring is helpful in order to provide suitable advice and support for the customer in difficulties, it should not be too intrusive and lead to concerns of a 'Big Brother' system. Furthermore, members of the credit reporting system may seek to prioritise their debt collection activity relating to one customer over that of another. This harmful behaviour for the consumer is prevented in some countries through local consumer credit legislation, while in others there is a need for rules to control it.

As comprehensive credit registers hold a lot of information about most – if not all – consumers within a market, consumers may feel they have no control over what data is recorded about them and how it can be used. One example of these concerns deals with automated systems. When used for assessments of creditworthiness, these systems provide a tool for more standardised credit decisions, but they should be used with certain

caution. Clear rules for the use of data to ensure fairness and transparency are critical.

Therefore, while credit reporting systems are essential in providing a level playing field for creditors and the tools for responsible lending and borrowing, thereby promoting economic growth, they may also be associated with security concerns. These concerns should be dealt with through a framework comprising of appropriate and proportionate legislation supported by potential codes of conduct, as well as by designing and developing credit reporting systems through engaging all stakeholders of the system. Chapters 3 and 4 of this report will discuss how these issues can be addressed in the use and development of credit reporting systems. An efficient and secure credit reporting system should include strong controls to mitigate the risks and concerns of a system that collects, holds and processes comprehensive private information. These solutions and remedies also come with a cost, however, which is why it is important to find a balance between the needs of different stakeholders when developing credit reporting systems that are efficient both from operational as well as from a cost perspective.

2. CREDIT REPORTING IN EUROPE

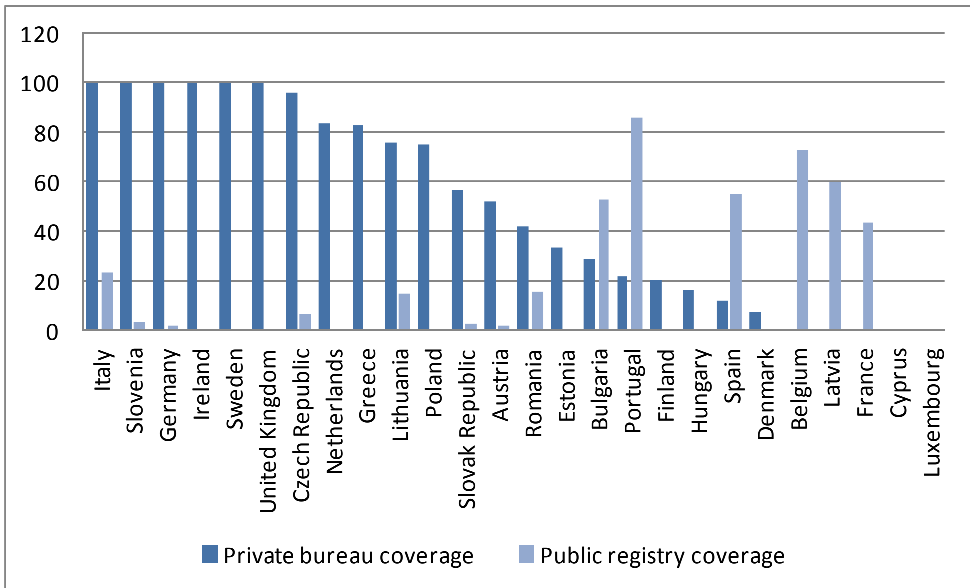
Credit reporting systems are generally accepted as being an essential component of an effective credit market. However, there are significant variations even within the EU in terms of their functioning. The extent and sharing of data, as well as the definitions and terms used in these processes, differ between countries largely, but not only, due to differences in legal frameworks and national infrastructures, further complicating this question. Sharing financial data naturally generates concerns over privacy, which is why a balance between its risks and benefits should be found at the outset so that the system can be based on trust and transparency and takes into account the interests of all stakeholders. This chapter aims to provide an overview of the different aspects of the functioning of credit reporting systems in the EU, and the differences in these systems among the member states.

2.1 The structure of credit reporting in the EU

Three types of credit reporting systems are present in the EU: systems with only private credit bureaus, systems with only a public register, and dual systems where both a public register and private credit bureaus operate. The system operating in a particular country often depends on historical factors, and even the roles of public registers differ across countries. While public credit registries (PCRs) are used by central banks for bank supervision, private credit reference agencies (CRAs) have become an integral part of the lending process in the financial institutions of many member states. The information in CRAs is used for creditworthiness assessments and on-going monitoring of borrowers.

The extent of individuals covered by PCRs or CRAs differs significantly among EU member states, broadly reflecting the different stages of maturity of the credit markets (Jentzsch, 2010). The available statistics about the coverage of PCRs and CRAs in the EU are, however, mixed. The World Bank has sought to determine the percentages of individuals covered in credit registers and bureaus in its Doing Business project (Figure 2).

Figure 2. Percentage of adults covered in credit databases in 2012



Source: World Bank Doing Business database (2012)

Notes:

In Denmark, the lenders base their creditworthiness assessment on a transcript of the borrower's tax files from the tax authorities. The tax files contain all information about the tax subject's income, his or her assets, his or her financial obligations and if he or she is in arrears concerning tax payments.

'Public registry coverage' reports the coverage of individuals and firms by a public credit registry with information on their repayment history, unpaid debts, or credit outstanding from the past five years—expressed as a percentage of the adult population. A public credit registry is defined as a database managed by the public sector, usually by the central bank or the superintendent of banks, which collects information on the creditworthiness of borrowers (persons or businesses) in the financial system and makes it available to financial institutions. If no public registry operates, the coverage value is 0.

'Private bureau coverage' reports the coverage of individuals and firms by a private credit bureau with information on their repayment history, unpaid debts, or credit outstanding from the past five years—expressed as a percentage of the adult population. A private credit bureau is defined as a private firm or non-profit organization that maintains a database on the creditworthiness of borrowers (persons or businesses) in the financial system and facilitates the exchange of credit information among banks and financial institutions. If no private bureau operates, the coverage value is 0.

The statistics retrieved from the report of this project and presented in Figure 2 can, however, be misleading if interpreted as a measure of overall credit information sharing in the countries. For example, Figure 2 reports coverage of only 72.6% for the Belgian public credit registry, when in reality 100% of the Belgian population is covered by the registry, as it includes information of only those with bank credit. This applies to many other countries, disguising differences in the recording processes. In France, the negative public file called FICP contains information of only 1.8 million adults which, in a country of 65 million inhabitants, does not amount to the 42.1% of adult population in given in Figure 2. On the other hand, those credit registers that show 100% coverage of their population may only have 100% of a limited universe of data.

Therefore, an assessment of the extent, not to mention the functioning, of credit reporting in different countries cannot be based on observing the rates of coverage in public or private credit registers.

A recent study by the Association of Consumer Credit Information Suppliers (ACCIS) seeks to address the question of data coverage by looking at the depth and breadth of data held by credit registers.[6] This study has sought to address the question of data coverage by looking at the depth and breadth of data held by credit registers, examining how much data (negative and positive) across how many types of agreement is held on each account. While this survey does not provide results reflecting the state in all EU member states, it does provide an overview of the extent of data sharing on the European level.

The results of the ACCIS (2013) study show that credit registers in Europe can be generally classified into four distinct groups, presented in Table 1. Negative data includes information about unfulfilled financial obligations, such as late payments (often 90 days), defaults, write-offs, bankruptcies and court judgments. Therefore, negative data is only registered upon the occurrence of an extreme adverse event. Positive, which is sometimes also referred to as full files, varies with coverage but always integrates negative-only files with other types of data such as

[6] ACCIS recently conducted a survey of 28 members across 21 countries to understand the levels of data that their members hold and why there are differences between them. Conducted in 2012, the survey includes respondents from Austria, Belgium, Czech Republic, Croatia, Cyprus, Hungary, Denmark, Germany, Spain, Ireland, Italy, Netherlands, Norway, Poland, Romania, Russia, Sweden, Slovak Republic, Slovenia, Switzerland and the United Kingdom.

account balances, on-time payments, early arrears, debt ratios, account type, loan type, repayment patterns, etc.

Table 1. Segmentation of Credit registers

Credit register segment	Description	Frequency
Advanced credit registers	Providers of positive data with high coverage of adults and high levels of depth and breadth of data. These registers have the highest number of open credit accounts per adult population (2.8 times as many accounts per adult as the high positive providers and 97% more data than the negative-only providers).	9 %
High positive providers	Providers of positive data with lower levels of data and coverage of adults than advanced credit registers.	39%
Low positive providers	Providers of positive data with low coverage of data and adults (4.5 times less than high positive providers and 12.5 times less than the advanced credit registers).	30%
Negative-only providers	Providers of negative data only.	22%

Source: ACCIS (2013).

©ACCIS

As Table 1 shows, there is a significant difference in the level of data held per adult between countries as, when compared to the most advanced credit registers, the 'high positive credit registers' hold 64% less data per adult, while the 'low positive credit registers' hold 91% less data per adult. 'Negative-only credit registers' hold 97% less data than the credit registers in most advanced credit reporting systems. The results reported in Table 1 corroborate the current situation where a majority of EU member states facilitate the sharing of at least some positive credit data, but on different levels. A key difference is the incidence of the collection and sharing of data on early arrears, which is not universal in positive systems.

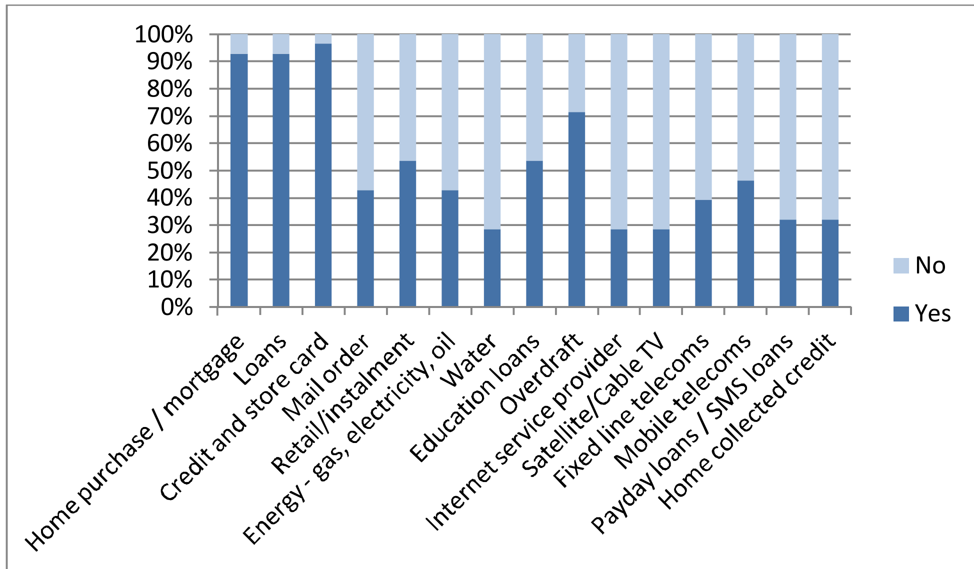
The variation in data gathered between member states starts even from the content of negative data recorded. For instance, neither bankruptcy nor court data is collected in all member states, which is

concerning given that it forms an important basic block of credit reporting systems. While the content of data reported is limited in some countries to public data only or negative data only, other countries also report positive data in addition to both public and negative data. In some countries, positive credit reporting is prohibited and the creditor's own private positive files are often the only source of credit information apart from that which can be obtained directly from the applicant. However, for creditors with no files on a new customer, there is limited information available for creditworthiness assessments in these countries.

In addition to including negative and positive information, credit reporting can also vary in terms of the comprehensiveness of the data, which reflects the extension of credit reporting to other sectors beyond traditional creditors. Comprehensive credit reporting is based on the collection of information from a wide variety of sources and sectors, which may include retail, telecoms, energy, water, and insurance, among others. In the UK, for instance, credit bureaus collect and report data from banks and building societies, credit card issuers, debt purchasers, finance houses, home collected credit, insurance credit, home shopping, high street and online retailers, payday loans, telecoms and internet providers, as well as energy and water providers.

The findings of the ACCIS (2013) survey on credit registers in Europe show that there is still significant variation in the breadth of information reported to credit registers, as can be seen in Figure 3. While the majority of credit registers cover home purchase loans/mortgages, other loans and credit/store cards, there still appear to be significant gaps in coverage for utilities, telecoms and for suppliers of smaller value debts such as retail, mail order, overdrafts, home collected credit and payday/SMS loans.

Figure 3. Breadth of data in credit registers



Source: ACCIS (2013).
©ACCIS

The survey shows that Denmark, Germany and the UK cover the widest range of agreements. However, there are further variations in the levels on which certain data are collected. For example, Denmark holds court data only at present, while negative data includes arrears from the members of credit registers. A positive credit register has recently been launched in Denmark, although with very limited data. Germany, while holding some positive data, does not generally hold early arrears.

Additionally there is the question of the retention of data after an account has been settled. Some countries require that the information be removed as soon as an account has been settled, even if it was in default and was settled months or even years after it was due.

The differences between credit reporting systems may hinder the development of cross-border financial services when citizens move from one member state to another by impeding cross-border access to data and by making the interpretation of foreign credit reports difficult (European Commission, 2009). The facilitation of cross-border credit reporting has improved in the past years and currently there are several reciprocal arrangements in place between credit registers in different countries, facilitated using a model agreement from ACCIS, to allow access to data across borders.

2.2 The regulatory framework

The underlying differences among EU member states in terms of credit reporting systems result to a great extent from differences in legislative frameworks. In some member states, data sharing is required by law while in others, data sharing is voluntary and usually based on reciprocity. Reciprocity is a rule that ensures that only those organisations that share data may receive it. In the ACCIS survey, 86% of credit registers reported to be operating under reciprocity requirements, and of the 14% where reciprocity is not a requirement, all but one credit register holds negative data only.

In spite of these requirements, there are legislative barriers restricting the consumer accounts, and the depth of data from those accounts, that may be shared. A survey conducted in 2010 by the ACCIS showed that the most frequently quoted legal issues for either not sharing data in existing portfolios or not sharing portfolios at all are the banking secrecy and the data protection regulations (ECRI, 2011). Data protection rules are directly applicable to processing credit data. Within the EU, credit registers must comply with national legislation implementing the Data Protection Directive 1995/46/EC, where Article 7 sets the criteria for making data processing legitimate as described in Box 4. The grounds for processing varies from country to country, but most credit registers obtain default or negative (60+ days in arrears) data under the 'legitimate interests' of the data controller described in Article 7. This condition requires the data subject to be notified that such processing will take place and that there are processes and protections in place to mitigate such processing. In some member states, non-negative data may also be processed under this condition, while in other member states it is processed with the consent of the data subject. Consumers can refuse consent at the outset or withdraw it later, which can result in a less than comprehensive picture for any lender seeking to assess a customer's financial status.

Box 4. Lawfulness of data processing in Europe

According to the Article 7 of the European Data Protection Directive the processing of personal data is allowed only if:

a) The data subject has unambiguously given his consent; or
b) The processing is necessary for the performance of a contract to which the data subject is party or in order to take steps at the request of the data subject prior to entering into a contract; or
c) Processing is necessary for compliance with a legal obligation to which the controller is subject; or
d) Processing is necessary in order to protect the vital interests of the data subject; or
e) Processing is necessary for the performance of a task carried out in the public interest or in the exercise of official authority vested in the controller or in a third party to whom the data are disclosed; or
f) Processing is necessary for the purposes of the legitimate interests pursued by the controller or by the third party or parties to whom the data are disclosed, except where such interests are overridden by the interests for fundamental rights and freedoms of the data subject which require protection under Article 1(1).

Therefore, there are strict rules and criteria in place to protect the data subject. The consumer must be informed if the credit register data has contributed to a decision to decline an application and be told how to check his file and possibly get data amended. The consumer also has a right to not be subject to a purely automated negative decision in cases where it has a significant impact on the individual. Automated processing is allowed when entering or performing a contract, but the data controller must ensure that the data subject is able to express his or her point of view in the case of disagreement.

However, the differing interpretations and, in some cases, implementations of the Directive have led to significant differences in the level of data sharing and availability among the member states. The data protection authorities in some countries interpret the Directive in significantly different ways, notably in relation to legitimacy, purpose limitation, necessity, authorised actors, and the proportionality principles, therefore restricting what data can be gathered and shared, for which purposes, how it can be used and by whom. This is an example of why the

European Commission has proposed a Regulation to ensure consistent enforcement of data protection throughout the EU.

While data protection legislation provides the legal framework for credit reporting, the reporting and use of credit data is conducted under the framework of consumer credit legislation, which can sometimes result in conflicts. In some countries, creditors are obliged by law to provide public credit registers with data, while in the case of credit registers data provision is generally agreed voluntarily and based on contractual obligations. Furthermore, some existing and especially forthcoming legislation states that the creditor is responsible for assessing the economic impact of repaying the debt on the consumer. Articles 8 and 9 of the Consumer Credit Directive deal with the 'Obligation to assess creditworthiness' and 'Database access'. Article 8(1) provides that, "Member States shall ensure that, before the conclusion of the credit agreement, the creditor assesses the consumer's creditworthiness on the basis of sufficient information, where appropriate obtained from the consumer and where necessary, on the basis of a consultation of the relevant database." Many member states have directly implemented this in their national legislation, leaving it up to the creditors to decide when it is necessary to consult a credit register. Other member states have made this compulsory, such as Belgium, Hungary, Netherlands and Portugal, while in Poland the Banking Act already included a legal definition of an assessment of creditworthiness.[7] In some countries such as the UK and Italy, however, the use of credit register data in credit decisions is recommended for a proper creditworthiness assessment, and a creditor is therefore required to reasonably justify the decision not to consult a credit data register. Access to the relevant databases is directed in the Article 9 to be non-discriminatory and in compliance with the data protection legislation. The implementation of the Directive is now under review and results from an impact study are expected later this year.

While the CCD stipulates that creditors must assess a customer's creditworthiness before granting credit, no such EU-wide legislation exists yet for mortgage credit. Some member states have also applied the CCD to mortgage credit, while some have not. Section 4.3 provides a more thorough description of this process.

---

[7] See European Parliament (2012) for a review of the implementation of the Directive.

The legislative framework for insolvencies also affects both the role and extent of credit reporting. There are no uniform regulations on the reporting of information on consumer bankruptcies or for how long this information should be retained, causing significant differences in the opportunities for consumers and creditors to avoid or overcome these situations (Anderson et al., 2011). Furthermore, in some countries, default is defined by the lender instead of being defined by legislation, making it very difficult to have consistent and comparable statistics about the extent of and dealing of insolvencies.

In addition to the legislation directed towards credit to consumers, regulation directed towards banks also has an impact on credit reporting systems and their activities in the EU. The Capital Requirements Directive for credit institutions and investment firms (Directives 2006/48/EC and 2006/49/EC) establishes the period of data retention for credit data that has to be used in credit risk models. It also requires creditworthiness assessments to be carried out for prudential purposes. [8] The proposal for the Regulation on Prudential Requirements for Credit Institutions and Investment Firms as part of the new Capital Requirements Directive IV Framework, currently under consideration, continues to make these requirements.[9]

Further impacts arise from other legislative proposals posing further requirements also for the availability of data on consumers. For instance, the current regulatory initiative to ensure all EU citizens have a basic bank account is part of the policy agenda to promote an EU Single Market where EU citizens can access financial services in any member state, and this requires efficient credit data sharing across countries. Similarly, as the fraud prevention and anti-money laundering measures are of paramount importance for creditors, it is essential that creditors have access to relevant identification data throughout the EU. Finally, the initiatives to facilitate switching banking service providers should be seen in conjunction with the resulting need for accurate and up-to-date data about consumers.

---

[8] See Capital Requirements Directive 2006/48/EC ANNEX III Part 6 and ANNEX VII Part 4.

[9] See European Commission (2011b).

2.3 Post-crisis environment for credit data sharing

The recent financial crisis has changed the landscape of the consumer credit market through an emerging trend of re-nationalisation. The Commission is working hard to resume the deepening of EU market integration, and the Single Market Act II published in late 2012 proposes four areas of concentration to promote this development: 1) integrated networks; 2) mobility of citizens and business; 3) the digital economy; and 4) consumer confidence and cohesion. Needless to say, efficient credit reporting is a crucial factor for all of these areas.

The crisis led to concerns about consumer over-indebtedness, arrears and foreclosures and about how such risks might be mitigated (EBA, 2013). It therefore demonstrated the importance of sound and efficient assessment of borrowers' creditworthiness in ensuring efficient and sustainable retail financial services. Recent empirical research provides support for this. In particular, Houston et al. (2010) has found that information sharing among creditors reduces the likelihood of financial crisis.

Because of the significant implications of the crisis on those European households with mortgages, mortgage legislation has been considered one of the most important steps to fight the crisis, and within this policy discussion, the assessment of creditworthiness has become a key issue. In its report requested by the G20, the Joint Forum recommended in 2010 that "supervisors should ensure that mortgage originators adopt minimum underwriting standards that focus on each borrower's capacity to repay the obligation in a reasonable period of time". The Joint Forum repeated this recommendation in its 2013 consultation report on mortgage insurance, as it emphasises that even strong standards by mortgage insurers cannot prevent defaults if the creditors have weak underwriting standards.

The two key EU initiatives relevant to assessments of consumer creditworthiness are the negotiation of the Commission Proposal for a Directive on Credit Agreements Relating to Residential Property[10] (Mortgage Credit Directive) and the review of the implementation of the Consumer Credit Directive. Once approved, the Mortgage Credit Directive (MCD) should provide EU solutions to some of the issues relating to indebtedness and responsible lending in mortgage credit, as it will require creditors to assess creditworthiness before making any loan (EBA, 2013).

[10] European Commission (2011a).

In the Impact Assessment conducted in the planning of the Mortgage Credit Directive published in 2011, the Commission stated that positive effects of creditworthiness assessments would be reinforced if combined with non-discriminatory access to databases by creditors, homogenisation of databases, and the requirement of the borrower to provide correct information on his or her situation. However, the report expressed doubts over the feasibility, at least in the short term, of homogenisation of databases, due to the difficulty of agreeing on the standards for data content and data registration to be applied across the EU. Also, non-discriminatory access to databases was seen as unable to completely solve the problem, as the use by credit registers of different definitions and registration criteria may render the information obtained from a foreign database difficult to exploit.

In 2012, several reports by public authorities outlined the development of creditworthiness assessments as one of the main objectives in ensuring responsible crediting and financial stability. The European Banking Authority (EBA) Standing Committee on Financial Innovation[11] stated, based on contributions from member states' competent authorities, that the work of the EBA should be directed at combating over-indebtedness, for which it identifies the assessment of borrowers' ability to pay as one of the key factors. On the other hand, the Committee acknowledges the difficulties with creditworthiness assessments for consumers with lower credit ratings.

The Financial Stability Board (FSB) states in its Principled for Sound Residential Mortgage Underwriting Practices that a robust and effective assessment of individual affordability must underpin any sustainable lending model, stressing that their principles focus on the credit-granting decision. In particular, the FSB underlines that a borrower's income capacity is a key input into effective mortgage underwriting, and sets out that creditors should obtain sufficient income history on borrowers and make appropriate efforts to capture any variability in their income by collecting and analysing sufficient income history. Furthermore, these income reports should be based on authoritative sources.

The work conducted by different authorities in the recent years to overcome the challenges of the post-financial crisis economic environment has triggered authorities and other stakeholders to draw up general

[11] See EBA (2012).

principles and guidelines for responsible lending. In 2009, the Expert Group on Credit Histories (EGCH), commissioned by the European Commission, published a report analysing data sharing in the EU, especially in the cross-border context. The EGCH stressed that member states differ significantly in terms of content of their credit databases, in particular regarding concepts, definitions and thresholds, types of credit reported, retention periods and update frequencies.[12] The group therefore recommended that some convergence be achieved with respect to these issues to contribute to reaching a level playing field, particularly with regard to the type of data contained in credit registers. The group acknowledged, however, the difficulties in fully standardising the content of databases, stressing the differences between member states' legal and market conditions.

The diversity of credit reporting systems throughout the world and the absence of an internationally agreed framework for credit reporting policy triggered the World Bank to develop a set of General Principles for Credit Reporting. With the aim of contributing to financial stability, economic growth, access to finance and responsible lending, these principles suggest the key characteristics that should be satisfied by different systems and the infrastructure needed to support these systems. The underlying principle for the data to be used in credit reporting states that credit reporting systems should have relevant, accurate, timely and sufficient data collected on a systematic basis from all reliable, appropriate and available sources, retained for a sufficient amount of time. The main innovation of the report is that it provides recommendations for effective oversight of credit reporting systems. The report argues that while central banks, financial regulators and other relevant bodies may oversee credit reporting systems, one or more authorities should be appointed as primary overseer. The oversight body should adopt credit reporting standards and principles to be followed in the market.

New measures continue to be explored at both the national and EU level to assist both creditors and borrowers in responsible lending and borrowing. The results of a survey of members of the Standing Committee on Consumer Protection and Financial Innovation (SCConFin), undertaken by the EBA at the end of 2012, show that responsible credit is still considered one of the mains areas of concern among its members. Driven

---

[12] See European Commission (2009).

by these results, SCConFin's work on good practices and possible future guidelines on responsible lending and on the treatment of borrowers in payment difficulties is considered an important contribution by the EBA.

3. FACILITATING ACCURATE AND EFFICIENT CREDIT REPORTING

An important question is how the data collected should be processed and used in order to help the creditor in making a well-informed creditworthiness assessment of its customer. This chapter discusses the characteristics of a credit reporting system that effectively enable information flows relevant to making decisions related to credit agreements, within the boundaries of the legal framework, and assesses the measures to mitigate risks associated with these information flows.

3.1 Ensuring data quality

Data quality is the basic building block of an effective credit reporting environment (World Bank, 2011). Therefore, as stated in the World Bank General Principle 1, credit reporting systems should have relevant, accurate, timely and sufficient data collected on a systematic basis from all reliable, appropriate, and available sources, and should retain this information for a sufficient amount of time. Accuracy of data implies that the data is free of error, truthful, complete and up to date.

In order to achieve consistency and continuous data accuracy, definitions and distinctions used in these processes are of utmost importance. While there are specific rules in place in some EU member states, there are still significant differences among and even within some countries in these applications. Credit registers have an important role in this. To make the use of this data efficient and correct, the standards for reporting and gathering it should be transparent and well known by the data providers, users and subjects. This means that the definitions used for classifying and processing data should be unified to avoid interpretation errors and to enable fair comparison. For example, creditors for different types of credit products should be able to differentiate between data reported in relation to different types of credit, enabling them to understand the data reported and how it reflects on the product they are about to grant to the customer. This requires that credit reporting systems distinguish between data reported on different kinds of credit products.

Ideally, for national as well as cross-border credit reporting to function, the definitions of at least the most standard terms, such as 'default', should be understood and preferably comparable among member states.

The timeliness of data implies not only that the data is reported to the credit registers on a frequent basis, but also that the updated data is made available to data users without a significant lag. This is why the credit reporting service providers and data providers should apply clear and detailed rules for updating the information, with rules ensuring that updates be performed on the basis of pre-defined schedule or specific trigger events (World Bank, 2011). These rules also contribute to the overall accuracy of data if the credit register has clear data specifications set out in their membership requirements so that any aspiring data provider/user member knows exactly what is required. These specifications should include requirements on the identification information for each account so that it can be accurately matched, as well as a range of mandatory fields and values. No new member should be signed up until testing has taken place to ensure they meet the standards and will be able to in the future.

In order to achieve consistently sufficient data, credit reporting service providers should work with all stakeholders and regulators to set clear rules on minimum and optional data inputs (World Bank, 2011). Credit reporting service providers should be able to collect and process all the relevant information needed to fulfil their lawful purposes and to enable any lawful user to adequately evaluate and manage credit risks on a continuous basis (World Bank, 2011). A certain set of basic negative information is crucial for credit decisions. All credit reporting systems should have full coverage across all liabilities and, if possible, income and assets too. The World Bank (2011) states in its principles that data elements to be collected should include, at a minimum: identification, information on the credit including original amount, date of origination, maturity, outstanding amount, type of loan, default information, arrears data and transfer of the credit when applicable.[13]

---

[13] Also, the FSB (2012) states in its Principles for Sound Residential Mortgage Underwriting Practices that creditors should establish appropriate processes to assess the borrower's ability to repay the loan, which should include an appropriate consideration of other servicing obligations, such as the level of other debt (secured and unsecured), the characteristics of the loan, and evidence of delinquency.

If borrowers understand and engage regularly with the credit register, any data that needs amending is more likely to be identified. Transparency of the credit reporting and usage processes ensures their quality, as well as directing data users towards reasonable use of data. Therefore, the involvement of the data subjects is a crucial building block of data quality. As the World Bank General Principles state and the EU DPD also requires, consumers should have the right to object to their information being collected for certain purposes, the right to be informed on the conditions of collection, the right to access their own data periodically at little or no cost, and the right to challenge the accuracy of the information about them. In addition, consumers should be made well aware of their rights and options for affecting and accessing the information about them, and must be told which data contributed to a credit refusal.

Consumers should also be engaged in assurance of credit data quality through the option to have an explanation or note added to the data to explain the reason behind a certain event. This, together with rules that stipulate a prospective lender must acknowledge the note and not process through automated systems, is essential in giving the borrower an opportunity to provide their information to prospective lenders. There should be controls and guidance as to what such a note can include and how to handle the maintained information.

Adding notes and special markers to an individual's credit file is an important tool to prevent vulnerable consumers from being harmed through standard data processing, a concern raised in Section 1.5.

However, the information given to consumers about their rights, and the means of providing it, should be considered carefully. Providing consumers with too much information can lead to confusion if they do not understand the data about them and how it is processed. Therefore, the information needs to be easy to understand and relevant so that consumers are encouraged to take control of their own financial wellbeing.

3.1.1 Access to credit data

In order to achieve consistent and accurate credit reports with sufficient and timely coverage, the credit reporting systems should operate securely and efficiently. Efficiency of the systems implies that credit reporting service providers should strive to be efficient both from an operational as well as from a cost perspective, while continuing to meet users' needs and high standards (World Bank, 2011). In addition, the data should not be

excessively fragmented, where the user ends up having to go to several sources to fill the gaps, as this is inefficient and costly for all stakeholders. To promote the collection of data on a systematic basis from all relevant and available sources, the World Bank have stated in their General Principles that data providers should refrain from entering into exclusivity agreements with a particular credit reporting service provider and should share data widely and equitably across the system, as this is beneficial for the credit reporting system as a whole.

The more efficiently credit data reporting networks function, the more consumers will benefit from the increased customer mobility and increased competition between providers. Similarly, more efficiency will generate increased opportunities for economies of scale and scope, benefiting providers both domestically and across borders. Sufficient and timely coverage of databases also requires that all creditors who report data generally have equal access to respective databases. Restrictions to sharing, accessing or using data, which may pose risks to competition, can stem from regulatory requirements (regulatory failure) or limitations originating at market level (market failure)[14]. These restrictions generally materialise through access criteria[15] or through the fee structure.

Deficiencies in credit reporting systems may generate barriers to entry in the banking industry because the newcomers cannot access the same information about customers as the incumbent players (Dell'Ariccia et al., 1999; Claessens and Laeven, 2004). These information asymmetries can also incentivise entry through mergers and acquisitions, instead of competition increasing greenfield investments (Jappelli and Pagano, 1993). Additionally, competition among the incumbent creditors can suffer as the lack of common information gives a competitive advantage to the banks that already have information about a customer (Jappelli and Pagano, 2002). Consistently, Tsai et al. (2011) find that banks prefer to expand to countries where the credit reporting system provides a better quality of credit information in terms of timeliness, accuracy and completeness.

---

[14] SEC(2011) 356 Impact Assessment Annex 4 accompanying the Proposal for a Directive on Credit Agreements Relating to Residential Property, Commission Staff Working Paper.

[15] For example, authorised usage (undertaking credit granting activity), banking license, geographical presence, and reciprocity agreements.

Controls should also be in place to prevent inappropriate or illegal accessing of the credit databases, a concern raised in Section 1.5. While the data protection legislation stipulates for which purposes and by whom the private data can be used, there will always be unscrupulous organisations seeking to get around the rules. Therefore, it is essential that each access relating to a credit application should specify the purpose for the request, and the data should be managed according to the membership criteria and purpose. So, for example, a default supplier can be restricted to receiving only default data. Certain purposes should only receive certain data; for example, ID checks do not need actual account balance and payment data. Furthermore, if the local laws and rules allow, access to the data for the purposes of marketing can be controlled to prevent, for example, "fishing" of customers based on their characteristics.

Summaries of data are a useful mechanism to restrict the level of detail available by purpose or to prevent abuse. The use of summary data and warnings against set criteria could also provide one solution to preventing overly intrusive monitoring of customers by lenders.

3.1.2 *Extending the reporting networks*

The most common purpose for processing credit data is credit risk management, which is why the actors generally using credit data come from the traditional financial services industry, including banks and other creditors, credit card issuers, and insurance companies. However, in some countries non-financial service providers, such as telecommunication companies, gas and water providers, and retailers, have also joined the credit reporting systems. Including utilities and telecommunications data in credit reporting systems can benefit all stakeholders in the systems. Creditors get more comprehensive data to use in their credit decisions, consumers can enjoy credit files which wouldn't otherwise probably exist, credit is granted based on broader information about a customer's financial position, and intervention can occur earlier for customers in financial distress.

Utilities companies get access to credit reporting systems through the reciprocity principle as they report payment performance data on their customers to the system. This helps them to better understand the profile of their customers and thereby to choose appropriate terms of business for each customer. It also helps them in dealing with their existing customers, as they can proactively monitor their customers and identify signs of financial distress at an early stage. Furthermore, if the customer ends up in

financial difficulties, the service provider can adapt the contact and debt management strategies depending on the profile of the customer.

Extending credit reporting to sectors other than financial services can potentially contribute to the prevention of over-indebtedness. Over-indebtedness can result from multiple financial liabilities of a consumer, not just financial credit. Disney et al. (2008) report, using a panel data based on household interviews in the UK, that the most common form of arrears relate to utility bills (including gas, electricity, water, and council tax), rather than financial debt. Therefore, in order to prevent the customer from taking more debt than he or she is capable of bearing, it is important for the debtor to have an overview of all of the customer's financial obligations, including credit as well as financial obligations resulting from telecommunications and utilities.

These comprehensive credit files can be of special advantage in debt management situations, since a thorough overview of a customer's full liabilities ensures effective repayment planning. Furthermore, as consumers stop paying their debt instalments in a hierarchical way according to their personal priorities, sharing data on all debts it is of significant value for early intervention. Depending on their preferences, customers might already be facing serious financial problems and be over-indebted by the time they stop paying their consumer or mortgage credit.

In Section 1.5, this report outlined how extending credit reporting access to providers of non-financial debt, such as telecommunications and electricity providers, raises special concerns of data definitions and quality, as not all actors across economic sectors are regulated in the same way. To overcome this challenge, the set of data specifications set out in their membership requirements, in order that any aspiring data provider/user member knows exactly what is required, is important. No new member should be signed up until testing has taken place to ensure they meet the standards and will be able to do so in the future.

To provide effective control, the rules need to be tightly specified at an organisational, product, portfolio and account level such that only those applications that will be shared into the register may access the data to make a decision. There are different ways of setting out the rules, and this can be in legislation or Codes of Conduct (perhaps then embedded in contracts). An example of such a solution is the Principles of Reciprocity[16]

[16] http://www.scoronline.co.uk/principles/

in effect in the UK. The rules are negotiated and agreed between the members of the register and discussed with the regulators to ensure they comply with the Data Protection Act.

Reciprocity, whilst a common and important control, need not prevent access by authorised parties and it is possible to agree, or legislate for, exemptions such that regulators, the police or others may access certain data sets (raw or summarised, personal or anonymised) for agreed purposes.

3.2 How should the credit data be used?

Creditworthiness is not a constant quality of a consumer, but rather depends on the type of credit or other service in question as well as the environment in which the credit is to be taken. Comprehensive credit data itself does not lead to robust credit decisions, but it does make them possible. Robust decisions depend on the breadth and depth of the data and how it is used. For this purpose, it is important that the creditors have access to data that is accurate and understandable. Credit reporting systems play a key role here and should be able to gather all information about data subjects that is relevant for credit decisions in a timely manner, and be able to retain this information for a sufficient amount of time. The completeness and accuracy of the data is the key, rather than the use of specific systems for gathering the data. Furthermore, credit data needs to be used in the way that obtains the intelligence out of the data with a robust and transparent methodology.

There are different systems for gathering the required information in order to make credit decisions. In some cases, the creditor only needs the credit report to check the accuracy of information received from the customer or to supplement missing information in its own files. So-called derivatives of credit data are one way for lenders to obtain the required information for their purposes. Some loan products are built on frequent personal contacts between the creditor and the borrower, which might impact the extent of credit data the creditor needs to request from the credit register.

Automated credit scoring has enabled credit registers and creditors to use large amounts of data and combine different information into one single indicator applicable for credit decisions. Credit scoring can be used to measure the statistical probability that credit will be repaid or, alternatively, of default. It is often employed within automated decision systems alongside a series of rules and controls. Consumer representatives

have generally preferred a greater emphasis on manual analysis of credit data rather than on automated scoring.[17] However, systems that employ credit scoring have been shown to be superior to the manual methods, as they allow more credit to be granted more efficiently, more transparently and more safely. For example, work undertaken in the UK by HM Treasury as part of the Equality Act showed credit scoring to be a fair mechanism enabling those frequently subject to discrimination in manual assessments to be treated according to the true risk of the proposition. Therefore, it ensures consistency and fairness in the credit decision process. However, automated credit decisions cannot be adopted in all cases for practical and economic reasons. Accordingly, special cases are often taken out from the overall scoring and dealt with manually and the law does not allow negative credit decisions to be based exclusively on automated decisions.

Regardless of how much and what information is necessary to achieve what the creditor deems as a robust credit decision, all equal creditors should have non-discriminatory access to accurate data about their customers.

3.3 Cross-border exchange for the single market

Cross-border credit data sharing and comparability is a matter concerning not only borrowers that wish to get credit outside their home country. Rather, it concerns all consumers as cross-border data access affects competition among creditors and is reflected in the ease of market entry, thereby impacting consumer choice and the cost of financial products.

The World Bank General Principles of Credit Reporting (GP) state that, where appropriate, cross-border credit data transfers should be facilitated, provided that adequate requirements are in place. The GP further argue that the feasibility or desirability of cross-border transfers should be based on a cost-benefit analysis that considers market conditions, the level of economic and financial integration, legal and regulatory barriers, and participant needs. In doing this, there should be a framework for cooperation and coordination between the relevant regulators and overseers. Cross-border credit to consumers is still limited, which has generally been used as a reason for not intervening in the problems with

---

[17] SEC(2011) 356 Impact Assessment Annex 4 accompanying the Proposal for a Directive on Credit Agreements Relating to Residential Property, Commission Staff Working Paper.

cross-border exchange of consumer credit data. However, the restrictions to cross-border exchange are one of the factors for this limited provision of cross-border credit. While the recent financial crisis stalled the move towards more financial market integration in the EU, several recent initiatives are currently being undertaken to renew the growth of cross-border financial markets.

The European Parliament (2012) also stated in its initiative on the implementation of the Consumer Credit Directive 2008/48/EC that improving the cross-border consumer credit market would generate added value in Europe by boosting the internal market, and that this could be achieved by better informing consumers about the opportunities to obtain credit in other member states.

Therefore, standardisation of key data availability and their definitions – at least at the highest levels – should be fostered to facilitate access to this data to help citizens when they move across borders and seek access to financial services and credit. A potential step would be to create a mechanism for sharing data on defaults and, in particular, on defaults against persons known to have absconded. This would help consumers moving from one country to another, as it would guarantee creditors in their new country that the customer is not already overburdened financially. It is also a key objective for organisations that are compelled to offer student finance on equal terms despite the possibility that students will return to their country of origin and be beyond existing debt collection mechanisms. As the difficulties for cross-border credit reporting currently arise from differences in national legislation, future improvements in the legal framework would play a significant role in this development. This requires the assessment of the implementation of the Consumer Credit Directive and its interplay with the future data protection regulatory framework in order to achieve more legal clarity at the EU level.

The Expert Group on Credit Histories (European Commission, 2009) expected in its report that once the economic recovery is on more stable ground and data availability increases, credit reporting could increase its importance for retail credit market integration. While harmonising the content of data used in credit reporting in different EU member states is considered problematic, the EGCH recommends that work be done towards convergence in the contents of databases, in particular in terms of the concepts and definitions used. The first step in this process would be for the credit data industry to develop practical solutions that would assist creditors and consumers in understanding foreign credit reports.

Given that a reliable and efficient identification system is a cornerstone for secure financial services and electronic commerce, work towards a system that facilitates the use of identification data across EU member states would be beneficial. The EGCH considered a solution relying on the portability of registration numbers difficult to implement in practical terms, and that the introduction of a new standard agreed by all credit registers as a common identity format would entail significant costs (European Commission, 2009). However, while the development of an EU identification scheme is outside the scope of this report, a system where identity systems or documents, recognised across the EU and issued by member states, are generally listed and known could be a less costly solution to the problem of identification.

4. THE ROLE OF THE LEGISLATIVE FRAMEWORK

A robust legal and regulatory framework is critical to the success of credit reporting systems in supporting efficient and sustainable retail financial services. For credit reporting systems to be efficient and contribute fully to economic growth, they need to operate within a legal framework that supports secure data processing by authorised parties. The legislative framework has an important role in protecting the privacy of individuals, but also in ensuring that the required data can be accessed by authorised actors to provide the services that generate economic growth. This means that authorised purposes, authorised users and legitimate interest are in line with the credit granting environment, and that the quality and usability of data is ensured through data subjects' access to information and through sufficiently long data retention periods. Because of the regulatory obligations that many creditors face, their access to all relevant databases should also be guaranteed.

As credit reporting functions are at the intersection of several regulatory frameworks, there is a need to bridge the gaps between the different frameworks through rules and standards. In this, regulators should work together with the data users, providers and subjects in order to reach a balanced approach.

4.1 Network of different legislative frameworks

Credit reporting is more a network of different actors than a single industry. Credit registers deal with the gathering, processing and reporting of data that creditors and consumers use. Therefore, rules applicable to this activity should cover all participants in the network. Policy-makers must place responsibilities and liabilities on the parties on which they must be reasonably placed – the consumer, the creditor and the credit registers – as they are all network participants (Jentzsch, 2010) together with regulators and supervisors. Regulation that sets boundaries for only one participant in this network is likely to have unintended consequences. For instance, regulation that leads to credit rationing

through a decreased supply of credit would have consequences on the sustainable growth of EU economies. Credit rationing does not usually affect big companies and wealthy borrowers with extensive credit history, but rather smaller companies and individuals with little or no credit history, who are in fact in greater need of credit. Through information sharing as well as supporting regulations, such constraints can be lowered (Jentzsch, 2010).

The World Bank (2011) also notes that there is a risk of the legal framework being too restrictive, thus hindering the development of an efficient credit reporting system. When designing new laws or regulations, or amending existing ones, regulators should carefully weigh the intended benefits against the potential negative consequences such new rules may have on the credit reporting system as a whole. This also means that penalties should be proportional to the offence and the exact circumstances. In order to encourage competition, regulation should not become a barrier to entering the market through prohibitively high costs of compliance.

Credit reporting legislation has to be seen as a framework of legislations directed towards different parties. The regulatory framework for credit reporting is set by credit legislation, data protection legislation, anti-money laundering legislation, and by banking secrecy rules. Prudential requirements for credit institutions also affect the use of credit data. Crediting legislation sets the minimum requirements for using the data in credit decisions, while data protection regulation provides boundaries for the systems.

General Principle 4 of the World Bank states that the overall legal and regulatory framework for credit reporting should be clear, predictable, non-discriminatory, proportionate and supportive of data subject rights, with effective judicial or extrajudicial dispute resolution mechanisms in place. This means that the legal and regulatory framework is sufficiently precise to allow data controllers, users and subjects to foresee the consequences their actions may entail. This precision should come from clearly stating the types of data that can and cannot be collected, which types of users can access the credit reporting databases and under what conditions. The key terminology used throughout the credit reporting systems and regulatory framework, including the rules and other norms, should be consistent at the domestic level. Also, the supply of data and access to it should be established in a fair manner.

Therefore, the regulatory framework has an important role in ensuring the safety and efficiency of credit reporting systems. However, new laws or regulations, or amendments to the existing ones, they should be carefully weighed so as not to impose over-restrictive provisions that would have negative consequences on the credit reporting system as a whole. The three main criteria for the proportionality of laws and regulations – adequacy, necessity and non-excessiveness – should be reflected in the legal and regulatory framework supporting the collection of credit and related data from businesses and individuals, and the use of such data (World Bank, 2011).

4.2 Data protection legislation

The core principle driving the EU Data Protection Directive is that the fundamental right of privacy for individuals is safeguarded, while ensuring that personal data is able to flow freely from one member state to another. However, the role of data protection legislation in companies' business operations differs significantly between industries. While for some industries, the data protection legislation only impacts the collection and processing of data they perform in *support* of their main services, for credit registers the collection and processing of data *is* their main service, making data protection legislation the primary legislation for them in many EU countries. Furthermore, the regulatory requirements for financial stability purposes, with which regulated industries such as the crediting industry have to comply, make their grounds for collecting and processing data significantly different from other industries where data is collected merely for business purposes. Legislation should therefore refrain from directly describing data processing practices as it can potentially impact the viability of industries in different ways. Data protection legislation should rather focus on protecting privacy in a balanced and principle-based way, not stipulating specific and descriptive ways for data to be handled.

EU legislators are currently in the process of revising the data protection framework in order to achieve consistency in the levels of data protection levels across the EU. When the legislative measures are "upgraded" from a directive to a regulation, its provisions need to be carefully assessed from the perspectives of the different industries affected.

For credit reporting systems and their participants to support sustainable and inclusive provisioning of financial services to individuals, legislation – whether data protection or otherwise – should ensure that the relevant information can be gathered and retained for a sufficient period,

and that the parties needing the information have the legitimate right to access and process all relevant data. The regulatory requirements arising from CCD, future MCD, CRD and AML form an operative framework for creditors, where they have an obligation to assess the creditworthiness of consumers based on sufficient information retained for a sufficient period of time. Data about credit behaviour is relevant for credit decisions for some years after the closure of the previous credit, and the data retention rules set the boundaries for the maximum retention period. Also, the Capital Requirements Directive states that the data period used for quantification shall be sufficient to provide the credit institution with confidence in the accuracy and robustness of its estimates[18]. A rule giving the consumer the possibility to order the deletion of this data before completion of the maximum retention period would make the credit files biased. Because of the potentially negative tone of some economically significant and predictive information about consumers, or the potentially damaging effect of the removal of some data collected under the consent condition, it is important that data protection legislation explicitly authorises the collection and the use of credit reporting data by players such as creditors and credit registers based on legitimate interest, as the Article 7(a) and (f) of Data Protection Directive does.

Data protection legislation also has an important role in setting the obligations and responsibilities of the data controller. The credit data controller is responsible for the quality of the processing of the data that they receive and distribute to authorised users. Therefore, data protection legislation should not set requirements that hinder the ability of the participants in the credit data register to control and ensure the quality of the data they distribute. For instance, the principle of 'data portability' currently under policy discussion in the EU would take full control of the data away from the credit reference agency, as there is a risk of the data being altered by some parties between the data subject receiving the credit file and presenting it to the data user. This could compromise the accuracy of the data and increase the risk of fraud associated with credit reporting. The obligation for data portability would also not be in line with the recommendations of the EGCH (European Commission, 2009) that it

[18] See Capital Requirements Directive 2006/48/EC ANNEX VII Internal Ratings Based Approach – 2. Risk quantification. This data is also required to be kept for three years.

should be left to each individual lender to decide which data access model offers the most convenient and cost-effective solution to data portability.

The role of data protection legislation is fundamental for cross-border exchange of credit data. The significant differences between member states with regards to the interpretation of the current Data Protection Directive, notably in relation to legitimacy, purpose limitation, necessity, authorised actors, and the proportionality principles, make efficient credit data sharing within and between some member states very difficult. Furthermore, the EGCH states in its report that the absence of a reliable EU-wide identification scheme means that any cross-border reporting system will remain imperfect (European Commission, 2009).

4.3 Regulation of credit to consumers

The use of personal data is necessary for secure and efficient financial services for consumers. This is why the Consumer Credit Directive and the Capital Requirements Directive set an obligation for consumer credit providers to assess the creditworthiness of customers using necessary data, also for the purposes of risk management and identification. The forthcoming Mortgage Credit Directive (Directive on Credit Agreements Relating to Residential Property) is likely to serve as a precedent for how the use of credit information will be regulated. In its Impact Assessment for Mortgage Directive, the European Commission set as its objectives ensuring access to appropriate information to assess creditworthiness, and ensuring that creditors adequately assess customers' creditworthiness, given their needs and preferences.

The Commission proposal for a Mortgage Credit Directive stipulates that an assessment of creditworthiness should be based on objective criteria in order to verify the prospect of the customer meeting his or her obligations under the credit agreement. According to the proposal, the Directive will also require that the creditworthiness assessment be carried out on the basis of sufficient, proportionate and appropriately verified income and financial information, obtained by the creditor from relevant internal or external sources. Furthermore, the Directive will require that each member state ensures access for all creditors to databases used in that member state for creditworthiness assessment and consumer monitoring purposes. The Mortgage Credit Directive, in its current negotiation process, therefore seems to be placing an important role on credit reporting systems in credit granting decisions.

The Mortgage Credit Directive will make an important contribution to the regulatory framework for retail credit in the EU. After this piece has filled the gap that was left by the limitations of the Consumer Credit Directive, the EU will have in place a set of rules that promote responsible lending. However, the adoption and enforcement of these rules by the industry and regulators requires further attention.

The assessment of the enforcement and implementation of the existing legislation on credit to consumers is currently undertaken by the European Commission under the Consumer Credit Directive 2008/48/EC. In its own initiative report on this implementation, the European Parliament points out that one of the purposes of the Directive was to ensure the availability of information in order to facilitate the operation of the single market in the field of credit, and takes the view that the provisions on creditworthiness assessment provided for in Article 8 play an important role when it comes to improving consumer awareness of the risks involved in taking out a loan, especially in a foreign currency.

Therefore, the enforcement and the implementation of consumer credit regulation should take an EU-wide perspective to allow for efficient credit data sharing in order to truly promote cross-border credit. The surrounding regulatory framework should be synchronised to both allow and ensure the necessary data flows.

5. CONCLUSIONS

This report emphasises that a well-functioning and comprehensive credit reporting system is in the interest of all stakeholders, as it promotes well-informed credit decisions, a level playing field in the market, customer mobility and choice, as well as financial inclusion. However, while bringing significant potential benefits, credit reporting systems also bear significant risks and concerns regarding privacy, security, accuracy of data and social inclusion.

This report has sought to provide the arguments and the evidence to help strike a balance between the benefits and the costs associated with credit reporting systems, and has suggested ways to further develop these systems whilst mitigating the associated risks.

The creditworthiness of a consumer is a concept susceptible to change, influenced by the type of credit product in question as well as the environment in which the credit is granted. Different systems exist to collect the information required to assess the creditworthiness of an applicant borrower. It is important that for this purpose, the creditor has access to the whole ecosystem of credit reporting, including private and public credit registers, databases provided by public authorities, and the creditor's own internal databases, as well as information provided by the applicant.

To achieve consistency, the definitions and distinctions used in these processes are of utmost importance. To make the use of this data efficient and correct, the standards for reporting and collecting data should be transparent and well-understood by both data providers and data users, including consumers. This means that the definitions used for classifying and processing data should be unified – at least at the highest levels – to avoid interpretation errors and to enable fair comparison. This is especially important in fostering cross-border credit data transfers.

In the development of this, the inclusion and engagement of consumers as data subjects is crucial. If borrowers understand and use their own credit data, any data that needs amending is more likely to be identified through regular engagement by the borrower with the credit

register. The information used for credit reporting therefore needs to be understandable and useful so that consumers are encouraged to use their data themselves and to take control of their own financial wellbeing. Transparency of credit reporting ensures the quality of the processes and the involvement of the data subjects is a crucial building block of data quality.

The legislative framework has an important role in protecting the privacy of individuals and also in ensuring that the required data can be accessed by authorised actors in order to provide services that generate economic growth. Therefore, authorised purposes, authorised users and legitimate interest outlined in the data protection legislation should be in line with credit reporting environment as well as the credit granting process, which is also legislated through crediting specific directives. Legislation also has a role in facilitating access to databases for creditors in order for them to fulfil some of the requirements set out in the credit directives. The quality and usability of data should be ensured by data subjects' access to the information and through adequately long data retention periods.

The group considers that the role of data protection regulation is to guarantee privacy and the rights of the data subjects, while facilitating free but appropriately controlled data flows in the economy. The current revision of the EU data protection legislation is an opportunity to harmonise and balance the environment for credit reporting. However, when directing or even restricting data processing, the legislation should be in line with other legislations regulating the crediting industry, such as Article 8 of the Consumer Credit Directive and the upcoming Mortgage Credit Directive, both of which require creditors to assess the creditworthiness of consumers before granting credit.

REFERENCES

Anderson, R., H. Dubois, A. Koark, G. Lechner, I. Ramsay and T. Roethe (eds) (2011), *Consumer Bankruptcy in Europe – Different Paths for Debtors and Creditors*, Florence: European University Institute.

Barron, J. M. and M. Staten (2003), "The Value of Comprehensive Credit Reports: Lessons from the U.S. Experience", in M. M. Miller (ed), *Credit Reporting Systems and the International Economy*, Cambridge, MA and London, England: MIT Press.

Brown, M., T. Jappelli and M. Pagano (2009), "Information sharing and credit: Firm-level evidence from transition countries", *Journal of Financial Intermediation*, Vol. 18, pp. 151-172.

Claessens, S. and L. Laeven (2003), "What drives bank competition? Some international evidence", *Journal of Money, Credit and Banking*, Vol 36, pp. 563-583.

Del-Rio, A. And G. Young (2006), "The determinants of unsecured borrowing: Evidence from the British Household Panel Survey", Bank of England Working Paper No. 263, London.

Dell'Ariccia, G., E. Friedman and R. Marquez (1999), "Adverse selection as a barrier to entry in the banking industry", *RAND Journal of Economics,* Vol. 30, pp. 515-534.

Dell'Ariccia, G. and R. Marquez (2004), "Information and bank credit allocation", *Journal of Financial Economics,* Vol. 72, pp. 185-214.

Disney, R., S. Bridges and J. Gathergood (2008), *Drivers of Over-indebtedness*, Report to the Department of Business, Enterprise and Regulatory Reform, Nottingham, UK: Centre for Policy Evaluation and University of Nottingham.

Djankov, S., C. McLiesh, and A. Shleifer (2007), "Private credit in 129 countries", *Journal of Financial Economics*, Vol. 984, No. 2, pp. 299-329.

DTI (2004), *Tackling over-indebtedness: Action Plan 2004*, Report of the Advisory Group on Over-indebtedness, London: Department of Trade and Industry, July.

EBA (2012), *Financial Innovation and Consumer Protection – An overview of the objectives and work of the EBA's Standing Committee on Financial innovation (SCFI)*, London: European Banking Authority.

––––––––– (2013), *Report on consumer trends – Supervisory concerns regarding consumer protection issues in 2012/13*, London: European Banking Authority.

ECRI (2011), *The European Credit Information Landscape: An Analysis of a Survey of Credit Bureaus in Europe*, ECRI Industry Survey for Association of Consumer Credit Information Suppliers (ACCIS), Brussels: European Credit Research Institute and ACCIS.

Eurofinas (2011), *Fraud prevention and data protection – A Eurofinas-ACCIS Report on Fighting Fraud in Consumer Lending*, Brussels: Eurofinas and ACCIS.

European Commission (2009), *Report of the Expert Group on Credit Histories*, Final Report of the Expert Group, Brussels: DG Internal Market and Services.

––––––––– (2011a), *Proposal for a Directive on credit agreements relating to residential property*, COM(2011) 142 Final, Brussles: European Commission.

––––––––– (2011b), *Proposal for a Regulation on prudential requirements for credit institutions and investment firms*, COM(2011) 452 Final, Brussels: European Commission.

––––––––– (2012a), *Communication on safeguarding privacy in connected world – A European Data Protection Framework for the 21st Century*, COM(2012) 9 Final, Brussels: European Commission.

––––––––– (2012b), *Proposal for a regulation on the protection of individuals with regard to the processing of personal data and on the free movement of such data (General Data Protection Regulation)*, COM(2012) 11 Final, Brussels: European Commission.

European Parliament (2011), *Responsible Lending – Barriers to Competition*, DG For Internal Policies, Economic and Monetary Affairs, IP/A/ECON/ST/2011-05, Brussels: European Parliament.

––––––––– (2012), *Implementation of the Consumer Credit Directive*, DG for Internal Policies, Internal Market and Consumer Protection, IP/A/IMCO/ST/2011-15, January 2012, Brussels: European Partliament.

FSB (2011), *Consumer Finance Protection with particular focus on credit*, Basel: Financial Stability Board.

––––––––– (2012), *FSB Principles for Sound Residential Mortgage Underwriting Practices*, Basel: Financial Stability Board.

Houston, J. F., C. Lin, P. Lin and Y. Ma (2010), "Creditor rights, information sharing, and bank risk taking", *Journal of Financial Economics*, Vol. 96, No. 3, pp. 485-512.

Jappelli, T. and M. Pagano (2002), "Information sharing, lending and defaults: Cross-country evidence", *Journal of Banking & Finance*, Vol. 26, pp. 2017-2045.

Jentzsch, N. (2010), *Financial Privacy: An International Comparison of Credit Reporting Systems*, 2nd Edition, Heidelberg: Springer.

Kempson, E., S. McKay and M. Willitts (2004), *Characteristics of families in debt and the nature of indebtedness*, Department of Work and Pensions Research Report 2011, Corporate Document Services.

Padilla, A. and M. Pagano (1997), "Endogenous communication among lenders, and entrepreneurial incentives", *Review of Financial Studies* 10, pp. 205-236.

Padilla, A. and M. Pagano (2000), "Sharing default information as a borrower discipline device", *European Economic Review,* Vol.44, pp. 1951-1980.

Pagano, M. and T. Jappelli (1993), "Information sharing in credit markets", *Journal of Finance,* Vol. 48, pp. 1694-1718.

Ramsay, I. (2011), "Between neo-liberalism and the social market: Approaches to debt adjustment and consumer insolvency in the EU", in R. Anderson, H. Dubois, A. Koark, G. Lechner, I. Ramsay and T. Roethe (eds), *Consumer Bankruptcy in Europe – Different Paths for Debtors and Creditors*, Florence: European University Institute.

Tsai, H., Y. Chang and P.-H. Hsiao (2011), "What drives foreign expansion of the 100 multinational banks? The role of the credit reporting system", *Journal of Banking & Finance*, Vol. 35, No. 3, pp. 588-605.

Turner, M. A., R. Varghese, A. S. Lee and P. Walker (2006), *Give credit where the credit is due: Increasing access to affordable mainstream credit using alternative data*, Washington, D.C.: Political and Economic Research Council PERC and The Brookings Institute.

Turner, M. A. and R. Varghese (2007), *The economic impacts of payment reporting in Latin America*, Chapel Hill: Political and Economic Research Council PERC.

Turner, M. A., P. D. Walker, S. Chaudhuri, J. Duncan and R. Varghese (2012), *Credit impacts of more comprehensive credit reporting in Australia and New Zealand*, Durham: Political and Economic Research Council PERC.

World Bank (2011), *General Principles for Credit Reporting*, Washington, D.C.: World Bank.

Appendix 1. Glossary of Abbreviations

AML	anti-money laundering
CCD	Consumer Credit Directive
CRA	credit reference agency
CRD	Capital Requirements Directive
DP	data protection
DPD	Data Protection Directive
DPR	Data Protection Regulation
MCD	Mortgage Credit Directive
PCR	public credit registry
GP	General Principle

APPENDIX 2. TASK FORCE MEMBERS AND INVITED GUESTS AND SPEAKERS

Chair: Dieter Steinbauer
Professor, Dr.

Rapporteur: Elina Pyykkö
Research Fellow
CEPS/ECRI

Task Force Members

Adler, Clemens
Head of Quantitative Solutions
Deutsche Bank AG

Bysikiewicz, Axel
Head of Corporate Governance
SCHUFA Holding AG

De Mesmay, Jean-Eric
Director of Institutional Relations
Cofidis

Delava, Anke
Legal Adviser
Eurofinas

Delli, Raphael
Financial Reporting Advisor
European Savings Bank Group

Dunlea-Peatross, Treena
Assistant General Counsel
Citi

Gelpi, Rosa-Maria
Chairwoman of the Board
ECRI

Guermonprez, Damien
Chief Executive Officer
Buy Way Personal Finance

Giraud, Alexandre
Senior Legal Adviser
Eurofinas

Guthke, Thorsten
Head of Legal Department
European Savings Bank Group

Hauff, Anette
Public Affairs Manager
Deutsche Bank AG

Key-Vice, Gillian
Vice President
ACCIS

Klatte, Britta
Head of International Cooperation
SCHUFA Holding AG

Lamidey, John
Chief Executive Officer
Consumer Finance Association

Langlois, François
Head of Public Affairs
BNP Paribas Personal Finance

Liutkute, Loreta
Senior Manager
Visa Europe

Marshall, Loretta
Public Affairs Manager
ACCIS

Mitra, John
Marketing & Communications Director
International Personal Finance

Munroe, Neil
President
ACCIS

Nielsen, Susanne
Secretary General
Danish Mortgage Credit Complaint Board

Rees, David
Director Legal Affairs
Provident Financial

Richmond, Victoria
Group Public Affairs Manager
International Personal Finance

Vasile, Claire
Manager EU Public Affairs
PayPal

Vestentoft, Jeppe Torp
Head of Legal Affairs
Association of Danish Mortgage Banks

Weibel, Fabienne
Deputy Head of Government Relations
PayPal

Williams, John
Credit Director
International Personal Finance

Task Force Observers

Barter, Alastair
Senior Policy Officer
UK Information Commissioner's Office

De Frutos Gómez, José Manuel
Policy Officer
Directorate Data Protection
European Commission - DG Justice

Johansson, Per
Legal Officer
European Data Protection Supervisor

Lissowska, Maria
Head of Sector
Directorate Financial Services and Redress
European Commission – DG Health and Consumers

Montes, Fredes
Legal Specialist
World Bank

Pereira, Ceu
Senior Payment Systems Specialist
World Bank

Invited Speakers

Ferretti, Federico
Lecturer in Law
Brunel University

Griffiths, Max
Head of Credit Risk
British Gas

Guglielmetti, Mario
Policy Officer
Directorate Data Protection
European Commission - DG Justice

Jones, Gareth
Director of Risk Management
PayPal

Pauli, Frank-Christian
Policy Officer
Financial Services, Banking
Federation of German Consumer Organisations

Tutton, Peter
Social Policy Adviser
Step Change Debt Charity

Walker, Patrick
Director of Research
PERC

Wilshere, Karen
Kew Risk Management

CEPS and ECRI Researchers

Chmelar, Ales
Researcher
CEPS, ECRI

Lannoo, Karel
Chief Executive Officer
CEPS

Pyykkö, Elina
Research Fellow
CEPS, ECRI