Position Paper

Proposal for a Directive of the European Parliament and of the Council on credit agreements relating to residential property

May 2011

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About ACCIS

Established in Dublin in 1990, the Association of Consumer Credit Information Suppliers (ACCIS) is an international non-profit association under Belgian law bringing together 37 consumer credit reference agencies in 27 European countries and associate members from all other continents. Our members issued over 850 million credit reports to credit granting organisations in 2009

ACCIS' main role consists of representing, promoting, protecting and preserving the common interests of its members. This includes in particular the representation and advocacy of members' interests vis-à-vis government agencies, the public and all other third parties and to inform its members about matters of concern to them. It also tries to coordinate their mutual interests and to represent them in the world committee. ACCIS aims to create a legal climate in which its members can continue to offer and further develop their services both at home and in Europe.

The Association works in cooperation with other European trade organizations active in the sector at EU level, US-based sister organization CDIA and the engaged Global Consumer Credit Reporting Network.

Since its creation, ACCIS has actively supported, as one of its main - and statutory – aims, the development of the common European market by promoting cross-border exchange of credit information between European credit reference agencies. In 1996, ACCIS developed a model contract on the basis of which credit agencies operating in the EU are able to collaborate to the benefit of creditors and consumers acting at a trans-national level.

Association's answers

Overview of the proposed directive

ACCIS welcomes the EC proposal on **credit agreements relating to residential property**, because it believes that the economic and financial crisis has shown that a new approach to the relationship between lenders and consumers is needed.

As regards our industry and the responsible lending and borrowing issue, ACCIS believes that Credit Bureaus (CBs) are already playing, and will continue to play, an increasingly crucial role to support lenders and borrowers and help them to lend and borrow responsibly**.** Credit Bureaus establish a link between lenders and borrowers, as a trusted third party custodian of data in the credit chain, with the objective to increase transparency and consistency, reducing information asymmetry and, above all, support an informed credit transaction for both parties.

Such benefits can only be achieved in those countries where credit registers can store both positive and negative credit data. **ACCIS believes that without full credit data sharing, responsible lending and borrowing cannot be fully achieved.**

These Association statements are crucial since the new Directive focuses on the definition of "**creditworthiness assessment**", Chapter 5. We believe that the discussion of creditworthiness in the Directive is largely driven by the need to protect the borrower from irresponsible lending or borrowing. Assessing whether lending is responsible i.e. affordable, forms a constituent part of any creditworthiness assessment, rather than the two being the same. It is entirely possible for a borrower to be financially able to service and repay debt as it falls due (affordability) thought they might decide not to do so (lack of creditworthiness). The likelihood that this latter possibility may occur is indicated by credit scores which show whether consumers have met their credit obligations in the past, and the likelihood of them doing so in the future.

The distinction between the ability to repay, and repayment actually taking place, is at the root of many of our observations which follow.

After Chapter 5, the other part of the directive which really concerns Credit Bureaus is Chapter 6, entitled "**Database access**" and the original proposed use of delegated acts to define the terms of access. Due to the critical role of the CBs we do not believe it is appropriate for such definitions to be set by delegated acts and welcome the proposed removal of this section from the Directive agreed by the Council. It is an unfortunate fact however, that the availability of data, even with the full consent and

knowledge of the data subject, varies considerably across member states. ACCIS would welcome steps from the European Commission to enable data sharing in line with that recommended by the World Bank in their recent report from the Taskforce on Credit Reporting[1].

In the area of credit referencing ACCIS generally supports all the European Commission proposals but in the following sections has concerns on the wording and its potential for misunderstanding:

[1] Link

Recital 24

Amendment suggested

An assessment of creditworthiness should take into consideration all ***available information*** ~~*necessary factors*~~ *that could influence a consumer's ability to repay over the lifetime of the loan including, but not limited to, the consumer's income, regular expenditures, credit score, past credit history, ability to handle interest rate adjustments, and other existing credit commitments* ***including those concluded with other service providers such as telecommunication and energy providers, insurance companies, or retailers****. Additional provisions may be necessary to further elaborate on the different elements that may be taken into consideration in a creditworthiness assessment. Member States may issue guidance on the method and criteria to assess a consumer's creditworthiness, for example by setting limits on loan-to-value or loan to- income ratios.*

Comments

Identification of ability to repay over the lifetime of a loan is likely to pose difficulties. The most common causes of financial difficulty are changes in personal circumstances such as loss of income or change in dependants. There is therefore a risk that strict interpretation of the phrase *"necessary factors"* could lead to unfeasible results. A requirement to consider the *"available information"* might be more realistic.

ACCIS believes that when alternative data or non-financial services credit data (e.g. obtained from merchants, utilities providers, landlords, etc.) are available, they should be used as they substantially contribute to reduce information asymmetry and add even more value to the relationship between lenders and borrowers. This data provides more information about the commitments and indebtedness of the consumer. Thus, lender can decide not to provide new credit because this would stress the financial situation of the consumer or vice versa, the consumer can decide to ask for more credit.

Recital 27

Amendment suggested

Consultation of a credit database is a useful element in the assessment of creditworthiness. Some Member States require creditors to assess the creditworthiness of consumers on the basis of a consultation of the relevant database. Creditors should also be ***required/permitted*** ~~*able*~~ *to consult the credit database over the lifetime of the loan in order to identify and assess the potential for default. In the event that such a potential is evident or objectively demonstrated, the creditor should contact the consumer to discuss the different options to avoid the possibility of default, such as a rescheduling of the loan. In any event, the creditor should not consider withdrawing the credit without having first explored all possible alternatives with the consumer to avoid default. Pursuant to Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data, consumers should* ***have been*** *informed by creditors of the* ***likely*** *consultation,* ***and such advice may form part of the Privacy Notice when the credit relationship is opened*** ~~*of the credit database prior to its consultation,*~~ *and* ***consumers*** *should have the right to access the information held on them in such a credit database in order to, where necessary, rectify, erase or block the personal data concerning them processed therein where it is inaccurate or has been unlawfully processed.*

Comments

The current wording suggests that lenders should be able to consult databases for customer management but does not go as far as suggesting that such consultation should be made. If it is a requirement to consult such databases at the outset exists, such checks should also be made at regular interval throughout the life of the loan. Responsible lenders that have access to performance information on other debts can identify at an early stage those customers that are showing signs of stress and engage with them to help them manage what is, for most consumers, the largest debt they have – their mortgage.

Later in the same section there is a reference to the need for borrowers to have been informed about consultation of databases prior to such checks taking place. ACCIS totally supports such a requirement. However, the way that this is currently worded could be interpreted as requiring multiple notifications each and every time such checks take place. If that is meant with the current wording, we would like to stress that such regular and onerous communications are of no particular value to consumers and increase the operational costs.

Recital 28

Amendment suggested

To prevent any distortion of competition among creditors, it should be ensured that all creditors (including credit institutions or non-credit institutions providing credit agreements relating to residential immovable property) have access to all public and private credit databases concerning consumers under non-discriminatory conditions, ***the latter including also the respect of the reciprocity principle.*** *Such conditions should not therefore include a requirement to be established as a credit institution. Access conditions, such as the costs of access or requirements for any request for information to be based upon a request for credit would continue to apply. Member States are free to determine whether, within their jurisdictions, credit intermediaries may also have access to such databases.*

Comments

Reciprocity is the cornerstone of building an effective credit database, ensuring that those who benefit from the use of credit data to assess risk and fulfil their regulatory obligations also provide the necessary information to allow others to do so. In a positive data sharing scheme, ensuring that all credit commitments are recorded also means that the correct credit expenditure position of the consumer is reflected so as to support the responsible future extension of credit.

This point is also mentioned in Recommendation n. 6, in the Report of the Expert Group on Credit Histories: "*R.6: The EGCH recommends that compliance with the non-discriminatory access to databases requirement in Article 9(1) of the Consumer Credit Directive should be considered, in particular, as providing foreign creditors access at the same level and terms as local creditors, i.e. with no additional barriers or privileges, and respecting the principle of reciprocity, without prejudice to data protection rules, as stated in Article 9(4) of the Consumer Credit Directive.*"

Credit Bureaus operate on the basis of mutual benefit to all providers, subjects and recipients of data. In order to maintain the ongoing commitment to report full and accurate data on all accounts, CBs should adopt the principle of reciprocity meaning that creditors are only entitled to receive data on the basis of what they contribute to CBs. This should be respected at national level as well as at cross border level. If the access to databases is required to be non discriminatory, foreign creditors can see and consult data on the basis of what they could provide; otherwise it will be discriminatory for local creditors.

Recital 29

Amendment suggested

Where a decision to reject an application for credit is based on data obtained through the consultation of a database or the lack of data therein, the creditor should inform the consumer thereof, of the name of the database consulted and of any other elements required by Directive 95/46/EC so as to enable the consumer to exercise his right to access and, where necessary, rectify, erase or block personal data concerning him and processed therein. Where a decision to reject an application for credit is based on an automated decision or on systematic methods such as credit scoring systems, the creditor should inform the consumer thereof and explain the logic involved in the decision and of the arrangements enabling the consumer to request the automated decision to be reviewed manually, ***the explanation of the logic involved in the automated decision should be given in general terms to avoid potential manipulation of credit scores.***

Comments

Recital 29 states that where rejection is based on credit scoring the creditor should *"explain the logic involved in the decision"* but recognises that such information should not be provided where it would be contrary to the prevention of criminal offences. We believe the latter statement must prevent the detailed explanation of scoring logic.

The principal concern with increasing transparency of scoring systems is the risk of manipulation. Credit scorecards are confidential and their details are known to only a small number of staff within any lending organisation. This is because knowing how the scorecard works would heighten the ability of fraudsters to manipulate the system. Fraud serves to increase the cost of borrowing for honest consumers, while funds obtained in this way can feed to organised crime and even terrorism. Further, if individual consumers can see how to manipulate the system, they could be tempted to try to commit such fraud themselves, where they would never otherwise consider it. Thus, explaining detailed scoring logic conflicts with the prevention of fraud.

A further general difficulty lies in making such an explanation to consumers. By their nature, credit scorecards are a statistically derived mechanism to correctly grade the level of risk associated with a borrower.

Chapter 5 - Article 14, paragraph 2, letter e)

Amendment suggested

(e) Without prejudice to the general right of access contained in Article 12 of the Directive 95/46/EC, where the application is rejected on the basis of an automated decision or a decision based on methods such as automated credit scoring, the creditor informs the consumer immediately and without charge and that the creditor explains the ***general*** *logic involved in the automated decision to the consumer* ***and gives adequate information about the reason for such decline.***

Comments

This section covers the need for consumers to understand the reason why they might have been rejected for the credit for which they have applied and to receive an explanation of how the decision might have been made if there was any use of credit scoring.

Credit scoring is a method of assessing large amounts of data in a consistent manner based on a statistical assessment of the value of certain data items to a given outcome. In the case of credit underwriting where large amounts of, sometimes, conflicting information may be available it enables that information to be fairly and consistently weighted against other information. Providing that the input information is correct, all relevant information is taken into account and that the statistical model is properly constructed it habitually results in more applicants obtaining credit than when a manual and subjective system is employed.

It is important that lenders do properly construct and monitor their scoring models but it is not possible or relevant for applicants to know what is in the model itself. We believe a detailed disclosure will certainly conflict with the prevention of fraud and such a requirement should be removed in the interests of prevention of financial crime. This is in addition to the practical difficulty involved in explaining a complex statistical mechanism which front line staff as well as consumers could find highly non intuitive. A basic explanation of the principles involved would be more practical and helpful for consumers.

Chapter 6 - Article 16, paragraph 2

Amendment suggested

~~*Powers are delegated to the Commission in accordance with Article 26 and subject to the conditions of Articles 27 and 28, to define uniform credit registration criteria and data processing conditions to be applied to the databases referred to in paragraph 1 of this Article.*~~

~~*In particular, such delegated acts shall define the registration thresholds to be applied to such databases and shall provide for agreed definitions for key terms used by such databases.*~~

DELETION

Comments

Delegate acts give the Commission the powers to define credit reporting standards. ACCIS has concerns about the idea that attempts should be made to harmonise credit referencing definitions and standards. As the report of the Expert Group on Credit Histories makes clear, substantial divergence exists between member states:

"Standardisation of definitions, thresholds, types of credit reported, retention periods, and update frequency would be the ideal. However, ***this is not a workable option, at least in the short term****. No common view exists on how those data registration criteria should be standardised. Criteria differ for a wide range of reasons, such as the different purposes of the data in credit registers. They are also generally the outcome of a balance of interests and have been fixed sometimes after long discussions at national level."*

Experts in the group did comment that a common understanding on the concepts and definitions could be *"more easily"* achieved. However this is a comparative statement to be taken in context to the recognised difficulty of undertaking standardisation in other areas.

The EGCH recommended that Credit Registers should *"seek some degree of convergence of the content of their databases at the appropriate time... Efforts should take into consideration the cost and benefits of the solutions to be implemented, as well as their impact in terms of data protection."*

This suggests voluntary transition by operators of credit registers towards convergence is desirable, rather than a mandatory solution. However, it is the final sentence that is key. **Definition of uniform credit registration criteria and data processing conditions would be a costly undertaking for credit registers and depending on requirements for the creditors who contribute to them. There is no**

evidence that this cost would be justified by effectively stimulating a wider mortgage market. Potential also exists for unplanned consequences to emerge.

The Impact Assessment itself states in respect of *"1.5: Homogenise the content and characteristics of databases"* that *"doubts on the feasibility, at least in the short term, of Option 1.5 remain due to the difficulty to agree on the standards for data content and data registration to be applied across the EU".*

Annex 4 to the Impact Assessment aims on page 228 to quantify the benefits of Option 1.5 using an assumption that the average EU default rate for mortgage loans could be reduced by 2.5–3.5 basis points due to increasing homogeneity of data for credit assessments. We would question the principles underlying this assumption, as well as the basis for the specific reduction estimate.

We recognise that there could be potential benefit in terms of making it easier for lenders to perform credit assessments using their existing processes, and therefore that the cross border market could expand providing possible consumer benefit. However we reject the concept that credit assessment would be improved with any significant reduction in the default rate. This assumes that homogeneity is the same as improvement, which is clearly not the case. The policy presented appears to be that of convergence to the most commonly used standards. It perhaps also assumes that credit assessment outside the creditor's country of operation, i.e. using different data, is performed to a lower rather than equivalent standard to its core credit assessment process.

The Annex also states that *"Creditors will face no costs as it is assumed that all costs are borne by the credit registers"*. This is inaccurate. Information is supplied to the credit reference agencies by creditors already in line with standard definitions such as that of default. Each and every creditor who supplies data would therefore have to change their systems to accommodate any revised definitions with associated cost.

In the absence of any realistic reduction in default rates from homogeneity, we do not believe the imposition of uniform criteria likely to be justified by the remaining factors and so do not consider these powers to be appropriate.

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