

# **The Law and Consumer Credit Information in the European Community**

The Regulation of Credit Information  
Systems

**Federico Ferretti**

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# **The Law and Consumer Credit Information in the European Community**

Consumer credit information systems are the tools used by the majority of lenders to manage credit risk, with lenders accessing credit reference databases managed by third-party providers to evaluate a consumer's credit application. So far, the subject of consumer credit reporting has been left to the predominant attention of the economic and business management scholarship, and little or no consideration has been paid to the issue by lawyers. This book aims to rectify this, examining the legal framework and compliance in the European Community (EC) of such consumer information sharing arrangements, which have become increasingly integrated in the credit granting practices of the Member States.

The book looks at the laws that surround and affect consumer credit reporting, including bank secrecy obligations. Consumer credit reporting and its relationship to human rights is also explored, as every individual in the EC is entitled to informational privacy. The book asks questions such as to what extent should the privacy of consumers be balanced against the aims and functions of consumer credit reporting, and how do the financial information sharing arrangements comply with the positive law, particularly the European data protection legislation?

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**To Stella and Biricchino**



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# Abbreviations

ACCIS	Association of Consumer Credit Information Suppliers
CEPS	Centre for European Policy Studies
CICR	Inter-ministerial Committee for Credit and Savings (Italy)
CRA	Credit Reference Agency
DPA	1998 Data Protection Act (UK)
DTI	Department of Trade and Industry (UK)
EC	European Community/ies
ECOA	Equal Credit Opportunity Act (US)
ECRI	European Credit Research Institute
EC Treaty	Treaty of the European Communities
EU	European Union
FCRA	Fair Credit Reporting Act (US)
ID card	Identity card
OFT	Office of Fair Trading (UK)
PCR	Public Credit Registry
UK	United Kingdom
US	United States
WGCR	Working Group on Credit Registries

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# Introduction

This work explores consumer credit information systems as a tool used by lenders to manage credit risk. Such devices have become the instruments most extensively used by the credit industry to underwrite decisions on borrowings or the supply of goods and/or services to consumer customers. Lenders, in fact, access credit reference databases managed by third party providers (the so-called 'Credit Reference Agencies') in order to evaluate a consumer's credit application and his/her creditworthiness.

The rapid development and increasing sophistication of information technologies and systems, coupled with the increasing competition between lenders and issues of borrowers' indebtedness, have made data sharing mechanisms in the credit market a topic of recent interest among academics in a number of disciplines.

In particular, economists have long stressed the importance of information in credit markets, and support the development and expansion of data sharing in the financial system in order to meet the problem of asymmetrical information between borrowers and lenders, as well as problems of bad selection by lenders and the risk that arises from personal, as distinguished from physical, characteristics of borrowers that increases the possibility of an economic loss (so-called 'moral hazard').

In addition, new trends in the use of consumer financial information are beginning to emerge, which make some justification for the expanding use of these data. A recent one, for example, is the use of this information to prevent customers from becoming over-indebted.

Thus, the purpose of this study is to take a lawyer's perspective on the subject-matter, and to identify and examine the legal framework and compliance in the European Community (EC) of such consumer information sharing arrangements, which have become increasingly integrated in the credit granting practices of the Member States.

Far from challenging economic theory about the importance of information in credit markets, the basic problem of this work is to gauge how, and to what extent, the application of such a general theory is influenced when individuals/consumers are involved, giving consideration to their rights as recognised in the EC. In particular, as the financial information of individuals

is at stake, a primary concern is to establish to what extent the right to informational privacy of individuals is respected. In fact, while internationally there is the tendency for more information in the financial dealings of companies to promote transparency, particularly after the corporate scandals of the recent years worldwide, at the same time there is the need for increased privacy protections as regards individuals in an age of ever-advancing sophisticated information technologies.

In Europe, informational privacy is an established personality right of every individual that safeguards important civil liberties and values. Actually, it has been elevated as a human right that could be sacrificed or balanced (as the case may be) when in conflict with other prevailing or equal rights, or the general interest.

To what extent should the privacy of consumers be sacrificed or balanced vis-à-vis the aims and functions of consumer credit reporting? How do financial information sharing arrangements comply (if they do comply in the first place) with the positive law, particularly the European data protection legislation? Are there any other laws that surround or affect the consumer-reporting sector (including, but not limited to, bank secrecy obligations)? And, finally, are the present arrangements and practices satisfactory to protect consumers in the wider context of the integration of European consumer credit markets and the rules of the Common Market, as well as the recent developments and trends towards a closer European integration?

These are the central research questions that this study attempts to answer.

The approach that this work takes in order to provide an answer to this set of questions is a theoretical one, valuing most highly the fundamental rights of the individuals at stake, and taking seriously the respect of the positive law regardless of any thoughtful criticism that it may attract. In fact, for instance, it does not propose different or better data protection regimes than the existing one to adjust to the evolution of technologies or new economic theories. Of course, this study does not disregard alternative viable proposals for a specific side regulation of the sector. Likewise, it does not disrespect *per se* the economic interests of the credit industry. Indeed, it certainly does not intend to endorse any anti-capitalist message, and considers profitability a perfectly legitimate interest to be carried out and ideally achieved. It simply looks at the issue from the perspective of civil liberties, freedom and the respect of rights over profit seeking at all costs and greed, supporting the view that market forces do not necessarily have to override or squeeze the fundamental rights of individuals/consumers.

In fact, if credit reports are a valued element for the industry for improving business management efficiency and productivity, i.e. profitability, from the point of view of consumers nowadays more than ever credit reports are becoming the key to access credit, financial services, purchase of costly goods and/or services, insurance, telecommunications, etc. They have become a matter of economic and social inclusion or exclusion of individuals, who are arguably the weaker party in the economic relationship. This seems to be



too much of an important issue of social justice to be left to market forces. In other words, thus, not only does this research take the perspective of protecting civil rights and liberties, but it is also particularly concerned with problems of distributive justice as a necessary component and rationale for the regulation of the economy.

Admittedly, this approach will not result in the best economic interest of the credit industry in the terms presently put forward by the economic and business management theoretical literature. However, the utilitarian interests of business ventures should not suppress or impose the sacrifice of prevailing established rights of individuals and consumers, especially when no evidence of cause and effect is offered by economic theory to justify such an imposition, raising in a lawyer the suspicion of abusive commercial practices – certainly not a novelty in the business-to-consumer domain.

Thus, following the increasing literature in economic disciplines on the benefits of consumer information sharing, the real purpose of the research is ultimately to stimulate the intervention of lawyers in the study of the sector, and promote a debate that could look at the issue from a different perspective to be eventually taken to the attention of the competent European policy-makers.

Definitely, the subject matter under study should not be left in the exclusive domain and control of economists and lobbyists.

Already at this introductory stage, a few major difficulties arise.

The first one is that it is very difficult to provide a standard explanation of what exactly constitutes credit reporting and its functions, which organisations are involved, and how they operate.

This complexity arises from the fact that credit reporting differs greatly in structure and the way it operates around the world, depending largely on national cultures, jurisdictions, institutional arrangements and the economic and regulatory environment.

Another source of difficulty is the inconsistency in the terminology used in the credit industry and in the literature on the subject: ‘Credit Bureau’, ‘Credit Reference Agency’, ‘Credit Reporting Agency or Firm’, and ‘Credit Registry’ are the synonymous terms commonly used by the credit industry to describe either private or public organisations that collect, file, elaborate, disseminate and disclose either business or consumers’ financial data to their members (the lenders).

The frequent lack of a clear and precise distinction between business and consumer credit reporting is a further particular source of confusion when trying to identify the role and function of credit reporting systems in the economy and society, the legal environment in which they operate, and the actors involved, thus posing additional terminology overlaps and creating dangerous grey areas. It would be a mistake, in fact, to consider the credit reporting of consumers and businesses the same way, particularly as far as the identification of the legal setting is concerned or when dealing with policy considerations.