

Consultation response on the legal framework for the fundamental right to protection of personal data

December 2009

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**Consultation response on the legal framework for the
fundamental right to protection of personal data**



Directorate-General for Justice, Freedom and Security
Unit D5 – Data protection
European Commission

By email: JLS-PRIVACY-CONSULTATIONS@ec.europa.eu

Brussels, 31 December 2009

Dear Sir/Madam,

Re: Eurofinas' consultation response on the legal framework for the fundamental right to protection of personal data

Please find herewith Eurofinas' consultation response on the issue of data protection.

Our comments stress the importance for all lenders to have access to both credit and fraud data to facilitate their sound lending practices.

In the light of national discussions on data processing we voice our opposition to any compulsory detailed disclosures of credit scoring methods. As explained in our response, any such disclosures would adversely affect risk management processes for lenders.

Eurofinas holds the view that the current Data Protection Directive (95/46/EC) is a gold standard in data protection and we see it as premature for the European Commission to propose a new Directive. As such, we support a process of evolution of the current Directive through improved implementation to assist pan European data flows.

Any review process regarding the implementation of the Data Protection Directive should be transparent and allow for the expression of stakeholder views in line with the Better Regulation agenda, the importance of which was recently reinforced in the conclusions of the Competitiveness Council meeting of 3-4 December 2009.

Finally, Eurofinas supports the Article 29 Working Party's recent decision to add the issue of cross-border credit data access (and exchange) to its agenda. We stand ready to contribute our industry expertise regarding the cross-border access to (and exchange of) credit data as a means to further develop their work.

I stay at your disposal to answer any question you may have on our response; alternatively feel free to contact my colleague Ravi Bhatiani (r.bhatiani@eurofinas.org - tel: 02 778 0562).

Yours sincerely,

Tanguy van de Werve
Director General



ABOUT EUROFINAS

Eurofinas, the European Federation of Finance House Associations, is the main voice of the specialised consumer credit industry at European level. It currently represents 16 Member Associations, in turn bringing together more than 1,000 finance houses, captive companies, specialised and universal banks. Together, these consumer credit providers financed over 400 billion euros worth of new loans during 2008, with outstandings reaching 745 billion euros at the end of the year. Companies represented through Eurofinas employ some 90 000 individuals.

Consumer credit providers may be of several natures and our members' members can be grouped into the categories below. Around 90% of the companies represented through Eurofinas are specialised lenders, falling into the first three categories:

- Finance houses: specialised consumer credit providers without a banking licence;
- Captive companies: parent companies of these companies are manufacturers (e.g. car manufacturers). Captives may or may not have a banking licence;
- Specialised banks : institutions with a banking licence but an activity focused on consumer credit or/and mortgage lending; and
- Universal banks: banks providing all kinds of products retail, corporate, etc., including consumer credit.



1. ALL LENDERS REQUIRE DATA ACCESS

Specialised lenders

It is important for the European Commission to ensure that **all lenders** are able to access and exchange consumers' credit data both at national level and in a cross-border pan European context.

This point is of particular significance to the specialised consumer credit providers that Eurofinas represents.

Data access is key when distributing a credit at the point of sale or over the internet where there is no direct and/or face to face contact between the applicant borrower and the lender. For lenders specialized in such distribution channels, a pre-existing relationship may not already be in place with the applicant borrower.

This contrasts with banks which may already have longstanding relationships with their clients and hence rich internal client data (including a history of recent banking transactions such as standing orders and direct debit lists as well as data on savings).

Access to credit data promotes sound lending practices

Lenders follow sound lending practices, which can help reduce levels of consumer over-indebtedness.

Access to, and exchange of, credit data is one of the tools which helps to ensure continued sound lending practices by credit providers. This reflects the spirit of Article 8(1) of the Consumer Credit Directive (2008/48/EC), which requires lenders to assess a consumer's creditworthiness on the basis of sufficient information.

Effective lending checks, made possible through the access to, and exchange of, the applicant borrower's credit data, allows lenders to effectively identify and *accept* potential 'good' applicant borrowers during a creditworthiness assessment.

Conversely, effective lending checks help identify and *decline* potential 'bad' applicant borrowers during a creditworthiness assessment.

Access to credit data facilitates portfolio management

Lenders need to understand the repayment behaviour of their customers over the credit lifecycle, and after the expiry of the credit agreement, for reasons related to managing their loan portfolios.

For example, repayment behaviour needs to be compared against a lender's own expectations for its loan portfolio in order to assess the portfolio performance.

Additionally, credit data access throughout the credit lifecycle allows lenders to quickly research the causes of any changes in repayment patterns (such as growing delinquency).

Such access also places lenders in a better position to respond quickly to changes in repayment behaviour and to anticipate a rise (or fall) in levels of bad debt.

In cases where a borrower is unable to repay a loan within the timeframe set down by a consumer credit agreement, continued access to a borrower's credit data is necessary. In such situations, credit data access after the expiry of the credit agreement aids lenders in managing cases of delinquency, developing their future underwriting strategies (e.g. by refining creditworthiness assessments and scorecards) and optimizing the effectiveness of their collections' operations.

It is equally important for lenders to share fraud data

Fraud data is a major issue for the specialised lenders that Eurofinas represents.



Both credit data and fraud data are necessary for lenders to grant loans responsibly. Responsible lending includes not only the creditworthiness assessment of an applicant borrower but also understanding the likelihood of a fraudulent application **and the prevention of frauds such as identity theft.**

Moreover, the sharing of fraud related data is necessary to protect the consumer. Once a consumer's identity becomes compromised or is stolen, it is in his or her interest that consumer credit providers prevent the use of this identity by fraudsters in loan applications.

A market led solution in fraud prevention

CIFAS is the UK's Fraud Prevention Service. Founded in 1988, CIFAS is a not-for-profit membership association solely dedicated to the prevention of financial crime.

Following a rapid rise in fraud losses in the 1980s, which affected retail lenders predominantly, a number of lenders met in 1987 to consider their position. Following a series of meetings the retailers came up with the CIFAS concept and in late 1988 CIFAS became operational.

When a Member of CIFAS searches the CIFAS database through one of its agencies, the Member is made aware of the need to investigate by means of a flagged warning.

This warning does not mean that the individual has been blacklisted. It means that extra precautions should be taken to ensure that the application or facility that has prompted the check is genuine and this protects the individual against potential fraud.

The CIFAS Member is then required to conduct an investigation into the case and not just reject the application (or account/product/facility/insurance policy/employment) as it may be a genuine application rather than one submitted by a fraudster.



2. DATA PROCESSING

The type of information generally used in scoring systems

Finance companies need to use a certain amount of personal data in order to i) satisfy regulatory requirements and ii) to assess objectively the creditworthiness of their customers.

This data comes from various direct and indirect sources such as:

- the loan application form and other information supplied by the customer to the finance house (income, family status, length of employment, number of loan applications, etc.);
- experience of business relations with the customer to date (credit history, including current and past credit commitments);
- credit bureaux/credit risk agencies whose role is to provide credit information on consumers; and
- depending on the country, public sources including bad debtor lists, court judgements or bankruptcies in the applicant's name.

Scoring systems typically weigh up and decide the contribution of individual information items taken from the above sources. This means a score can comprise a large number of items of relevant criteria, each weighted differently and with no single item dominating. No one factor is ever decisive in itself though some factors can be significant.

When calculating a scorecard, finance companies only use data that is statistically suitable for predicting the probability of default and whose effectiveness can be economically or objectively explained. Again, by complying with anti-discrimination rules, sensitive factors such as race and religion are not included as information to be provided to the lender in the application forms and therefore are not taken into account by credit scoring.

Detailed disclosures of scoring systems are unacceptable

Details of existing scoring methods and how they work are confidential trading information that belong to (and confer economic benefits upon) the lenders using them.

Were any proposed revisions to the current European data protection regime to require detailed disclosures of consumer credit scoring methods (as is under discussion in certain national jurisdictions), both lenders and consumers would suffer.

If, as a result of such detailed disclosures, competing lenders knew each others scoring methodologies (i.e. specific IT system configurations/scoring software) there would be no incentive for lenders continued investment in developing new, innovative and ever more precise IT systems/software that are key in managing risk.

Consumers would then suffer due to higher interest rates compensating for less precise risk management strategies.

Of even greater importance, if the details of such scoring methods were to be disclosed (as a result of a change to European data protection legislation or through other (legal) requirements), the security and accuracy of the credit referencing system would be greatly reduced.



This could be the case where either a loan applicant or a finance company employee - such as the loan officer in charge of granting the credit uses the disclosed information to make fraudulent applications. By knowing which information items are taken into account in the score or which criteria have a larger weight within the overall score, the applicant borrower or employee may falsify the data when applying for the loan thus reducing the predictive power of scorecards.

The costs related to this increased fraud risk would be passed on to borrowers through higher interest rates on loans thereby greatly reducing loan affordability.

The trust between a lender and a borrower is key to having a mutually beneficial business relationship. If lenders were to inadvertently aid fraudsters by disclosing detailed consumer credit scoring methods then the image of the industry would suffer as this trust is lost.

Against this background, Eurofinas stresses that there should be no duty (nor any indirect requirement), to disclose **detailed** consumer credit scoring methods as a consequence of any future legislative review.

That being said, finance companies/trade associations can (and do¹) disclose to consumers the **general principles** of credit scoring. Indeed, helping potential borrowers understand the underlying mechanisms of credit scoring is one way in which a lender can contribute to a borrower's financial education in the context of responsible lending (see later *Access to information*).

¹ For example, see http://www.fla.org.uk/filegrab/1Yourcreditexplained_19_01_07.pdf?ref=20



3. EXISTING LEGISLATIVE PROVISIONS

Right of access by a data subject

Eurofinas recognises that a data subject (in this case the consumer) has a right of access to their data under Article 12 of the Data Protection Directive 95/46/EC (DPD).

Data quality

Eurofinas supports data access for consumers not least because it contributes to data quality.

As discussed below, Eurofinas is in favour of initiatives that can help to improve data quality taking into account the impact in terms of costs and benefits of such initiatives.

Fraud detection

A key benefit of a consumer accessing their credit data lies in fraud detection.

A consumer's right of access is of benefit in detecting anomalies in his/her credit data. Such anomalies need to be highlighted to investigate whether a genuine error or a potential fraud is the cause.

Without excessive expense

Eurofinas supports the existing situation that an appropriate contribution by the consumer should be requested for database access.

It is clear from Article 12(a) of the DPD that an appropriate contribution can be requested from data subjects for such access.

The provision of data held within a database has a cost. Thus if credit databases are forced to give consumers access to their credit data 'free of charge', any administrative costs incurred would likely be borne by the lenders who consult the credit data.

Ultimately, lenders would recover any extra expenditure by passing these costs to consumers through (*inter alia*) product fees and/or interest rate adjustments.

In countries (such as the UK) where an appropriate contribution² is usually paid by a consumer for accessing their credit data, Eurofinas notes that no decline in the number of consumers consulting their data has been recorded.

Fraud deterrence

In addition it should also be recognised that requesting an appropriate (not for profit) contribution by consumers for data access is critical in deterring fraudsters from obtaining high volumes of consumers' credit data.

If data access upon request were to become free of charge then consumers **would face an increased risk of frauds** (e.g. 'account takeover') with its attendant detrimental consequences.

Right to rectification

Eurofinas wholeheartedly supports, in principle, measures aimed at controlling data quality.

It is clear that the rectification of inaccurate data contributes to data quality.

² Circa £2 in the UK.



Thus, in situations where consumers have accessed their credit data and found it to be incorrect, a consumer should be able to rectify that data.

Hence, we support the current right to rectification of incorrect or inaccurate data as laid down in Article 12(b) of the DPD.

Damages

As stated above, in cases where credit data is incorrect, consumers have the right to access (and correct) their data as held in credit databases in accordance with Article 12(b) of the DPD.

Consequently, neither lenders nor credit databases can be held liable for damage suffered due to the refusal to grant a credit because of 'wrong' credit data. We therefore oppose any payment of damages to data subjects *triggered* by the mere presence of 'wrong' data.

In any case there is no right to credit; freedom of contract dictates that lenders can readily refuse to grant a credit irrespective of the credit data used.

4. FEASIBLE IMPROVEMENTS TO THE CURRENT REGIME

Access to information

Data subjects need to be made aware about the rights conferred upon them by the DPD in order to obtain the benefit thereof.

Thus **access to information** on the data subjects/data holder's rights set down in the DPD **is key**.

This information should be easily obtainable and should include some explanation on the various redress mechanisms available in case a data subject's data set is inaccurate.

Relevant information campaigns supported by the European Commission would therefore be of value.

Eurofinas notes that conferences such as the 19-20 May 2009 conference organised by the European Commission entitled *Personal Data, More Use More Protection* are useful reference points for all parties interested in the rights and obligations stemming from the DPD.

Access to justice

Access to justice will help data subjects to seek redress in case of a breach of their rights guaranteed by the DPD.

However, justice served through the courts can be an expensive and time consuming process for all parties involved.

Improving access to justice through the development of an ADR system which addresses the specific concerns raised on specific issues e.g. on the issues related to the access to, and exchange of, credit data would be more effective.

A self-regulatory ADR system would offer data subjects a quick, uncomplicated, easily-accessible and cheap means of redress by avoiding the complexities and delays of a judicial process.



5. NO NEED FOR A NEW DIRECTIVE

Better interpretation of existing rules needed

Eurofinas stresses that national Data Protection Authorities should work towards more convergence or harmonisation in the interpretation of data protection rules and practices in order to facilitate, for lenders, the process of *cross-border* data exchange and acknowledges that the Data Protection Directive 95/46/EC (DPD) has been interpreted differently across the EU 27.

Particular differences exist in the interpretations of the:

- 'authorised purposes' of using credit data; and
- 'authorised actors' for exchanging credit data

which have been interpreted narrowly or broadly dependant upon the jurisdiction involved. This has led to divergent credit data access/exchange landscapes within the EU.

DPD implementation

At the very least, reviewing the way that the DPD has been implemented, with a view to *fully* harmonising the ability of all lenders and credit bureaux/registers to access and exchange credit data, would facilitate, in particular, the *cross-border* access to, and exchange of, credit histories.

Reviewing the way that the DPD has been implemented with a view to facilitating the fight against fraud also has merit.

In 2007, Eurofinas held a Discussion Day on Fraud to create a forum where Eurofinas members presented their local situations regarding *inter alia* the use, and exchange of, fraud data. The main obstacle to the effective use, and exchange, of fraud data as cited by members was their local data protection laws, which prevent the use/exchange of such data.

At the Discussion Day, a specific reference was made to Schengen rules which do not permit access by industry in one Schengen country to databases on stolen IDs of other Schengen nationals. While the information does exist it may only be accessed by police forces.

Another problem highlighted was that consent (from fraudsters!) may be required before being able to consult the relevant fraud data. An additional point was made that fraud data sharing may in some instances not be allowed cross-border. With criminals often operating across borders, the possibility to be able to share such data is essential.

Any review process to take into account the concerns highlighted above should be transparent and allow for the expression of stakeholder views in line with the Better Regulation agenda, the importance of which was recently reinforced in the conclusions of the recent 2982nd Competitiveness Council meeting that took place on 3-4 December 2009.

No new Directive needed

Eurofinas holds the view that the current Directive is a gold standard in data protection and we see it as premature for the European Commission to propose a new DPD. As such, we support a process of evolution of the current Directive through improved implementation to assist pan European data flows.

Article 29 Working Party

Article 29 of the DPD establishes a Working Party on the *Protection of Individuals with regard to the Processing of Personal Data*.



Included in its mandate is the provision of expert opinion from Member State level to the Commission on questions of data protection.

As a means to further develop, from a national perspective, the data protection elements particular to lenders such as the cross-border access to, and exchange of, credit histories, Eurofinas supports the Article 29 Working Party's recent action to add the issue of cross-border **credit** data access and exchange to its agenda and looks forward to a comprehensive report outlining its findings.

6. NEW CHALLENGES FOR PERSONAL DATA PROTECTION

Innovation

Consumer credit markets are some of the most dynamic markets in financial services. As such, innovation is a vital component of consumer credit providers' strategies.

The internet is increasingly regarded as a major distribution channel for consumer credit products (e-commerce). Specialized consumer credit providers have developed online applications on their websites along with partnerships with retailers/motor dealers that allow consumers to apply for a consumer credit directly on a lender's website or on the website of the supplier of the good/service.

Technological improvement is key to facilitate such developments and is evidenced by the creation of online simulations, electronic signatures and smart conversational agents.

E-commerce offers the potential to increase the volumes of lending transactions across borders. This will magnify the importance of unhindered pan-European data flows in the future as lenders need to ever more assess the creditworthiness, and fraud risks, of borrowers who may be located in a different country.