

CREDIT BUREAUS IN TODAY'S CREDIT MARKETS

AMPARO SAN JOSÉ RIESTRA

**ECRI RESEARCH REPORT NO. 4
SEPTEMBER 2002**

The European Credit Research Institute (ECRI) is a non-profit international association established in March 1999 in partnership with the Centre for European Policy Studies (CEPS) in Brussels. Its principal goal is to promote the study of the various aspects of the retail financial services sector at the EU level. ECRI's activities include the creation of a database on consumer credit in the European Union, research and analysis of developments in retail financial markets and the organisation of seminars on all issues affecting the industry.

This report was prepared by Amparo San José Riestra, a CEPS Research Fellow in the ECRI programme (e-mail: amparo.sanjose@ceps.be). The views expressed in this study are attributable only to the author in a personal capacity and not to any institution with which she is associated.

ISBN 92-9079-394-5

© Copyright 2002, 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 European Credit Research Institute.

European Credit Research Institute
Place du Congrès 1, B-1000 Brussels
Tel: 32(0)2 229.39.11 Fax: 32(0)2 219.41.51
E-mail: info@ecri.be
Website: <http://www.ecri.be>

CONTENTS

Executive Summary.....	i
Introduction	1
1. The role of credit bureaus	1
1.1 The basics of credit bureaus	1
1.2 Mastering risk: A core competitive asset of credit providers.....	3
1.3 Credit bureaus in economic literature.....	4
2. Credit bureaus in Europe	5
2.1 Public versus private credit bureaus	6
2.2 Information collected by credit bureaus	6
2.3 EU national credit bureaus	8
2.4 International arrangements for the exchange of information.....	12
3. Legal and regulatory issues.....	13
3.1 The general framework of data protection	13
3.2 Privacy in credit markets: The US vs the EU.....	15
4. Preliminary issues for discussion.....	16
4.1 Positive versus negative data: The protection of privacy.....	17
4.2 Positive versus negative data: Any links with over-indebtedness?.....	18
4.3 Institutional implications of over-indebtedness.....	23
4.4 The challenge of the single retail credit market.....	25
5. Conclusions	27
References.....	29
Annex I. Definitions	31
Annex II. Data Protection Laws in the EU Member States	32

CREDIT BUREAUS IN TODAY'S CREDIT MARKETS

ECRI RESEARCH REPORT NO. 4

AMPARO SAN JOSÉ RIESTRA

EXECUTIVE SUMMARY

In all EU countries today, lenders can access information in databases to help them assess the creditworthiness of a credit applicant. The establishments that compile these databases are known as credit bureaus, credit registries or credit reporting agencies. Credit bureaus gather information on the payment history of borrowers and issue credit reports prior to the underwriting of a loan, whether for the purpose of buying a house, a car, opening a credit line or simply subscribing to a mobile telephone service.

In the United States, data from credit bureaus on consumer borrowing, payment behaviour and other aspects of household finances have become the cornerstone of underwriting decisions on consumer loans. Credit bureaus in the United States collect and store comprehensive data for over 200 million adult residents. More than 2 million credit reports are sold by credit bureaus every day. It is widely accepted that the development of the credit bureau industry has played an essential role in the expansion of the North American credit market.

The type and quantity of data available and the mechanisms by which this information is shared vary greatly across EU countries. Lenders often provide information to credit bureaus voluntarily, although in some cases, the authorities impose this disclosure via public registers. The data collected can vary over time and between countries and usually consist of past instances of default or payments having fallen in arrears (known as 'negative' information). The data can also be of a 'positive' nature, however, to include a customer's outstanding liabilities, maturities and other details about his or her credit history.

Credit bureaus are often cited as a valuable instrument in the fight against the growth of over-indebtedness through their extensive collection and sharing of positive data. The industry, social actors and public policy authorities, however, do not agree on the impact of the availability of detailed financial information collected by credit bureaus. Moreover, previous statistical studies have not found evidence correlating the collection of this type of data with lower levels of over-indebtedness in a country. According to recent surveys, in fact, over-indebtedness occurs in most instances as a result of a 'life event', e.g. the loss of a job or the break-up of a family unit due to a divorce or the death of one of the partners – factors that cannot be predicted *ex ante*. In addition, differing cultural and spending habits result in divergent attitudes towards the repayment of contracted debts.

European society attaches great importance to the protection of the right of the individual to privacy, and regards with suspicion the compilation and distribution of files containing personal data. It is necessary, therefore, to negotiate a balance between the rights of the individual and the need of lenders to have access to information on the payment history and practices of loan applicants. Despite recent efforts at harmonisation in this area, illustrated by the so-called Data Protection Directive, EU countries can apply more restrictive provisions, which explains why the regulatory framework of credit bureaus varies widely across the EU.

The debate on the role of credit bureaus in today's credit markets is not restricted to considerations of privacy protection and over-indebtedness. Another important factor is the lack of widespread cross-border credit, which threatens the completion of a truly single retail credit market. Accurate risk assessment of borrowers based in countries other than that of the grantor requires efficient

information-sharing agreements between all the credit bureaus in the European Union. The maintenance of transparent records within a secure framework that also respects the rules on privacy should ensure the discreet collection and processing of this information on consumers, and facilitate access to cross-border credit for all consumers. This exchange takes place, at present, however, only on a bilateral basis and is very limited in scope.

In light of the diversity of cultures and practices throughout the European Union and with a view to the forthcoming update of the EU Consumer Credit Directive, it has been argued by some that harmonisation of laws concerning data protection and the prevention of over-indebtedness represent essential requirements for the completion of a single retail credit market. In the minds of others, however, the existing patchwork picture is simply the temporary result of the functioning of different national markets, and transformation will come about with the evolution of the market.

Despite their tremendous importance, surprisingly scant attention has been paid in the literature to the role of credit bureaus in the credit markets of Europe today. Additionally, there is very little empirical research being conducted in this field. In this report we attempt to offer a view of the credit reporting industry in Europe, the laws by which it is governed and their impact on over-indebtedness, the availability of credit in the economy and the completion of the Single Market.

CREDIT BUREAUS IN TODAY'S CREDIT MARKETS

ECRI RESEARCH REPORT No.4

AMPARO SAN JOSÉ RIESTRA

Introduction

Credit bureaus collect various kinds of financial information on individuals. It is essential that credit and finance companies have access to this information in order to assess the creditworthiness of borrowers prior to granting them credit. Financial information is collected in all EU economies; some credit bureaus only collect and make available information on default payments, whereas others compile extensive files on outstanding credit and the repayment history of the individual.

An important distinction is made in the industry between negative (or black) information, which is collected only on borrowers with a history of payment defaults and positive (or white) information which is collected on all borrowers in the market, regardless of any previous payment incident. This paper refers to credit bureaus in their most extensive form, both public and private and those collecting both positive and negative information.

This paper is organised as follows. The first section presents the functioning of credit bureaus and discusses the rationale for their existence within the credit market. The second section covers the different approaches taken to protect private data in the EU and the US, in particular in the context of finance and credit. The third section deals with particular issues arising in the field of credit bureaus, such as social and public policy-makers' views on the limits to the collection of data, the role of exchanging information in the context of the EU market for the completion of a single consumer credit market and the utility of credit bureaus in the fight against over-indebtedness. The paper ends with a set of conclusions and recommendations for public policy.

1. The role of credit bureaus

When a lender first evaluates the creditworthiness of an individual, he gathers information from two principal types of sources. The first source is the lender's own database developed through years of experience in the market and which is composed of past and present clients. The second source is the information available via credit bureaus, which exchange information on the basis of reciprocal agreements and collect information on clients for all financial institutions in the market. The analysis of a client's creditworthiness is completed by information obtained directly by interviewing the applicant and the application of credit-scoring techniques. Consequently, credit bureaus are active players in the credit market.

Good screening of applicants and risk management are vital issues for lending institutions, which dedicate large resources to the screening of loan applicants before granting credit. Proof of this exhaustive screening is the rather high rejection rate of leading consumer credit banks, ranging between 15 and 20% of all applications. This meticulous screening process reduces the number of loans not recovered to a small fraction of the total, between 1 and 2% (Khalil and Parigi, 2001).

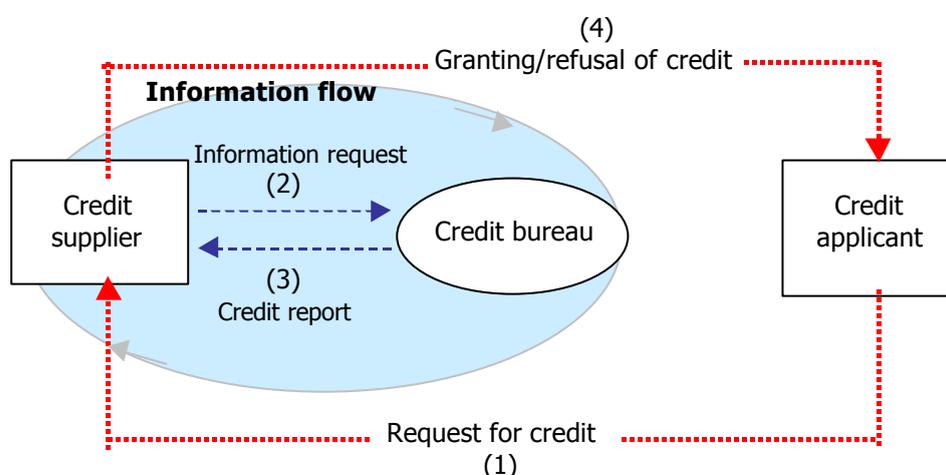
1.1 The basics of credit bureaus

Credit registries, or credit bureaus, are databases of information on borrowers in a financial system. The data are provided by lenders, and together with data from other sources, such as courts or tax authorities, are managed by central banks, private companies or professional associations, which compile all the information referring to an individual into a single file. In most cases, credit bureaus

operate on a reciprocal basis and only credit institutions supplying information to the registry can obtain information from it.

Data from the registries are made available for a fee in the form of credit reports to credit institutions. The credit report is a decisive factor when deciding whether or not to grant a request for credit or a loan and for credit management purposes, such as following up the solvency of a credit card holder. A credit bureau can issue several kinds of credit reports depending on the information gathered (positive or negative), the purpose of the information (housing or consumer credit) and the amount requested. In some countries, consulting credit bureaus' files prior to the underwriting of credit is obligatory by regulation.

Figure 1. How credit registries function



Credit bureaus have an important function within the credit market. They facilitate the assessment of a borrower's creditworthiness and act as a borrower's disciplinary mechanism, becoming key tools in the functioning of the credit industry, in particular for consumer credit institutions. In order for reputation to act as an incentive within the system, the borrower has to know that his payment record will become public knowledge: other lenders must be able to have access to information. In general, the major lending criterion is a bank's prior experience with the borrower, that is, the 'reputation' the borrower has established with the bank. If the borrower is not a client, the bank will first check his or her record with the credit bureau to learn of the existence of any unpaid credit.

At a later stage, by applying a credit-scoring model, lenders can assess the probability of repayment of the loan compared to the risks levels accepted by the credit institution. Overall, credit bureaus and credit scoring facilitate better screening of applicants, and ultimately contribute to the sound expansion of credit within the economy.

The benefits of credit bureaus to lenders and borrowers are obvious. Both parties in the relationship have an interest in maximising the number of good credit agreements granted and refusing the bad ones. For lenders, the optimisation of credit granted and refused is the key to ensuring the profitability of fund management. From the perspective of borrowers, there is an interest in obtaining access to credit in order to finance purchases; hence, the repayment of credit will ensure a clean record on the registry and allow future borrowings from the credit market. The interest of consumers and lenders thereby coincides. Lenders would be more willing to exchange information in markets where the mobility and the heterogeneity of borrowers reduce their ability to assess the creditworthiness of an individual on the basis of their own records alone. Credit institutions need to supplement their own information with information from other lenders. Equally, the larger the market is, the more incentive lenders will have to exchange information. It appears that lenders are

more inclined towards information-sharing agreements when operating in segmented markets, or where the mobility of customers is higher. In the United States for instance, where credit markets are segmented by regulation, credit bureaus are established as local or state players (Pagano and Jappelli, 2000). The same is true in Germany, where local entities associated with Schufa merged later into one single national company.

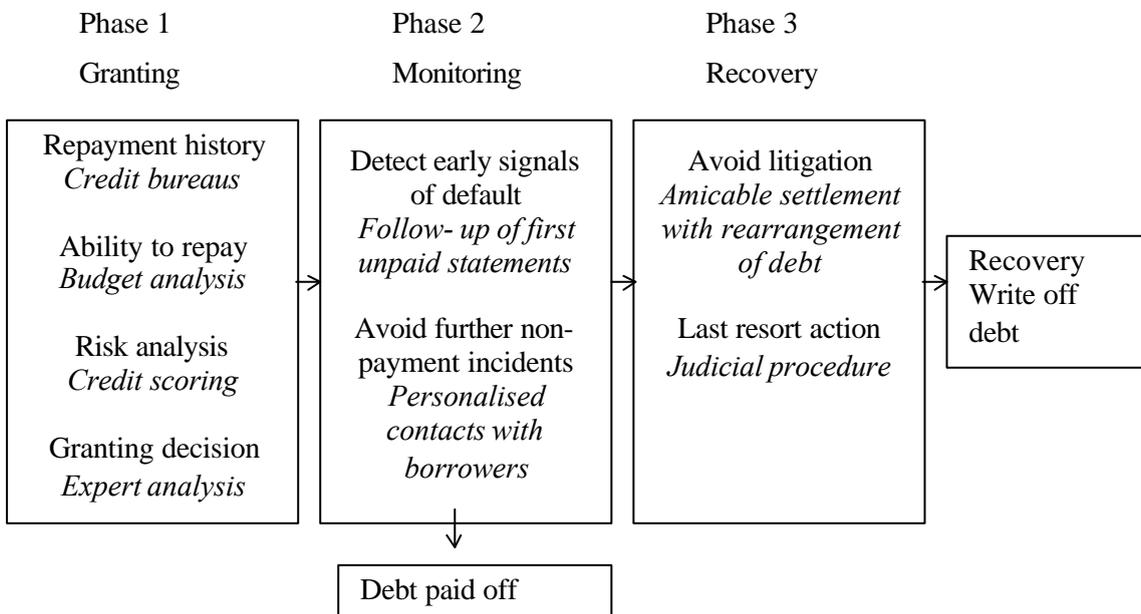
Nevertheless, since banks and financial institutions are concerned with the cost of creating and maintaining extensive records on individuals' finance, there are limits to the exchange of information. To ensure the quality of the information collected and exchanged in this context is also extremely demanding.

1.2 Mastering risk: A core competitive asset of credit providers

Mastering credit risk is one of the core competencies of credit providers. The process begins when the potential client approaches the lender and ends when the last statement is paid or, in the worst case, when the credit is considered unrecoverable and written off following a judicial procedure or the insolvency of the borrower. Credit bureaus are one element in this chain.

Before granting credit, financial companies carry out a thorough analysis of the borrower to determine his or her creditworthiness. This analysis includes the application of scoring techniques, a budgetary analysis of the applicant and a 'green light' from the credit experts of the lending institution. Risk assessment is especially important for the consumer credit sector, which typically grants a large number of small-sum credits. In this sector, profitability is only achieved by minimising the risk while ensuring at the same time that a sizeable volume of credits is granted. It is reported that each adult citizen in the UK and the United States is subject to a credit-scoring process (or behavioural scoring whereby lenders decide whether to increase the level of credit to an existing customer) at least once a month on average (ESRC, 2002).

Figure 2. Mastering risk



Credit scoring, a technique introduced by American and English credit bureaus, attempts to categorise credit applicants according to risk classes with the aim of identifying the probability of repayment. Basically, scorecards assign a score to the applicant borrower that expresses the odds of repayment. In most cases, the credit scoring systems are built on information from the client base of

the financial institution itself. In certain cases, however, they are built on the basis of positive information collected by credit bureaus.

Table 1. Risk of default according to credit scoring

Scores	Probability of default*
9	0.03 to 0.07%
8	0.09 to 0.3%
7	0.3 to 1.0%
6	1.0 to 3.0%
5	2.0 to 5.0%
4	3.0 to 7.0%
3	4.5 to 10.0%
2	6.0 to 13.0%
1	7.5 to 17.0%

* Random figures for the example.

The fixed cut-off point is the level on the scale of credit scores that corresponds to a particular credit risk, average marginal revenue and average credit loss, below which the credit product in question would generate a financial loss. Based on the degree of risk that it is willing to accept, the credit institution fixes the cut-off level (i.e. companies that might decide not to grant credit for scores lower than 4 will assume a maximum risk of 7%).

Credit scoring is particularly useful to lenders with a large portfolio containing smaller-sum credits, as in the case of financial institutions in the retail and consumer credit market. This type of lender holds files that contain sufficient information to allow for a relatively accurate assessment of credit risk per category of borrower, and to allocate new applicants to one of the identified categories.

Over the past three decades, credit-granting processes have undergone immense transformation, facilitated by the development of information technologies. In turn, this technological progress has reduced the average time and cost in making credit decisions and has improved their accuracy. The practice of almost ‘instant credit assessment’ would have been unthinkable without such developments. Currently, some countries rely more on automated credit-granting systems than on the information supplied by the applicant.

Once the credit has been granted, the evolution of the debt is monitored to detect early signals of default in order to prevent it. All financial institutions dedicate significant resources to the settlement of problematic debts, attempting to maximise the number of debts that are settled amicably to the benefit of both lender and borrower.

The final stage is a judicial settlement, with a court imposing the repayment and/or rearrangement of the debt, or declaring the debtor insolvent. Judicial procedures are not the best option for lenders, as they are both expensive and time-consuming - and do not necessarily result in recovery of the debt.

1.3 Credit bureaus in economic literature

Information exchange and the economics of information exchange have been the subject of a large body of academic literature, which shows that asymmetric information between borrowers and lenders can prevent the efficient allocation of credit in a market. Academic literature has identified asymmetric information as the defining characteristic of credit markets. These asymmetries cause adverse selection and moral hazard. For some, asymmetric information may eventually act as a barrier to entry (see Dell’Ariccia, 1998). Literature on credit bureaus, on the contrary, is more recent and is concentrated in a handful of authors.

According to this literature, several reasons account for the existence of credit bureaus. First, they ensure the best assessment of consumers' creditworthiness and their ability to repay prior to the underwriting of credit. Credit reporting thereby allows minimising the occurrence of default and controlling the moral hazard problem, acting as a 'borrowers disciplinary device'. Second, credit reporting assists in eliminating or diminishing the effects of adverse selection, ensuring 'more credit under better conditions'. For these reasons, commercial banks or financial institutions operating in the field attach high importance to the process of screening applicants prior to the granting of credit. Credit bureaus are an essential part of this process. Khalil and Parigi (2001) also show the importance of the screening procedure in relation to the large fixed recovery costs.

The adverse selection problem occurs because lower-quality borrowers, with higher credit risks, are the ones who are the most willing to pay higher interest rates, reducing the gains to both borrowers and lenders (Alary and Gollier, 2001). The adverse selection problem signals that when lenders cannot distinguish good from bad borrowers, all borrowers are charged an average interest rate that reflects their pooled experience. If this rate is higher than good borrowers deserve, it will push some good borrowers out of the market, leading in turn to banks charging even higher rates to the remaining borrowers. Through the sharing of information, the lender is able to distinguish bad from good borrowers in the market.

Better access to information helps lenders measure borrower risk more accurately and to set loan terms accordingly. Lower-risk borrowers would be offered more attractive prices, stimulating credit demand, and fewer higher-risk borrowers would be rationed out of the market because of lenders' inability to offer these borrowers accommodating rates (Barron and Staten, 2000).

The moral hazard problem implies that a borrower has the incentive to default unless there are consequences for his future applications for credit. This results from the difficulty lenders have in assessing the level of wealth borrowers will have accumulated by the date on which the debt must be repaid, and not at the moment of application. If lenders cannot assess the borrower's wealth, the latter will be tempted to default on their debt. Anticipating this, creditors will raise rates, leading eventually to the breakdown of the market (Alary and Goller, 2001).

According to Jappelli and Pagano (1999), credit bureaus play a key role as 'borrower discipline devices'. Every borrower knows that if he defaults, his reputation with all other potential lenders is ruined, cutting him off from credit or making it more expensive. The reputation of the borrower is a key factor in any assessment of his ability to repay; the information contained in a credit registry becomes part of the borrower's 'reputation collateral'. Late payments or defaults reduce this 'collateral', providing an additional incentive for timely repayment (Miller, 2000).

Limits to information-sharing on the financial history of borrowers exist namely because of credit institutions' fear of competition. This may be applied in the case of positive data, since all financial institutions agree to the exchange of negative information. By supplying information to credit bureaus, although they lose exclusivity of data, lenders ultimately gain for they are better able to distinguish the good borrowers from the bad ones. In a market with perfect information, where lenders are able to predict with certainty the repayment behaviour of borrowers, they would compete to attract good borrowers by offering better loan conditions (Jappelli and Pagano, 1999).

2. Credit bureaus in Europe

The cultural differences of European countries affect the typology of the existing credit bureaus. European countries not only have different traditions, but also specific laws regulating this issue. National markets also differ, with most of the countries having one large credit bureau dominating the market, as in the case of Germany, Finland, Ireland, France or Sweden, while in the UK and Italy, two or three companies share most of the market. In addition, public and private credit bureaus co-exist in certain markets, such as in the case of Belgium.

Furthermore, information collected by credit bureaus is regulated, ranging from only black information on default payers, to varying degrees of comprehensive American-style information on all individuals. The development of credit bureaus in Europe is uneven; countries such as Sweden and the UK have very comprehensive information in their credit bureaus, whereas strict privacy regulations have held back the establishment of private credit bureaus in France.

2.1 Public versus private credit bureaus

Credit bureaus in Europe are in most cases privately owned, independent companies, whose shareholders are banks and financial firms. In some cases, however, they are owned by associations, as in the case of the Belgian UPC, which is owned by the Professional Union of Credit providers.

Some public credit bureaus in Europe have been established to monitor the development of credit to individuals in the economy and the levels of indebtedness and over-indebtedness. Central banks or supervisory authorities mostly operate public credit registries, except in Finland where they are contracted out to a private company. Access is only granted to authorised central bank staff and to the reporting financial institutions. Despite common characteristics, public registries in Europe differ from country to country and seem to have developed independently without consideration to previous experiences in other countries.

Public registries may collect only negative information, as in the case of Denmark and France, but also credit exposure of borrowers, as is the case of the registry held by the Central Bank of Spain. Belgium has recently passed a law to allow for the establishment of positive credit bureaus; the register of the central bank will therefore be converted into a positive central office. Financial institutions are legally required to report to public registries. The information collected is available on a reciprocal basis to institutions contributing information to the registry.

The experience of Belgium shows that competition (one public and one private registry in Belgium) has brought benefits to the users. Perhaps forced by the lower prices of the UPC (Union Professionnelle du Crédit), the registry of the National Bank of Belgium has halved its prices since its inception, although they are still four to five times higher than those offered by the private registry. Consultation of the public registry for retail credit is compulsory prior to the underwriting of credit. This compulsory consultation might break the competitive balance between private and public credit bureaus and exacerbate the monopolistic character of the industry.

In practice, financial institutions in Belgium first consult UPC files and only when there is no negative record on the consumer in those files will the financial institution consult the public registry. (UPC receives around 10 million consultations per year, whereas the public central receives less than five million.) In the case of credit for non-private purposes, where consultation to the central bank registry is not compulsory, financial institutions prefer to consult the UPC. It seems that private and public registries however, do not have differential effects on credit market performance, and are therefore substitutes.¹

2.2 Information collected by credit bureaus

Credit bureaus are subject to the law of the land in which they operate, which results in some of them sharing certain characteristics while being unique in other respects. For instance, legislation in almost all countries establishes the type of information, the maximum length of time that such information can be stored on an individual's credit history, regulates the right of access to the information recorded and makes provisions for correcting errors or communicating one's inclusion in a registry.

¹ See Jappelli and Pagano (1999).

Credit bureaus collecting negative or ‘black’ (B) information only gather data on subjects that have previously defaulted on payments (delinquencies, charge-offs, bankruptcies, etc.). By contrast, positive or ‘white’ (W) information contains other elements of the financial standing of the individual that would allow for a more precise assessment of his or her ability to repay, such as accounts currently open, balances or credit limits. Positive reporting is based on the assumption that the analyses of today’s indebtedness indicate tomorrow’s solvability, whereas negative reporting considers that defaults and difficulties are the most relevant indicators with which to predict future insolvency (Table 2).

Table 2. Types of information and ownership of credit bureaus in Europe

Country	State- owned	Consortium of credit providers and associations	Private company owned by financial institutions	Private company not owned by financial institutions
Austria		X (B+W)		
Belgium	X (B)	X (B)		
Denmark			X (B)	
Finland	X (B)			
France	X(B)			
Germany			X(B+W)	
Ireland			X(B+W)	
Italy		X (B)	X (B+W)	
NL				X(B+W)
Portugal	X (B+W)			X(B+W)
Spain	X (B+W)			X (B+W)
Sweden			X(B+W)	
UK				X (B+W)

Note: B = black information. W = white information.

Source: Survey of credit bureaus.

An important consideration in information collection is the length of time that negative information should remain in an individual’s credit history. If the negative information remains on the record for an indefinite period, the borrower will have no incentive to improve his or her personal financial habits.

The cost of accessing a credit bureau’s database is not a negligible factor since that cost is finally passed along to the borrower. The fee varies from one EU country to another, with the average report estimated at between \$1-2 each (Jappelli and Pagano, 2000). Pricing structures, however, make the comparison difficult, due to the variety of information that can be provided and the practice of discussing the deals individually with credit institutions (see Table 3).

In many cases, the cost of the credit report is negotiated with the financial institution, depending on the volume; otherwise, the cost of running the credit bureaus is shared amongst all users, as a flat fee. Although the cost might seem small it is not negligible, i.e. it may not be very relevant for mortgage loans, but it can still be important for credit of small amounts granted to purchase retail goods.

Table 3. Sample prices of credit bureaus in Europe

	Providing negative information	Providing positive information
Austria	Average €0.5/report plus fixed fee €200-€600	Between €1.08 and €2.76/report plus fixed fee €200-€600
Belgium	Approx. €0.10/report depending on volume €0.45/report (NBB)	
Denmark	€37,52 to €248,87/year, plus €1.34/report	
Finland	Annual fee €0 €0.60/report	
Germany	Between €0.5 to €3 depending on the type of information, B or W	
Ireland		€1.86 to €2.22/report, depending on volume
Italy	€18,000/year (depending on the number of members)	€2.3/report
Netherlands		€0.453/report
Portugal	Average €0.70-€0.80/report	Average €0.50-€0.60
Sweden	Between €2 and €6/report depending on the type of information, B or W	
UK	Between €0.5 and €3/report depending on the type of information, B or W	

Source: National credit bureaus.

Individuals also have access to their records, although often at higher prices. In countries such as Denmark, Sweden and Belgium, access to these records is free, whereas in the rest of Europe it varies from €4 to €8/report.

2.3 EU national credit bureaus

We have already indicated that national credit bureaus within the EU operate in different legal and economic environments; hence, national credit reporting industries have distinctive elements. In the following section, we provide a comparative overview of the basic features characterising credit-reporting arrangements at national level.

Austria. The KSV private credit bureau collects both positive and negative information, which is exchanged between banks, insurance and leasing companies throughout Austria. Mail order, telecommunication and other user organisations participate only in the exchange of negative information.

KVS is a private association owned by members which contribute a small membership fee (between €200 and €600 a year) depending on the size of the organisation. The cost per report varies according to whether it is provided on or off-line, and covers positive or negative records. The average charge for negative reports is €0.5, while positive reports cost between €1.08 and €2.76.

Records are kept in the files for up to three years, if the debt has been recovered by the lender or a maximum of 30 years for unpaid amounts. The threshold for the collection of positive information is €1,000 and €5 for negative.

Belgium. Private registries existed in Belgium prior to the creation of a public registry by the National Bank of Belgium (NBB). The registry of the Belgian association of consumer credit companies, Union Professionnelle du Crédit (UPC), has existed for more than 50 years. This registry consists of 60 financial institution members of UPC, representing 96% of the Belgian

consumer credit market and 90% of the housing credit sector. It also covers credit for professional use, leasing to independent and liberal professions and credit cards.

The public registry, which has more recently been established (1987), makes reporting compulsory and thus, covers in totality the consumer credit and mortgage market. Consultation of the public registry, prior to the granting of credit, is compulsory for credit companies. Individuals must be informed of their inclusion in any negative registry listing.

National legislation prohibits the use of either registry for any use outside the scope of the assessment of creditworthiness, credit management or the verification of other payment instruments, such as cheques. Negative data are kept in the registry between a minimum of one year and a maximum of 10 years. The Belgian government recently approved legislation permitting the creation of a positive registry managed by the Belgian Central Bank. The present law allows for the creation of positive registries of private origin.

Denmark. Negative payment reports issued by Denmark's credit bureau are based on data received from customers, combined with data from the Danish Official Gazette (i.e. sales by court order, bankruptcies and initial cancellations of debts), which registers debts above €134. When lenders report a debtor to RKI Kredit Information A/S, the bureau sends a letter of notification informing the debtor that he or she has been registered with RKI. This letter has two purposes. First of all, it informs the debtor of his registration (which often results in the debtor paying off his debt in order to have his name deleted from the registry), and second, it enables the debtor to contact the credit bureau directly if he or she feels that the registration is unfair. In accordance with the Danish Data Protection Act, the credit bureau is required to delete the registration after five years, but the debtor has the option of being removed from the registry before then, by clearing the debt with the credit institution.

France. This is one of the countries where restrictive data protection provisions have hampered the development of credit bureaus. At present, there exists only a public registry of negative information, which is managed by the Bank of France. Although the question of whether to establish a positive central registry often arises, arguments in this direction have not been successful.

Germany. The first public registry in Europe was established in this country in 1934; it is owned and operated by the Bundesbank. Private banks and retailers own Schufa Holding AG, the largest private credit bureau in Germany dating from 1927. It covers a large part of the population, about 55 million persons and debts of over €100 (approximately).

The information collected is both positive and negative, organisations providing negative information can only access the same type of records. Prices vary depending on the information demanded and provided. When positive data is released, the consent of the individual is requested. Individuals also have the right to be notified of their listing and to correct, erase and block any data that are incorrect.

Ireland. The 30 member companies of the Irish Credit Bureau send monthly updated information to the credit reference agency. This includes the outstanding balance on any loan, any arrears that may have arisen and a history of the last 24 repayments. Regardless of a loan's repayment record, the bureau holds details for five years after the end of the agreement. Under Irish law, data can only be kept on borrowers who agree to their listing in such a record, but most loan applications include a credit reference consent provision.

Consumers can receive a copy of their personal credit information from the Irish Credit Bureau. They can also have information rectified or erased, or have a statement appended where the data are incomplete, incorrect or irrelevant for the purpose for which they are kept. Financial institutions registered with the Irish Credit Bureau are required, on request from an applicant, to provide the

name, address and telephone number of any credit reference agency used during the assessment of a loan application, where such records might have had a bearing on the decision.

Italy. This country has two well functioning credit bureaus, CTC (Consorzio per la tutela del credito) and CRIF. CTC is a creation of financial companies and is established as a non-profit company. It is a negative registry that covers 90% of the Italian market, with records of 700,000 bad payers. Information is updated monthly on the basis of homogeneous criteria by the great majority of consumer credit companies (both captive and non-captive), which can download complete files into their own databases, with the advantage of being able to consult the information in a preliminary way.

The largest private credit bureau in Italy is CRIF, which collects both positive and negative information for all types of loans without a minimum threshold. CRIF mainly lists customers of banks, recording roughly 650,000 loans. While CTC is significant with regard to irregularities in the non-banking field (in terms of volume, 65% concern car finance), CRIF represents the most complete existing file of bank origin. CRIF has records on 21 million people with outstanding debts in Italy. The information collected comprises the name, address and tax identification or fiscal code of the individual, the amount and type of loan, the number of non-paid instalments found and whether the loan is guaranteed by collateral.

The Netherlands. The Dutch Bureau Krediet Registratie, BKR, established in 1965, is considered by many as an excellent example of a positive central registry. It is the leading credit bureau in the Netherlands, covering close to 100% of the market and 6.5 million people. All banks and financial institutions lending to consumers contribute data to the registry, and it plans to include telecom companies in the future. The registry does not include positive information on mortgage borrowing, but only lists instalments that have been due for more than 120 days.

The cost of a report for a borrower is €0.43 and €4.53 for the consumer. In case of error, the borrower has to contact the lender, who will transmit an order to BKR to make the correction.

The positive data collected cover the amount, type and terms of a loan, the start and end date and for some types of loans, the date when the loan is likely to end. Demographic data are collected only for identification purposes, namely, name, address and date of birth. Past default incidents that remain unpaid will be kept on the record for an unlimited period, whereas those that are eventually paid are kept in the registry for five years, ensuring that lenders can distinguish those individuals who are delaying payments systematically.

Portugal. The main credit bureau in this country is Credinformações, which, as is also the case in Spain, is a joint venture between ASFAC (Associação das Financeiras para Aquisição a Crédito) and Equifax, established in 1995. Credinformações collects both positive and negative data only from financial institutional members of ASFAC. There are more than half a million entries in the database (mainly negative). The Bank of Portugal also runs a credit bureau to which financial institutions are obliged to supply information.

Portuguese social and cultural attitudes towards the exchange of information and the involvement of the public sector in this area have delayed the extension of the credit bureau to the rest of the financial sector. The Banking Secrecy Act does not allow sharing information between financial and non-financial companies; for this reason, no telecoms or utility company contributes data to the registry.

Since the beginning of the 1970s, the Bank of Portugal has managed a registry that records end-of month balances from all lending institutions in Portugal and distributes the aggregated data to lenders in the system. The minimum aggregated debt of individuals registered is €50.

Spain. A public central registry is managed in Spain by the Bank of Spain. It registers all outstanding credit above €6,000 (approximately) and is a positive registry. This threshold implies

that a large number of consumer credit loans are not registered by the public credit bureau. Reporting to the Bank of Spain is compulsory for credit institutions.

The largest private credit bureau is a joint venture of Equifax-ASNEF, the Spanish federation of finance companies, established in 1994. Telecommunication companies also feed the registry.

The legal framework for credit bureaus in Spain deserves particular attention since the operation of credit bureaus requires authorisation from the Competition Court (Tribunal de Defensa de la Competencia, TDC). Such practice is based on the following two assumptions:

- Credit reporting agencies constitute a form of trust between companies in the same sector to exchange information that will influence their commercial strategies, and therefore, this practice is prohibited.
- When companies exchanging information do not belong to the same sector, and therefore are not competitors, the existence of credit reporting agencies contributes to the improvement of commercial activities in the economy.²

These concerns of the Competition Court followed the establishment of a sector-oriented central registry of defaulters in the Spanish film distribution industry, whose circulation of information that identified 'excessive risks' gave rise to anti-competitive behaviour by distributors.

At present, credit-reporting agencies can obtain authorisation for five years and collect the same information as the Risk Central at the Bank of Spain. Nevertheless, regulation remains an important issue closely followed by the TDC and the Data Protection Agency, which often have different criteria (e.g. TDC write-off paid debts three months after payment whereas it is instantaneous in the case of the DPA).

Sweden. This country has developed credit bureaus similar to those operating in the US, i.e. with comprehensive registries containing both black and white information. The Swedish UC AB collects negative and positive information comprising demographic and credit-type information, and other financial information such as business activities of the individual, tax information (income tax, property tax and taxable wealth) and properties owned by the consumer.

In the case of American credit bureaus, information can only be released for the regulated purposes identified. Since the information is widely available not only to financial institutions but also to telecoms and oil companies and government, or for the leasing of apartments, it differs from the continental model of credit bureaus. In all cases, UC has to forward a copy of the report to the individual concerned, stating to whom the report was released.

Registration of a black record is not arbitrary; it first has to be recognised by the Swedish authorities as a formal payment claim. If the payment is recovered later, the record remains in the file until the end of the current year, plus three extra years (on average three and a half years). Unpaid incidents remain in the file as long as the lender is attempting to recover; if the lender abandons pursuit of the recovery, the record is held for ten years.

Information available in the credit bureau is widely used by financial institutions to construct generic scorecards. Given their tested accuracy, many large financial institutions that initially created their own application-based scorecards are now using generic scorecards.

United Kingdom. The UK credit bureau industry is well developed; it too resembles the circumstances in the US, with the participation of only private credit bureaus – in particular the dominant US companies, Equifax and Experian.

² Tribunal de Defensa de la Competencia, Resolución 239, Autorizaciones Singulares.

Information collected by credit bureaus comes mainly from three types of sources: banks and financial institutions, telecoms and utility companies and retailers. All of them provide negative and positive information. Information from credit partners is distributed on a reciprocal basis; i.e. companies providing negative information can only access negative data. English credit bureaus also possess information contained on the electoral roll. This is an important element, since in the UK and the US the electoral rolls, and credit bureaus, are used to verify the address of a person, whereas in other countries the search will be done through an identity card number.

Together, the negative and positive information collected covers 70 to 80% of the population. The figure for exclusively positive information is lower.

United States. The country where credit bureaus first developed has seen a concentration of industry players in recent years. Presently, only three big credit bureaus operate nation-wide and they share the market between them. US credit bureaus possess the most comprehensive data in the world. Information is stored on over 200 million adult residents and over two million credit reports are sold every day by the credit bureaus (Barron and Staten, 2000). Positive data collected include all details of defaults and bankruptcies, as well as complete information on outstanding credit. Credit bureaus are only allowed to release information regarding transactions initiated by customers. Defaults can only be kept for 7 years, 10 in the case of bankruptcy.

2.4 International arrangements for the exchange of information

The interconnection of existing credit bureaus is already underway in Europe. Given the fundamental differences when compared to the US market, however, where three private credit bureaus dominate, one should not expect the same concentration in the EU market, at least not in the short-term.

Achieving economies of scale, which imply that the larger the bureau the more complete the information is, has been the major motivation behind the merger process in the US, together with technology, deregulation of credit markets and integration of national economies. In the EU, the need for a single credit market and cross-border credit are the main factors driving the cross-border exchange of information. Cross-border exchange of information is, however, hampered by the reduced mobility of retail borrowers outside their own country. Banks and financial institutions therefore do not have sufficient incentive to further implement this exchange.

Given the considerable political and economic weight of banks and financial institutions in Europe, as well as the existing fragmentation, it is difficult to predict whether the industry is heading towards harmonisation. It is clear that with an increasing number of people in circulation within the EU, and the international operation of European banks and financial institutions, credit bureaus will be led, albeit slowly, to higher cross-border exchange of information. At present, there are some bilateral agreements in progress between the credit bureaus of several countries: Schufa Holding (Germany), KSV (Austria), BKR (Holland), CRIF (Italy) and NBB (Belgium). Some Anglo-Saxon organisations, on the other hand, are trying to extend operations to other countries (e.g. Experian and Equifax are expanding to Italy, Spain and Portugal).

The European Association of consumer credit information suppliers (ACCIS) is working towards the creation of a network of credit registries. After an initial discussion among the members with regard to the information to be exchanged, they have agreed upon the Key Factor System. This system will grant financial institutions access to cross-border records through their national credit bureaus on a reciprocal basis, i.e. Italian financial institutions requiring information through CTC (negative information) will have access to only negative information on Dutch individuals.

Key Factor is a technological platform that filters the information distributed according to the information provided by the credit bureau. At present, only the Dutch BKR, the German Schufa and the Italian CRIF are operational in the system. It is expected that the rest of the ACCIS

members will join over the course of the next few years. It remains to be seen, however, whether credit bureaus that are not ACCIS members, such as France, will join the platform.

3. Legal and regulatory issues

There is a general consensus in our society that the use of personal data, including the storage and security of such data, must be controlled. Furthermore, there is agreement that these concerns should be balanced by the legitimate interest of commercial or non-commercial organisations to process certain data. This is the case regarding financial data, since it allows minimising the risk of fraud and bad debts.

Public policy recognises that it is necessary for consumers to reveal some information related to their financial history when applying for credit. If consumers consider that the requested information is appropriate to allow for a thorough assessment of their creditworthiness, they are more apt to disclose private information in exchange for economic benefits. Often, however, consumers do not have a choice if they do not want to be refused credit. If the consumer, therefore, provides information in order to obtain credit, he should be assured that it is only within this framework that the data will be handled.

Consumers cannot always have control over the information held by businesses on their finances or themselves. At the same time, difficulties often arise for the consumer, due to this loss of control over personal information. Achieving a balance between both sets of interests is not easy. If regulation is too little, it might allow for the abuse of unscrupulous operators; likewise, if regulation is too strict, it can interfere in the legitimate functioning of businesses. Indeed, the degree of privacy protection plays an important role in the development of credit bureaus, as shown by the different environments of the US and France.

Nowadays, advances in computer technology and telecommunications allow personal data to travel across borders with much greater ease. Information relating to an individual's 'personal data' is collected and used for many aspects of everyday life. Personal data can be collected directly from the individual or from an existing database, and may subsequently be used for other purposes and/or shared with other parties.

In this context, national laws regarding data protection demand good data management practices on the part of data processing entities. These laws must guarantee the rights of the individual, such as the right to be informed when personal information is being processed, the reason for this processing, the right to access the data, the right to have the data amended or deleted and the right to object to certain data processing. Equally, the collection of 'sensitive data' is regulated everywhere in Europe. Data protection authorities, which exist in all EU countries, act as watchdogs to ensure the application of privacy laws.

The development of a frontier-free internal market and the development of the so-called 'information society' imply that processing of personal data will grow irrespective of national boundaries, and that data concerning the citizens of one member state are increasingly processed in other member states of the EU.

3.1 The general framework of data protection

Since the 1970s, several member states of the European Union have passed legislation protecting the fundamental rights of individuals, and in particular their right to privacy from abuses resulting from the processing of personal data (i.e. the collection, use and storage thereof). International institutions such as the United Nations, the Organisation for Economic Cooperation and

Development (OECD) and the Council of Europe³ have produced legal texts addressing these issues.

Data protection laws provide for a series of rights for the individual. These laws generally demand good data management practice on the part of the entities that process data ('data controllers') and cover a series of obligations. These include: 1) the obligation to use personal data only for specified, explicit and legitimate purposes; 2) the obligation to guarantee the security of the data against accidental, unauthorised access, or manipulation; and, in some cases, 3) the obligation to notify a specific independent supervisory body before carrying out all, or certain types of, data processing operations. These laws normally provide for certain safeguards or special procedures to be applied in the case of transfers of data abroad.

National data protection laws, however, feature some differences that could potentially create obstacles to the free flow of information or additional burdens for economic operators and citizens. Directive 95/46/EC on data protection was therefore developed to harmonise national provisions in this field. The Directive applies to any operation or set of operations that are performed on personal data.

The Directive lays down common rules that firms must observe when collecting, holding or transmitting personal data in their business or administrative activities. Of fundamental importance for firms is the obligation to collect data only for specified, legitimate purposes and to hold only data that is relevant, accurate and up-to-date. European citizens, in turn, are guaranteed a set of rights: the right of access to their personal data, the right to correct any data that is inaccurate, the right to know where the data originated, the right to refuse use of their data for activities such as direct marketing and the right of recourse if unlawful processing has occurred. The Directive prohibits the transfer of personal data to non-EU nations that do not meet the European 'adequacy' standard for privacy protection.

While the US and the EU share the goal of enhancing privacy protection for their citizens, their respective regulatory approaches differ. The United States embraces a sector approach that relies on a mix of legislation, regulation and self-regulation. In general, it can be said that EU and US data protection regimes differ significantly, although they have similar elements. The differences are based on cultural perceptions of privacy and personal information, and while Europeans approach the issue from the human rights perspective, the US understanding allows for a more liberal approach in which the economic good of information prevails (Jentzsch, 2001).

The approach of the US and the EU towards Internet technology also differs, the former being based on self-regulation, the latter on the drafting of comprehensive legislation. The US Fair Trade Commission (FTC) believes that self-regulation offers the best means for protecting consumers' online privacy for several reasons. First, voluntary codes are, by definition, developed and adopted by those with the greatest expertise and sensitivity to industry practices and conditions. Second, self-regulatory codes can be formulated and revised more promptly when necessary than can legislative codes. This allows firms to respond quickly to the rapidly evolving nature of the Internet and computer technology and to employ emerging technologies to protect consumer privacy. Third, when regulation is voluntarily adopted, compliance tends to be broader and enforcement more prompt. Finally, where an industry can regulate itself, the government need not devote as many of its limited resources to the task; therefore, encouragement of self-regulation is often an efficient and effective way for an agency to leverage its enforcement budget (FTC).

³ Convention 108 of 1981 establishes the basic principles regarding the protection of individuals with regard to the processing of personal data that can be found in all data protection laws in Europe.

Recently, the FTC, following an extensive survey of websites containing personal information, acknowledged consumer concerns regarding privacy on-line and the limited success of self-regulatory efforts to date. Consequently, the FTC has recommended to Congress the need to enact legislation in the field to complement self-regulation and consumer and business education (FTC, 2000).

By contrast, the European Union relies on comprehensive legislation that requires, for instance, the creation of government data protection agencies, registration of databases with those agencies and in some cases, prior approval before personal data processing can begin.

In order to bridge these differences and facilitate the compliance of US companies with the Directive, both economic areas engaged in discussions to develop the 'safe harbour' framework. Compliance with the safe harbour concept will assure EU organisations that a US company provides 'adequate' privacy protection, as defined in the Directive (Art. 25, para. 2).

3.2 Privacy in credit markets: The US vs the EU

The degree of privacy protection agreed upon varies from country to country. Japelli and Pagano (2000a) label as 'low protection' regimes those countries where information on borrowers' data can be accessed no matter the purpose, and as 'high protection' regimes those where information can only be accessed following the borrower's explicit consent. In a mid-range situation, we find countries where information is released following the involvement of customers in certain credit operations, such as applying for a loan or credit card, but without the customer's explicit consent.

The European Union places a significant regulatory burden on the credit reporting industry. The EU privacy directive greatly limits sharing of personal information, including credit data in credit bureaus (Galindo and Miller, 2001). Under directive 95/46/EC, automated data can only be accessed in the course of entering or performing a contract, and the directive falls within the 'high protection' category mentioned earlier. The European framework of data protection also provides the rights of notification when data are held on an individual or correction where there are any errors in the record. As with many other directives relevant to consumer protection, Directive 95/46/EC follows the minimal harmonisation approach, allowing member states to apply more restrictive provisions (see Annex II for a detailed listing of applicable laws in each EU member state). Additional legislation is provided at the national level.

In comparison to Europe, the US has a very open system for credit reporting with a relatively light regulatory approach. The US has allowed a significant degree of self-regulation by the credit reporting industry, which is done through the Fair Credit Reporting Act (FCRA) and the numerous state laws that deal with it. The FCRA sets forth legal standards governing the collection, use and communication of credit data and certain other information about consumers. A revised FCRA⁴ set new obligations for creditors and credit bureaus, imposing tighter conditions in order to address growing consumer concerns with privacy abuses by the industry. Enforcement, accuracy and privacy protection were to be enhanced by the new act.

Amendments included an opt-out procedure for inclusion in future lists. Consumers thereby gain protection against unsolicited credit offers, including the multiple credit card offers that many consumers receive on a daily basis. Previously, creditors were able to use the credit reporting agencies' file information as a basis for developing lists of consumers to whom to send offers.

Other significant amendments refer to information disputed by consumers in case of inaccuracies or errors. When a consumer disputes information in his or her file with the credit bureau, the implicated creditor has to check the possible error, review the information and report inaccurate or

⁴ The Consumer Credit Reporting Reform Act of 1996 amended the FCRA extensively.

incomplete information to all national credit bureaus. Furthermore, the new amendments establish a 30-day limit for the credit bureaus to resolve consumer disputes.

The US data protection legislation is completed with the 1999 Gramm-Leach-Bliley Act, which imposes significant restrictions on the ability of financial institutions to transfer the non-public personal information about their customers to a non-affiliated third party. One such example is when a bank shares the names and addresses of its customers with a wholly separate merchant. The Act basically requires that financial institutions must allow consumers to choose whether to have their non-public personal information disclosed to a non-affiliated third party. Before a financial institution shares such information with a non-affiliated third party, the institution must provide the consumer with a copy of this third party privacy policy. The financial institution must also give consumers notice of their right to 'opt-out', and give them the opportunity to exercise this right. The Act requires that financial institutions must allow consumers to decide whether to have their non-public personal information disclosed to a non-affiliated third party.

A very important difference between US and EU laws is the opt-out⁵ system in the US as compared to the opt-in system in the EU. Jentzsch (2001) points out that when the purpose is to collect extensive data, opt-out systems are regulators' preferred choice. Nevertheless, despite the presence of an opt-in system in Europe, in practice the consumer is rarely asked to opt-in, and an implicit consent is assumed. In Germany, for example, although the unambiguous consent of the borrower is necessary for positive information, denial of data transfer to the credit bureau will result in the refusal of credit.

With regard to the secondary uses of data, the EU is more restrictive than the US, where the opt-out approach is the rule, and where regulations provide transparency in data processing and establish registers of data collectors. New initiatives, such as the directive on data protection in electronic communications, do not achieve harmonisation between national laws; instead, they open the door to a variety of systems, as in the instance of the opt-in or opt-out system for commercial communications. Higher harmonisation and complete implementation of the data protection directive might be needed.

4. Preliminary issues for discussion

At the heart of the debate on information recorded in registries is a confrontation between basic principles. While it seems necessary to guarantee individual privacy protection on the one hand, there are on the other those who advocate that collection and use of positive information can play a role in combating over-indebtedness situations, which are associated with adverse social consequences.

Credit bureaus are an important element in the development of an integrated *cross-border retail credit market*. In this sense, the benefits of the exchange of information to the development of cross-border credit are incontestable, and therefore it would be desirable to allow for a system for the exchange of information. Nevertheless, the differences amongst European credit bureaus concerning the data collected and national legal provisions hamper the exchange of information. The possibilities for the establishment of this necessary exchange vary from the implementation of legal provisions at EU level, to the conclusion of voluntary bilateral or multilateral agreements. For the time being, agreements between credit bureaus in Europe are taking place on a voluntary basis.

⁵ In opt-out systems, consent of by the data subject is assumed unless the consumer explicitly exercises the opt-out option. In opt-in systems, the unambiguous consent of the data subject is required previous to any information sharing operation.

4.1 Positive versus negative data: The protection of privacy

Credit bureaus' activity is regulated almost everywhere under general data protection laws and in some countries they are also the object of specific laws.⁶ Privacy laws cover many aspects such as access to files, the nature of data (positive and negative), the elimination of records after a time or the limitation of certain types of information. Stringent rules apply to the processing of sensitive data, namely, data relating to racial or ethnic origin, political opinions, religious or philosophical beliefs, trade union membership and health concerns.

To avoid the arbitrary use of credit bureaus' information, regulation of this market is essential. If there is no uniform and transparent regulation for the use of credit bureaus' data, a perverse decision may result. For instance, an individual who has a low-profile credit record (e.g. from failing to pay a parking fine or a telephone bill due to a particular conflict with the company providing phone service, or due to ethical concerns about certain types of taxes from the public sector), will have a negative entry that could result in his being refused credit. The collection and dissemination by credit bureaus of this type of information has little to do with unreliable credit behaviour, and can exclude these individuals from credit markets. Moreover, full de-regulation of credit bureaus will result in biased behaviour by banks (Rubini, 2000).

National and European laws regulate the establishment of credit bureaus gathering positive or negative data. In general, it can be said that countries with Napoleonic codes (i.e. southern European countries),⁷ are more in favour of negative data, whereas Anglo-Saxon countries, with common laws, are more in favour of the compilation of positive data, the model pioneered by the US.

Boyes, Hoffmann and Low⁸ go further in the consideration of the data to be collected by credit bureaus. They consider the exclusion of variables such as race, sex, religion, ethnic background or other personal data as a degradation of the lender's ability to separate good from bad borrowers, inadvertently causing the reallocation of funds from consumer lending to other products. For them, the efficiency of lenders in assessing creditors is a more powerful argument than individual data protection and discrimination concerns.

This reasoning would lead to the conclusion that the existence of positive credit bureaus in a country would have a favourable impact on the rate of default. Nevertheless, the impact of positive records on the effectiveness of the overall assessment of risk is doubtful. Financial institutions, banks and all credit grantors base their credit risk assessment on their own databases of customers, constructed over many years of operations, which constitutes therefore one of their competitive assets, and not in positive data collected by credit bureaus.

Further consideration should be given to what constitutes essential information to facilitate the credit assessment process. It calls, perhaps, for further harmonisation of data protection laws. Data protection laws within the EU context for instance, prevent in some countries the collection by credit bureaus of data such as bankruptcies, legal incapacity, judicial resolutions for illness or mental reasons and judgements concerning financial crime. Without being a pure incident of default payment, these can be considered important elements in the assessment of repayment. Art. 8, para. 5 of the Data Protection Directive offers flexible criteria for assessment, and thus, opens the door to diverse national legislation in this field.

⁶ As in the case of Belgium, for instance, where provisions are contained under the Law of 12 June 1991 concerning consumer credit.

⁷ France has a negative public register. Spain has positive public registry, but only allows the operation of private negative registries. Italy, however, has positive registries.

⁸ The American Bankers Association, *Consumer Credit Delinquency Bulletin*, Third quarter, 1999 (cited in Miller, 2000, p. 6).

Box 1. The ambiguity of defining privacy

To illustrate the controversy concerning what constitutes excessive or justified collection of information by credit bureaus, let us look at the argument put forward by the French CNIL (Commission Nationale de l'Informatique et des Libertés).

The CNIL prevented several credit grantors from using borrowers' nationality as a factor to estimate their repayment ability. CNIL inspections found that scoring techniques often used categories such as *français*, *CEE*, and 'other'. The purpose of the inclusion of such criteria, according to credit institutions, is to facilitate the assessment of the difficulty to recover the debt in the case of the borrower moving to his country of origin. However, the CNIL sustained that a more appropriate criterion for foreign residents would be the inclusion of the *'titre de séjour'* validity period. It would constitute a relevant variable at least for long-term credits. Furthermore, CNIL argued that nationality does not constitute a determining criterion for the assessment of payment behaviour independently of social, financial and economic conditions of the borrower.

Later, the *Conseil d'Etat* annulled the CNIL decision and recognised that when the result of scoring techniques do not exclude automatically the individual treatment of the demand of credit, the information regarding nationality is adequate and permissible.

Sources: CNIL 1998 press release published on its website and Resolution from the *Conseil d'Etat* regarding to the file n° 204909, 30 October 2001.

4.2 Positive versus negative data: Any links with over-indebtedness?

Since the 1980s, European household debt has been on the rise. Indeed, indebtedness has begun to attract the attention of policy-makers and the media, especially given the current perception of dangerous indebtedness in the US market and decreasing savings ratios. The US 'open credit society' model began to be imported to Europe at a significant level as early as the 1960s. Despite this, links have not yet been established between the credit reporting scenario, the level of indebtedness and the occurrence of over-indebtedness. We shall see in the following discussion that there is no reason to think that the collection of positive vs. negative data affects the level of indebtedness or over-indebtedness.

The first element to consider is the level of household indebtedness, which has seen a steady increase over the past few decades. So far, the debate on the economic impact of indebtedness ratios in Europe is not particularly intense, since indebtedness levels are in most of the EU countries far below those of the US (see Table 4).

An important element to be taken into account in analysing levels of indebtedness is the relation between the different types of credit. The distribution of credit to individuals between consumer credit and other credit (mainly mortgages) varies significantly across countries. For instance, we see in Figure 3 that the Netherlands, which is one of the most heavily indebted countries, is to a large extent burdened due to housing credit. The contrary applies to Greece and Italy, both with low levels of indebtedness, both for mortgages and consumer credit. These differences should certainly be taken into consideration, as specific solutions will be required to fight over-indebtedness.

Although the rise of indebtedness is not particularly worrying from a macroeconomic point of view, it is believed to generate serious social consequences for households. The perceived dangers of high indebtedness levels for the economy should, however, be treated with prudence and take into account the 'wealth effect'. The wealth effect implies that consumers' growing debt-financed spending is based on their assumption that stock prices will provide a steady stream of capital gains for the indefinite future. Broader household participation in the stock market has generated an increase in their financial assets, diluting the weight of debt in the financial situation of households.

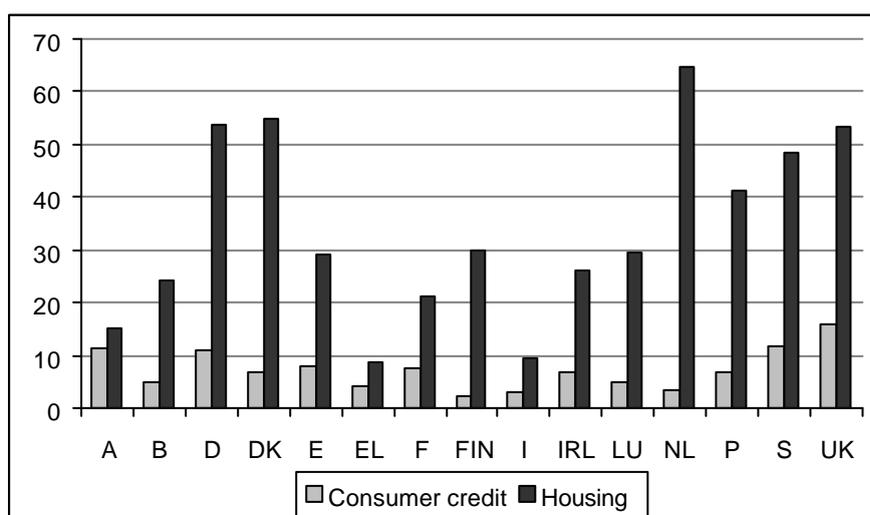
Table 4. Indebtedness levels as a percentage of disposable income

	1995	1999
Netherlands	89.4	118.1
Sweden	75.9	105.0
UK	97.9	101.6
Japan	85.0	100.2
US	83.3	97.5
Germany	49.9	63.7
Portugal	48.7	73.1
Austria	60.0	52.3
France	47.3	49.7
Belgium	42.4	45.7
Finland	38.5	44.2
Italy	32.9	34.2
Spain	31.6	29.7
Greece	6.8	14.0
Average	56.4	67.1

Note: The ratio has been rising for Sweden since 1995, but it is lower than the record level achieved in 1980, when it was close to 135%.

Source: ECRI, based on central banks' annual reports and national accounts.

Figure 3. Consumer credit and housing credit as a percentage of GDP



Source: ECRI, based on data drawn from central banks and national statistical offices.

The second element to consider is the phenomenon of over-indebtedness across the EU. It has to be noted that despite the public interest attracted by over-indebtedness, it is difficult to carry out an accurate assessment of the situation in Europe. The evaluation of the reality of excessive indebtedness is hampered by a lack of statistical data. Furthermore, a common definition at EU level that allows for the establishment of relevant comparisons is currently non-existent.

Definitions vary from recognising over-indebtedness only by the initiation of bankruptcy procedures, to the more flexible criteria that regards as over-indebted those individuals or families who merely perceive they have difficulties in repaying their contracted debts, without any default incident. The Economic and Social Committee of the EU, for instance, defines over-indebtedness as the state in which a household is 'objectively unable, on a structural and ongoing basis, to pay short-term debts taken out to meet needs considered to be essential, from their habitual income provided by work, financial investments or other usual sources, without recourse to loans to finance debts contracted previously'.⁹ The industry often classifies a credit as a default when 'the individual has failed to repay three consecutive instalments'.

Any efforts to measure the magnitude of over-indebtedness at EU level are impeded by the above-mentioned lack of a common definition and therefore comparable statistics. A recent study commissioned by DG SANCO estimates that 18% of families in the EU are over-indebted, a figure that the present study finds exaggerated. Such a high estimate is the outcome of a broad definition of over-indebtedness: 'A person is over-indebted if he or she considers that they have difficulties in repaying debts, whether consumer or mortgage debt' (ORC Macro, 2002).

Table 5 below shows some of the results of studies carried out at national level. In Belgium, for instance, the UPC registers 500,000 individuals with negative records in a population of over 10 million people, which gives a ratio of 5%. Since negative records are kept in the register over some time, however, it includes all individuals that have a negative entry due to problems in the past, not necessarily at present. In France according the Commission d'endettement,¹⁰ over-indebtedness concerns 2% of the total of families with outstanding debt. Table 5 presents estimations of over-indebtedness according to different sources in France, Belgium, the UK, Germany, the Netherlands and Sweden.

The third element to be taken into account in the study of over-indebtedness is its cause. According to surveys carried out in France¹¹ and Belgium, it seems that the use of credit is not the only factor causing repayment difficulties faced by over-indebted households, though it is clear that the accumulation of credit contributes to aggravate their financial situation. The advent of external factors is the main cause for the inability of individuals or families to repay debts, It seems clear that the expansion of consumer credit, often blamed for the growth of over-indebtedness, it is actually not decisive.

Classified by the type of debt affected, over-indebted families belong to two main groups; those who accumulated an excess of consumer credit debt, and those families with one or several housing credits, often combined also with consumer credit debt. There is also a small percentage of families whose over-indebtedness is non-credit related, for instance taxation or clearing of legal procedures.

⁹ From the Information report of the Section for the Single Market, Production and Consumption on Household over-indebtedness, CES 212/2000 fin, Int/043.

¹⁰ Indebtedness Commission. Over-indebtedness is defined as having a credit default dossier deposited with the Commission for over-indebtedness.

¹¹ <http://www.senat.fr/rap/r97-060/r97-0606.html>

Table 5. Over-indebtedness in Europe: A preliminary approach

	Source A	% of total population	Source B	% of total population
France	500,000 families ^a	2.0%		
Belgium	113,000 families ^b	2.5%	30,000-40,000 families ^c	0.8%
UK	1 million individuals ^d	1.6%	200,000 individuals	
Germany	2.5-2.7 million families ^e	7%		
Netherlands	200,000 families ^f	2.9%		
Sweden			430,000 individuals ^g	4.5%

^a IEIC, 'Etat du surendettement : éléments statistiques', September 2000.

^b Data from Groupe Action Surendettement de Belgique (Belgium Over-indebtedness Action Group). No definition of over-indebtedness given.

^c Estimated by the industry.

^d NACAB publishes statistics that quote one million enquiries, not actual people. It is often the case, however, that a person with a debt problem will phone several times. In a letter to the editor of *Credit Finance 2001*, Nick Pearson, a former employee of NACAB calculates the number of enquiries at roughly 200,000.

^e IEIC, 'Etat du surendettement: Eléments statistiques', September 2000.

^f IEIC, 'Etat du surendettement: Eléments statistiques', September 2000.

^g Individuals with non-settled formal payment claims included in the credit bureau. Past payment incidents settled with the lender are not included.

Tables 6 and 7 illustrate the causes of over-indebtedness based on surveys carried out in the Pontoise region of France and in Belgium.

Table 6. Causes of over-indebtedness found by the Indebtedness Commission in the Pontoise region of France

Indebtedness factors	Percent of total
Unemployment situation	42
Illness	11
Divorce or death of a partner	20
Suppression or reduction of social benefits	4
Other	23

Source: <http://www.senat.fr/rap/r97-060/r97-0607.html>.

The Pontoise Indebtedness Commission differentiated between active and passive over-indebtedness. Active over-indebtedness is characterised by the exaggerated accumulation of credit related to income, whereas passive over-indebtedness is caused by the advent of an external event that affects one's ability to repay. Overall passive over-indebtedness amounts to around half of the total.

Table 7. Causes of over-indebtedness in Belgium

	%		%
<i>Life events</i>	44.8	<i>High indebtedness level</i>	31.27
Unemployment	18.84	Excessive charges	16.09
Illness	6.64	Unexpected charges	3.15
Divorce	7.65	Provision of false information	8.44
Decease	4.56	Fiscal debts	0.34
Other	5.62	Others	3.26
<i>Non-financial causes</i>	14.96	<i>Liquidity difficulties</i>	6.52
Carelessness	13.16	<i>Other</i>	2.36
Supplier litigation	0.79		
Marriage litigation	1.01		

Source: ABB (1996).

From an analysis of the above results, it can be concluded that over-indebtedness is more often due to the occurrence of an event in an individual's personal life that disrupts the household's budgetary equilibrium and makes repayment difficult, than to the simple accumulation of debts.

There is a tendency to place the onus on the lender to assess and verify the consumer's solvency. Articulating the belief that 'more information is better', a report by the UK Department of Industry and Trade on how to tackle over-indebtedness mentions that 'the non-availability of data, such as student loans, current account and overdraft details, income and other regular financial commitments, e.g. rent and utility costs, precludes a full picture of the borrower being available' (Dti, 2001). In line with this reasoning, it is often suggested that lenders should consult positive databases of information on the financial situation of a household as an instrument to combat over-indebtedness.

Nonetheless, even positive credit bureaus do not include important aspects of a household's spending habits that are liable to have an influence on the ability to repay debts nor can a household be expected to foresee the advent of external events. To fully represent the financial situation of a household, credit bureaus should include information such as rent, utilities and other spending habits that show the family income with respect to the total of payments to be made.

The evidence found in European and US markets does not support the argument that there is a relationship between positive registries and lower levels of indebtedness. We observe that countries with positive credit registries, such as the UK, the US, Germany and the Netherlands, also have a high level of indebtedness (see Table 4), whereas Italy and Spain, which also operate positive registries, rank at the lower end of the table. On the other hand, France and Belgium, which only permit the operation of negative registries, have also kept low levels of indebtedness. Moreover, one must bear in mind that so far, no relationship can be established between indebtedness and over-indebtedness in light of the existing statistical data.

Given the facts presented in this section, it is difficult to argue that positive data collection could be an important tool to reduce over-indebtedness. We argue, therefore, that obliging lenders to consult positive information in credit bureaus is an excessively interventionist approach. Credit assessment methods are a key know-how and a competitive advantage of lenders, for whom correct assessment of borrowers' applications is essential to their survival in the market.

In economic terms, the consultation and the maintenance costs of such a comprehensive registry will be added to the bill of credit grantors, and ultimately to borrowers, whether good or bad payers, and will have a special impact on smaller lenders and low-value loans. The higher cost of a positive

registry is due not only to changes in its structure, the larger number of files treated or the complexity of these files, but also to input of the data and follow-up¹² procedures for these institutions. This, in turn, creates increasingly complex demands, such as the registration of revolving credit, e.g. the need to determine whether new credit only or unused available credit should be included in a particular case.

On the other hand, credit institutions might be tempted to use predatory practices made possible by access to positive information and might exceed acceptable limits in granting credit to 'good payers', in order to attract them to their institutions. Moreover, since credit bureaus are based on reciprocity, stored data will be available to all those inputting data into the registry, which, in the case of positive data, represents a sizeable number of organisations. This, in turn, gives rise to further concerns about privacy.

4.3 Institutional implications of over-indebtedness

The measures intended to combat over-indebtedness vary between prevention, advice, support, recovery and future social rehabilitation. Currently, countries approach over-indebtedness in many different ways. These nationally divergent approaches may generate discriminatory treatment of consumers and distortions of competition between economic operators. There are many aspects involved, such as consumer-training and education on debt, regulation of credit contract terms and practices of finance providers, the role of intermediaries, risk information, credit recovery procedures and the consequences of over-indebtedness in terms of bankruptcy proceedings. All the elements of the regulatory regime complement one another; their combination results in, more or less, restrictive credit environments.

Diverse legal systems have different economic implications, and bankruptcy laws are one of the elements that deserve explicit mention. The few studies that have been conducted on the impact of bankruptcy laws on credit in an economy are based on the experience of the US market. European provisions on debt settlement and bankruptcy are further proof of the diversity of EU national retail credit markets. This report does not aim to go in-depth to study these differences, but to present basic facts.

The limits to the open credit society

American law has a lax approach to individual bankruptcy that tends to avoid the problems of liquidation and discharges the borrowers based on the 'good faith' assumption. In the United States, consumer bankruptcy (Chapters 7 and 13 of the US Bankruptcy Code) is designed to give debtors a 'fresh start' at the expense of their creditors. After a household successfully files a Chapter 7 petition, its debts can be repaid only from wealth, and unsecured creditors cannot claim all the applicant's wealth. The law also establishes a wealth threshold for the discharge of unsecured debts. Under Chapter 13, the creditor is able to claim from the future income of the debtor, but the amount that can be reclaimed is also limited.

This 'fresh start policy' is founded on the concept of the 'self-made man'. It rests on the principle that consumers are economic operators in the market economy and that they should not be excluded from participating in the market after a situation of over-indebtedness. Over-indebtedness is considered a normal consequence of business activity and the effects should be internalised by credit providers.

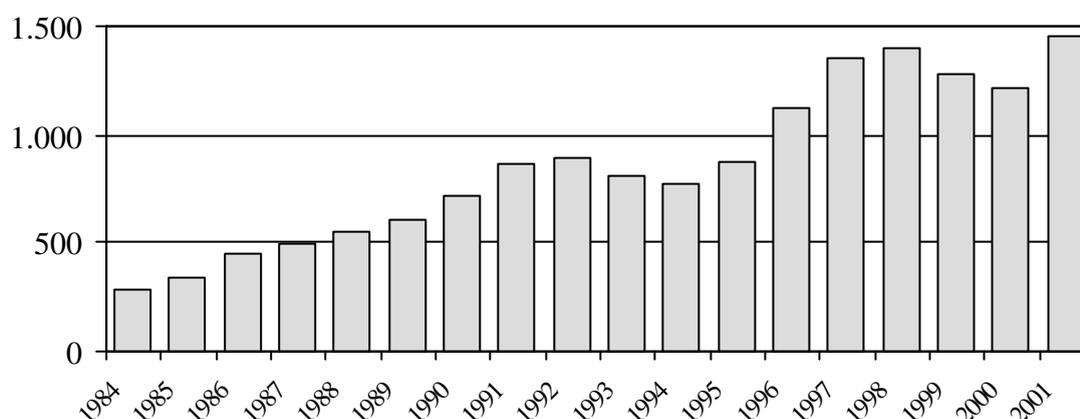
Under the US regime the individual himself or, once the debt reaches a certain amount, the creditors can request the initiation of bankruptcy proceedings, thereby opening the field to one of

¹² Australian laws allow for the recording of outstanding debts; however, these should be removed in the following 45 days to its settlement. Credit institutions therefore, generally opt for not including this type of information.

three possibilities: the rearrangement of debt, the adjustment of debt over a maximum period of five years or liquidation. In this respect, a similar system is in place in Germany, allowing for the liquidation of debtor assets or the rearrangement of debt (proving the good faith of the file applicant).

The system, however, has to be approached with caution since it might lead to the strategic use of bankruptcy. The recent explosion in personal bankruptcy filings in the US has motivated research into whether credit markets are being adversely affected by generous legal provisions. Personal bankruptcy filings have risen over 500% in the last two decades, with more than 1.2 million individual filings for the year ending 31 March 2001, either under Chapter 7 or 13. Research indicates that at least some of the individuals that voluntarily filed for bankruptcy under Chapter 7, which wipes out unsecured debt, appeared to have the economic capacity to repay a significant portion of their debts within a repayment plan.¹³

Figure 4. US personal bankruptcy petitions
(Twelve months, ending 31 December)



Source: CRC (2002). Data presented by the Credit Research Centre (CRC) at ECRI meeting 7 June 2002.

Furthermore, filing statistics may understate the importance of personal bankruptcy in the US as many debtors may implicitly use the threat of filing to evade collection efforts by their creditors (Hynes and Berkowitz, 1998).

The 'democratisation' of bank credit cards made credit more accessible to financially vulnerable borrowers, with lower income households having a growing percentage of credit cards. The vigorous expansion of credit opportunities has brought portfolio exposure to households living closer to the brink of payment troubles. Delinquency rates in credit cards have remarkably increased since 1995, and a reduction should not be expected in the near future.

In 1997, card issuers had gross losses of 6.6% of their portfolio, falling to 5.9% once recoveries are taken into account (OECD, 2001). The US credit card industry has benefited from the expansion of credit cards to the lower-income segments and has adapted to default levels that would have shaken-up risk management departments a decade ago.

¹³ Chapter 13 gives a debtor the opportunity to restructure his or her debts using future earnings without filing for bankruptcy.

The democratisation of credit, generous exemptions (safety levels) of bankruptcy laws, the reduction of the stigma associated with bankruptcy and the growing availability of post-bankruptcy credit are the factors behind the growth of households filing for bankruptcy in the US. Endorsing these findings the US is trying to move to a more restrictive regime for the discharge of personal bad debts.

The 'European model' is based on the re-education of the consumer: the consumer has failed to meet his moral obligations to society and should therefore bear the responsibility. Within the welfare system, over-indebted consumers are viewed as victims and should therefore be assisted. Latin countries put the onus on the sanctioning of borrowers that do not face their financial obligations, whereas Anglo-Saxon legislation tends to be more lax. In general, European citizens do not have access to lax individual bankruptcy provisions, and many countries tend nowadays to focus on the establishment of efficient extra-judicial debt settlement arrangements. So far attempts have not been as successful as they have been lengthy.

Bankruptcy provisions, however, are not the only legal element that affects the credit market. Based on the Italian market, Fabbri and Padula (2001) study the impact of legal enforcement systems on credit relationship between banks and consumers.¹⁴ They conclude that a badly functioning judicial system may cause households to be credit constrained, because banks would shelter their revenues by demanding a minimum amount of collateral, which will be higher for less efficient judicial systems. Second, the working of the judicial system can affect the amount of debt granted to all consumers, through its impact on the cost of credit; all things being equal, the cost of debt is lower where justice works better.

As we have seen, the issue of over-indebtedness has many facets. It is very important to ensure that changes in the regulations in the field of indebtedness are not disproportionate to the size of the loan and that they bring benefits to the consumer.

Prevention is the first key element to combat over-indebtedness. The occurrence of over-indebtedness can be reduced by making the partners involved more responsible, by facilitating access to information and by introducing changes to the existing insurance system. Consumer information and responsible lending should be present in any public policy strategy. It is accepted that consumers are not always aware of all the financial and legal aspects of borrowing, and often enter into contracts that are cumbersome and confusing.

Recently, legal initiatives in the field of credit, such as the forthcoming revision of the Consumer Credit Directive, have begun to target over-indebtedness. In order to reduce this phenomenon, the potential contribution of positive information provided by credit bureaus is being assessed. As mentioned earlier, the levels of over-indebtedness can hardly be related to the credit-reporting environment. Moreover, individual action, targeted at one of the elements, would not be useful if it is not complemented by other action in terms of prevention, consumer education and a legal framework comprising marketing practices, settlement procedures and bankruptcy provisions. All of the elements of the regulatory regime should be taken into account, bearing in mind that strong punitive laws will discourage borrowing, while laws that are too lax will make borrowers less cautious, thereby eventually reducing lending and increasing the cost of borrowing.

4.4 The challenge of the single retail credit market

As indicated in section 2, borrowers may have an incentive to signal their true risk level (if it is low) or to disguise it (if it is high). This asymmetry of information becomes more acute when dealing with cross-border credit. In fact, statistical evidence suggests that in practice a single credit

¹⁴ By assuming that the behaviour of legal institutions affects the liquidation value of the assets pledged as collateral by the borrower.

retail market does not exist.¹⁵ The importance of the availability and quality of information on the borrower's credit history is even greater in the event of cross-border credit to consumers established in different member states than that of the credit institution.

Over time, lenders learn to solve part of the problem created by asymmetry of information by maintaining a continuous relationship with the borrower; acquiring 'proprietary' information about their creditworthiness, and therefore a certain degree of informational monopoly about their customers, and thus market power. Credit institutions operating on a cross-border basis that do not have experience in the market will face more difficulties in assessing the creditworthiness of borrowers and in identifying 'good' and 'bad' borrowers than will national financial institutions. Moreover, consumers with negative records who are unable to obtain credit in their home country will be tempted to seek credit elsewhere.

Figures provided by the Belgium public registry (NBB) show that the number of consultations that result in the appearance of a negative entry amounts to 6.3%, when the consumer involved is from the same country as the credit institution (i.e. Belgian consumer, Belgian bank). It increases, however, to 12-13% when the consumer is from a different country (Belgian bank, Dutch consumer).

Asymmetry of information is in this sense a barrier to the development of cross-border lending activities as retail lending remains highly concentrated and dominated by domestic banks. So far financial institutions have limited their cross-border activities to wholesale banking. In a scenario where there exists the exchange of information between credit bureaus and where financial institutions have access to credit reports across the European Union, the individual with a negative repayment history will be refused further credit, as would be the case in their home country. The availability of information on the past behaviour of borrowers is therefore essential to the development of a cross-border consumer credit market.

Obstacles to the development of a single credit reporting industry within EU countries are often public-policy induced, namely, by the existence of regulations that prevent the exchange of cross-border information. Italian banks, for example, are required to report any loans made by their foreign branches to the Italian public credit registry, but not to the host country credit registry. Similarly, Italian companies can borrow abroad without any report being filed with Italian authorities. The integration of the capital market thus implies that public credit registries are losing the capacity to provide full, accurate and reliable information on the overall credit situation (Japelli and Pagano, 1999).

Indeed, it is clear that optimising the exchange of information will reduce the risk of default in cross-border operations. The question therefore is how to construct the most adequate framework for the exchange of information across Europe. Several alternatives appear feasible, including the negotiation of bilateral agreements, the establishment of a pan-European network and the harmonisation of regulation via a directive from the European Commission.

Adding a new piece of legislation might not be necessary, as the European directive on data protection already establishes the basis for the cross-border exchange of information. The principle of free movement requires that one should be able to move personal data freely between member states, while safeguarding the right of the individual to privacy. Although the latter was not always guaranteed under national laws, invoking the principle of subsidiarity has led to some disparities within the EU since adoption of the EU directive.

¹⁵ For instance, in the case of the Netherlands cross-border lending amounts only to 5% of total lending to individuals, 3.6% in Denmark and as little as 1.2% in France.

European credit bureaus are planning to establish cooperative agreements to provide lenders with cross-border information. It is not possible to say when these agreements will become effective, however, since differences in various data protection regulations covering the information collected, as well as technical and organisational problems have not yet been resolved. It remains to be seen which position the European Commission will adopt in the revision of the consumer credit directive.

In addition, some national registries have signed bilateral cooperation agreements, as can be seen in Belgium and the Netherlands, Belgium and Germany, Germany and Austria, and Germany and Italy.

The development of a truly integrated retail credit market requires the establishment of an integrated reporting system, where records are easily available to cross-border operations. Some argue that the different privacy regimes represent 'protectionist' barriers. National regulators have protected the status quo of information flows and data collection (Jentzsch, 2001). Moreover, legal and institutional determinants of lending and defaults affect the comparison of data across countries.

5. Conclusions

The exchange of a certain amount of information regarding the financial and payment history of borrowers is necessary to the development and smooth functioning of financial markets. Scale economies of gathering, processing and screening credit and non-credit information justify the existence of credit bureaus. Recent technological improvements have reduced the cost of collecting information and also the cost of sharing that information through credit bureaus. At the same time, however, there is an obligation to preserve the right of the individual to privacy concerning his or her financial transactions. A balance must therefore be found between the flow of private information and the development of efficient markets. The present data protection directive only provides for the harmonisation of minimum standards, and thus, further convergence of national data protection laws is also desirable to ease market integration.

The importance of the availability and quality of information on the borrower's credit history is even more important for cross-border lending. Borrowers with a bad repayment history are tempted to seek credit elsewhere. The improvement of cross-border exchange of information is therefore essential for the development of a single retail credit market. In this area, there is a role for public policy actors in removing any obstacles to the exchange of information, and ensuring that fears of competition from domestic institutions do not hinder the development of cross-border lending.

Public and private credit bureaus can work independently or in a complementary fashion but the obligation to consult public credit bureaus is likely to upset this balance. Public credit registries are considered important for economic policy-makers, allowing them to have first hand information in the evolution of credit and over-indebtedness in a country. Private credit bureaus may decide to specialise in a particular sector or to offer credit-scoring services. Consequently, the creation of a level playing field for the operation of both types of bureaus is crucial, and it should be left to the market to decide on the preferred option.

Credit bureaus are key actors in the assessment of an individual's ability to repay incurred debts and can serve as valuable disciplinary instruments vis-à-vis borrowers. This should not, however, lead to the conclusion that credit bureaus can provide perfect or quasi-perfect creditworthiness assessments. It might be tempting to believe that the incidence of default in a scenario involving positive credit bureaus is the result of irresponsible lending behaviour by credit institutions, and that therefore the burden of dealing with over-indebtedness should be passed on to them. Evidence from the US, however, where the percentage of accounts that are delinquent at any point in time is higher than in most EU countries, demonstrates that the collection of comprehensive information by credit bureaus does not ensure the ability to anticipate the occurrence of situations of over-indebtedness.

The data on over-indebtedness in the EU are too sparse and heterogeneous to allow us to establish any relationship between the level of over-indebtedness in a country and the type of credit bureaus existing in a country, or to assess the relationship between indebtedness and over-indebtedness. One should therefore be attentive to the qualitative aspects of over-indebtedness and the reasons that cause it. Evidence from existing data shows that factors other than the accumulation of debt are the main causes for excessive indebtedness. Also, the distribution of indebtedness – consumer, mortgage or other credit – plays an important role. Over-indebtedness is closely linked to the socio-economic context of households, such as unsteady employment, a death in the family or the break-up of the family unit – factors that cannot be reflected in credit bureau data.

Consequently, the collection and maintenance of more comprehensive information on certain expenditure patterns of households, such as the amount dedicated to rent, utilities or education, will not necessarily eliminate the occurrence of over-indebtedness. On the other hand, the collection and maintenance of adequate positive data will significantly increase technical, personnel and financial requirements of credit bureaus, raising the cost for credit institutions, which will ultimately be reflected in the cost of loans for consumers.

In terms of prevention of over-indebtedness, it is essential to provide education, information and advice on credit conditions, the risks of excessive multiple debts and rational household budget management. On the provider's side, it is essential to guarantee that marketing practices are not misleading and that contractual terms are clear. Consumer information, responsible lending practices and the legal environment should be balanced in any public policy strategy.

References

ABB (Association Bancaire Belge) (1996), Enquête statistique sur les causes de défaillance en matière de prêts et de ventes à tempérament.

Alary, D. and C. Gollier (2001), 'Strategic default and penalties on the credit market with potential judgement errors', EUI working paper.

Bagnato, P., D. Capuzzo and K. van Toorenburg (2000), *Retail Credit Survey*, 9, Assofin – Criff – Prometeia Calcolo, Italy.

Banco de España, (2000), 'Los establecimientos financieros de crédito. Actividad y resultados 1999', Boletín Económico, Septiembre, Madrid.

Banasik, J., J.N. Crook and L.C. Thomas., *Re-calibrating Scorecards*, University of Edinburgh, Edinburgh.

Banque de France (2000), *Over-indebtedness of individuals*, Fact sheet no. 119, France.

Barron, M. and M. Staten (2000), *The value of comprehensive credit reports: Lessons from the US experience*, Credit Research Centre, Georgetown University, Washington, D.C.

Dell'Araccia, Giovanini (1998), 'Asymmetric information and the market structure of the banking industry', International Monetary Fund.

Dti (Department of Trade Industry) (2001), Report of the Task Force on Tackling Overindebtedness, London.

Economic and Social Committee (2000), Information report of the section for the single market, production and consumption on household over-indebtedness, CES 212/2000 fin, Brussels.

Economic and Social Research Council (2002), *How people on low incomes manage their finances*, Swindon.

Fabbi, D. and M. Padula (2001), 'Judicial costs and household debt', Working Paper, 65, CSEF University of Salerno.

FTC (US Fair Trade Commission) (2000), Privacy online: Fair information practices in the electric marketplace, Report to the US Congress.

Filotto U. (1999), *Manuale del credito al consumo*, EGEA, Milano.

Félix, F. (1996), 'Belgique: vers un fichier positif?', speech at the reunion d'information – reflexion de l'Asffor, Paris.

Galindo, A. and M. Miller (2001), Can credit registries reduce credit constraints? Empirical evidence on the role of credit registries in firm investment decisions, Inter-American Development Bank.

Grant, C. (2000), 'Bankruptcy, credit constraints and insurance: some empirics', Working paper, 40 CSEF, University of Salerno.

Hyst, J.J. and P. Loridant (1998), 'Surendettement: Prévenir et Guérir', Rapport d'information, 60, Senat, France.

Hynes, R. and J. Berkowitz (1998), 'Bankruptcy exemptions and the market for mortgage loans', FEDS 1998 papers, Federal Reserve Board, Washington, D.C.

Japelli, T. and M. Pagano (1999), 'Information sharing, lending defaults: Cross-country evidence', Working Paper, 22, CSEF, University of Salerno.

Japelli, T. and M. Pagano (2000a), 'Information sharing in credit markets: The European experience', Working paper, 35, CSEF, University of Salerno.

- Japelli, T. and M. Pagano (2000b), 'Information sharing in credit markets: A survey', Working paper, 36, CSEF, University of Salerno.
- Jentzsch, N. (2001), 'The economics and regulation of financial privacy – A comparative analysis of the United States and Europe', working paper 128/2001, John F. Kennedy Institute of North American Studies, Berlin.
- Khalil, F. and B.M. Parigi (2001), 'Screening, monitoring and consumer credit', EUI working papers.
- Koford, K. and A.E. Tschoegl (1997), *Problems of bank lending in Bulgaria: Information asymmetry and institutional learning*, Financial Institutions Center, The Wharton School, University of Pennsylvania.
- Lehnert, A. and D.M. Maki (2002), 'Consumption, debt and portfolio choice: Testing the effects of bankruptcy law', FEDS 2002 papers, Federal Reserve Board, Washington, D.C.
- Mason Solicitors (1998), Handbook of cost effective compliance of Directive 95/46/EC.
- Miller, M. (2000), Credit reporting systems around the globe: The state of the art in public and private credit registries, World Bank, Washington, D.C.
- OECD (2001), *Economic Surveys*, United States, OECD, Paris.
- ORC MACRO, (2002), Study of the problem of consumer indebtedness: Statistical aspects, London.
- Reidemberg, J.R. and P.M. Schwartz (1998), *Data protection law and on-line services: Regulatory responses*, study commissioned by DG XV of the European Communities to ARETE.
- Rubini, H.J. (2000), 'De-regulated credit bureaus: Could they raise credit rationing?', paper available at Universidad del Salvador.
- Staten, M.E. (1999), *Evidence on bankrupt debtors' ability to pay*, Credit Research Center, Washington, D.C.
- Thomas, L.C. (2000), A survey of credit and behavioural scoring: Forecasting financial risk of lending to consumers, University of Edinburgh, Edinburgh.
- Vissol, T. (2000), Intervention of Mr. Vissol at the Eurofinas 2001 Varsaw conference.
- Wahl, C. (1997), Credit assessment yesterday, today and tomorrow, UC AB, Stockholm.

Annex I. Definitions

Credit bureaus	Organisations collecting, filing and distributing information, positive or negative, on borrowers.
Credit report	Information facilitated by the credit bureau to the potential lender on the future borrower containing details on an individual's debts, following the request of credit by the individual.
Credit scoring	Statistical programmes that establish the probability of repayment, or risk, of granting a credit. The bank might refuse a credit if its <i>score</i> is superior to the level of risk that the bank is willing to accept.
Default	Failure to repay a credit.
Fresh start	The characterisation of a debtor status, i.e. free of most debts. Giving debtors a fresh start is one of the purposes of the US bankruptcy code.
Negative information	Records consisting of delinquent borrowers, such as default payments, chargeoffs or bankruptcies. Also called <i>black</i> information.
Positive information	Records consisting of individuals with different outstanding type credit that have not necessarily failed to repay. It often includes the amount of the loan, the outstanding balance or revolving credit. Also called <i>white</i> information.
Public registries	Organisations established by central banks or supervisory authorities that collect, file and distribute information on borrowers' credit history. Financial institutions' reporting is compulsory.
Strategic default	When a consumer can repay a credit but decides not to do so.

Annex II. Data Protection Laws in the EU Member States

Country	Legislation
Austria	Federal law on data protection, 1978 amended 1986 Transposition directive 95/46/CE: Data protection act 2000
Belgium	Privacy protection law, 1992 Transposition directive 95/46/CE: Law 1998 Arrête royal du 13 mars 2001 portant exécution de la loi du 1992 relative à la protection des données personnelles Loi du 10 août 2001 relative à la Centrale des Crédits aux Particuliers
Denmark	Transposition of directive: Act on the processing of personal data, law 429, 31 May 2000. The act substitutes 'the public authorities' registers Act' and 'the private registers Act'
Finland	Databases on personal information, 1987 amended 1995 Transposition directive 95/46/CE: law 523, 10 February 1999
France	Law 78-17, 6 January 1978 on 'Information technologies, databases and liberties' Transposition directive 95/46/CE: Proposed
Germany	21 January 1977 federal law covering the protection against the abusive use of databases of personal data, modified by the protection of data law of 20 December 1990 and amended on 14 September 1994 Transposition directive 95/46/CE: proposed
Greece	Law 2472 on the protection of individuals regarding the use of privacy information databases, 26 March 1997 Law 2472
Ireland	Data protection law of 13 July 1988 Transposition directive 95/46/CE: proposed
Italy	Law 675 of 31 December 1996, on the data protection, modified in 1997, 1998 and 1999 Transposition directive 95/46/CE: effectuated by the above law Law 325 on security measures in the treatment of personal data, 3 November 2000
Netherlands	Legislation on data protection, 28 December 1988, completed on 21 June 1990 by a law on police data Transposition directive 95/46/CE: 6 June 2000
Luxembourg	Legislation on the use of personal data in information techniques, law of 31 March 1979, amended 1992

	Transposition directive 95/46/CE: Proposed
Portugal	Law 10/91 on protection of data of personal character in the information techniques, 29 April 1991, amended 1994 Transposition directive 95/46/CE: Law 67/98 26 October on data protection
Spain	Law on the treatment of personal data by electronic means, 29 October 1992 Transposition directive 95/46/CE: Law 15/99 personal data protection, 13 December 1999
Sweden	Law on data protection, 11 May 1973 <i>Transposition directive 95/46/CE: Law 204 on data protection, 24 October 1998</i> Credit Information Act
UK	Law on data protection, 12 July 1988 Transposition directive 95/46/CE: Data protection law, 16 July 1998 Law on access to information, 30 November 2000

ECRI PUBLICATIONS LIST

ECRI Research Reports

No. 4 *Credit Bureaus in Today's Credit Markets*, Amparo San José Riestra, September 2002

No. 3 *Consumer Credit Legislation in the Central and East European Countries*, Krisztián Csáky and Judit Kerékgyártó, July 2002

No. 2 *Consumer Credit Rates in the Eurozone: Evidence on the Emergence on a Single Retail Banking Market*, Stefanie Kleimeier and Harald Sander, January 2002

No. 1 *Consumer Credit in the European Union*, Nuria Diez Guardia, February 2000

Joint ECRI/CEPS Working Party Report

No. 38 *Regulating E-Commerce in Financial Services*, Nuria Diez Guardia, October 2001

These reports are available for free downloading from either the ECRI website (www.ecri.be) or the CEPS website (www.ceps.be). To order any of these publications in printed form, please contact the CEPS Publications Office: tel: 32.(0)2. 229.39.11 or fax: 32.(0)2. 219.41.51.