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ASSESSING THE IMPACT OF CREDIT DATA ON PREVENTING OVER-INDEBTEDNESS,  
CONTRIBUTING TO PRUDENTIAL REGULATION AND FACILITATING ACCESS TO  
AFFORDABLE AND QUALITY CREDIT

***About FSUG***

*The Financial Services User Group (FSUG) is an expert group set up by the European Commission following the core objective “to secure high quality expert input to the Commission’s financial services initiatives from representatives of financial services users and from individual financial services experts”. The mandate of the group is to:*

- *advise the Commission in the context of the preparation of legislative acts or other policy initiatives affecting users of financial services, including consumers, retail investors and micro-enterprises;*
- *provide insight, opinion and advice concerning the practical implementation of such policies;*
- *proactively seek to identify key financial services issues which affect users of financial services;*
- *where appropriate, and in agreement with the Commission, liaise with and provide information to financial services user representatives and representative bodies at the European Union and national level, as well as to other consultative groups administered by the Commission, such as the European Consumer Consultative Group, the Payment Systems Market Expert Group, the European Securities Markets Expert Group and the Expert Group on Financial Education.*

## Assessing the impact of credit data on preventing over-indebtedness, contributing to prudential regulation and facilitating access to affordable and quality credit

The extensive use of credit data has been promoted by a number of stakeholders, with the claim that it will help achieve a number of policy objectives:

- Prevent over-indebtedness by limiting irresponsible/predatory lending<sup>1</sup>
- Contribute to financial stability by limiting banks' credit loss risks<sup>2</sup>
- Facilitating the access to a more affordable and better quality credit for consumers<sup>3</sup>

This paper builds on the FSUG discussion paper entitled "**Consumer data and practices of creditworthiness assessment**" which has covered many key questions related to use of credit registers and creditworthiness checks. After an overview of the policy contexts and the different policy objectives that credit registers seek to achieve, the discussion paper goes on to explore the types of credit data available in credit registries, to what ends the data is used (e.g. fraud prevention, marketing, scoring...) and the difference between public and private credit registers. Finally, the discussion paper reviews major challenges facing the growing use and reliance on credit data such as ensuring the data's quality, transparency (access to the data and information about how it is used), security of the data, cross-border exchange of data, competition, data protection and consumer protection.

While this paper only covers **credit registers**, the FSUG wishes to underline that this is part of a much larger scope and discussion, around big data and the use of information from other sources such as the Internet and social networks in assessing creditworthiness and credit scoring. The use of other data sources besides credit registers will be covered in a broader paper about big data.

In this paper, we assess whether credit registers and the extensive use of credit data fulfils three essential policy objectives:

- 1) Do credit registers and the use of credit data help prevent over-indebtedness?
- 2) Do credit registers and the use of credit data contribute to a better access to credit at a more affordable cost?
- 3) Do credit registers and the use of credit data help fulfil prudential regulation and financial stability objectives (better manage and hedge risks...)?

While each of these questions deserves its own paper, we will carry out a basic comparison between the extent of data used<sup>4</sup> and key indicators of over-indebtedness<sup>5</sup>, cost of credit<sup>6</sup> and the exposure of financial institutions to credit defaults<sup>7</sup>.

The methodology to obtain the figures for the extent of credit data used is based on a simple sum of the type of information included in a credit register. For instance, including information on

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<sup>1</sup>[http://www.accis.eu/uploads/media/ACCIS\\_Response\\_to\\_FSUG\\_Position\\_Paper\\_October\\_2013.pdf](http://www.accis.eu/uploads/media/ACCIS_Response_to_FSUG_Position_Paper_October_2013.pdf)

<sup>2</sup><http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTGLOBALFINREPORT/0,,contentMDK:23489368~pagePK:64168182~piPK:64168060~theSitePK:8816097,00.html>

<sup>3</sup>OECD, Facilitating access to finance, <http://www.oecd.org/investment/psd/45324327.pdf>

<sup>4</sup>depth and breadth of data based on the ACCIS 2012 member survey

<sup>5</sup> DG SANCO study 2014 which relies on SILC surveys from 2008 and 2011:

[http://ec.europa.eu/consumers/financial\\_services/reference\\_studies\\_documents/docs/part\\_1\\_synthesis\\_of\\_findings\\_en.pdf](http://ec.europa.eu/consumers/financial_services/reference_studies_documents/docs/part_1_synthesis_of_findings_en.pdf)

<sup>6</sup> FSUG retail market integration data collection 2015.

<sup>7</sup> EBA bank stress tests: <https://www.eba.europa.eu/documents/10180/669262/2014+EU-wide+ST-aggregate+results.pdf>

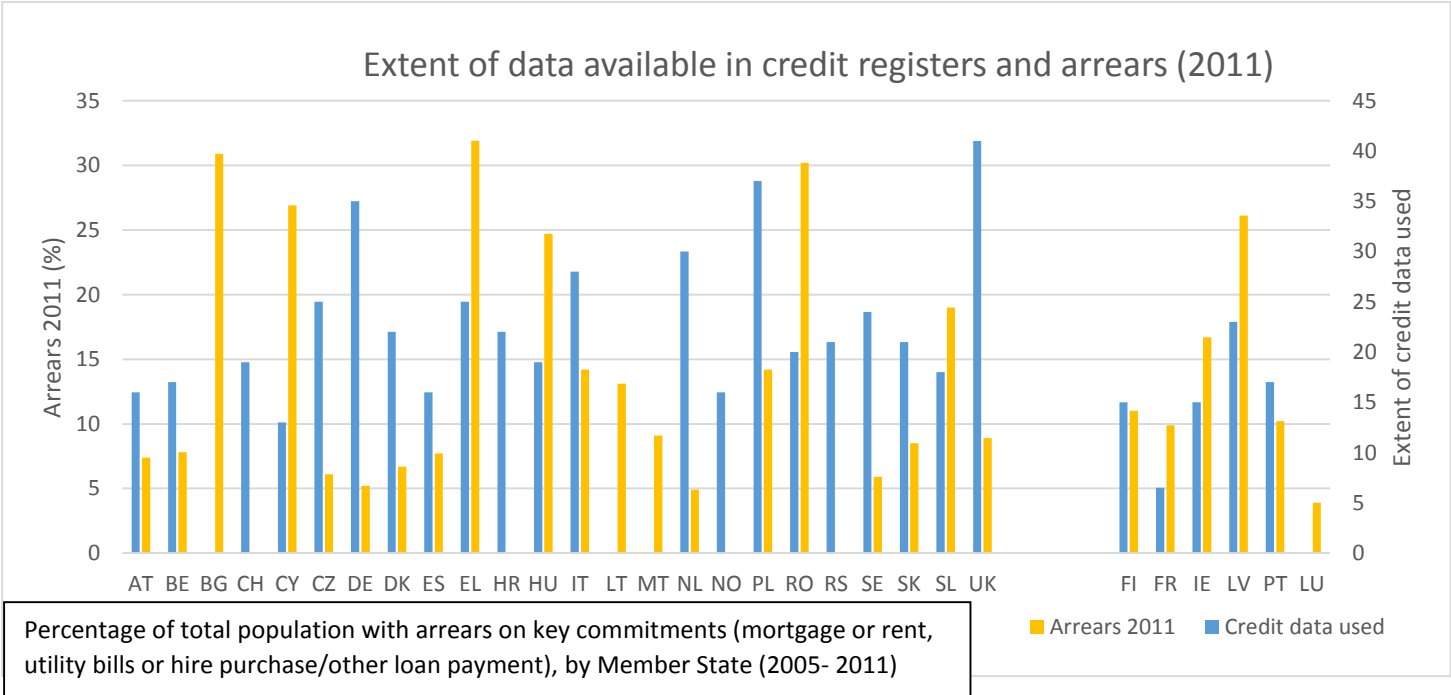
telecommunication bills will add 1 to the credit register’s figure on data use. For simplicity, there is no differentiation between the type of data used. This means that including the name of a consumer (which is universal to all credit registers) will have the same “weight” as collecting data about utility bills. Also, Finland, France, Ireland, Latvia, Portugal and Luxembourg are set apart from the other countries since the source used to calculate the extent of data used comes from a different source (the report of the Expert Group on Credit Histories from 2009)<sup>8</sup>.

Two observations can be made from these deliberate methodology choices:

- Firstly, the figures are inherently **conservative** in nature since credit registers with hardly no data at all such as the French credit register will still have a comparatively **high score** in their data use compared to more comprehensive credit bureaus since basic data such as the name, address, will account for the same value as more detailed data.
- Secondly, the figures only serve the purpose of finding out whether **using more data** has an impact on the policy objectives listed above. They say nothing about the business model of a credit bureau (public, private...) and its specific way of operating.

With that in mind, let us examine whether more credit data use helps achieve the following policy objectives.

1) Do credit registers and the use of credit data help prevent over-indebtedness?<sup>9</sup>

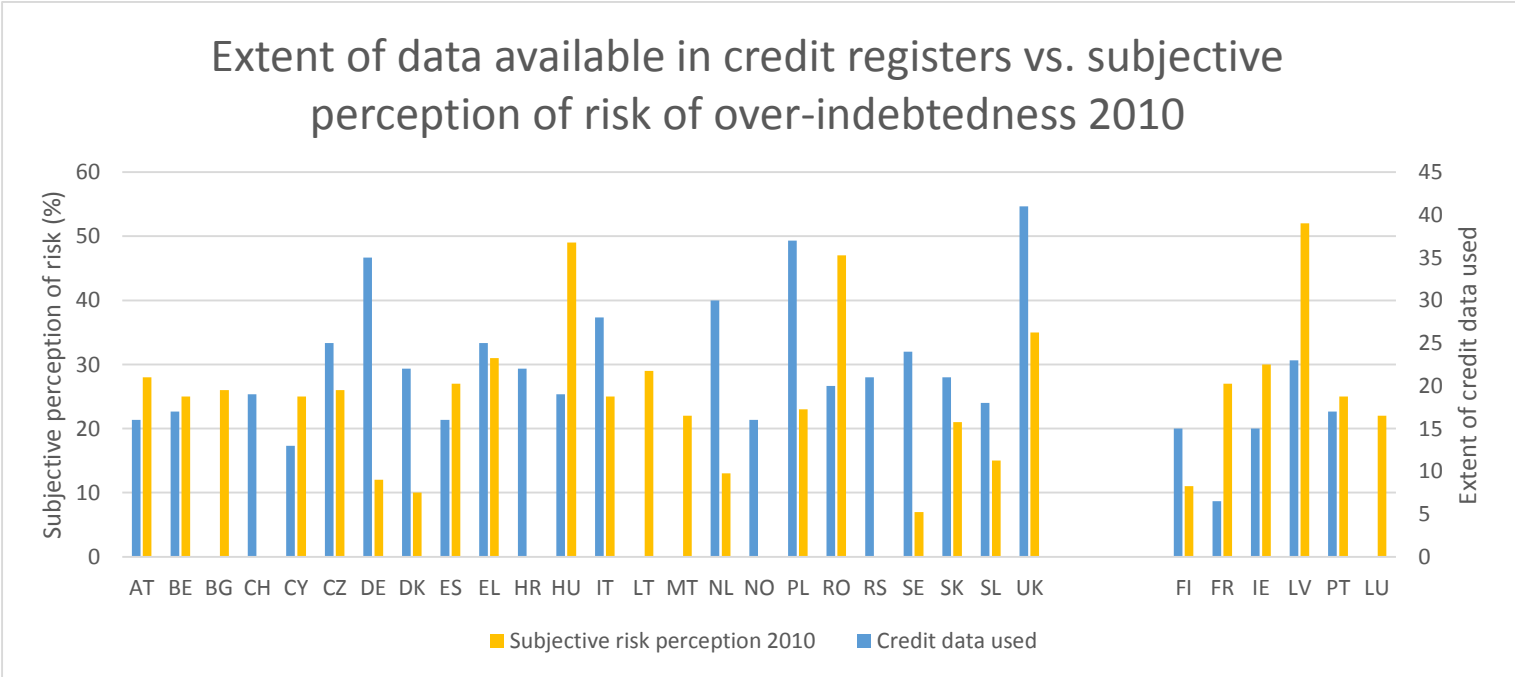


<sup>8</sup> Please note that some countries are in a special situation. For instance, France has only very limited data in the centralized credit register run by the Banque de France (negative data) but private banks have their own data about their customers in their databases. While French banks do not necessarily collect more data than other banks in Europe, they may hold more data than the French credit register and carry out scoring based on their own data and methods.

<sup>9</sup> The frequency of arrears data comes from the SILC study of 2011, table 7, p. 44. in the 2014 DG SANCO study on over-indebtedness.

Looking at the graph above, it is clear that no obvious links exist between the frequency of arrears in the different EU countries and the extent of credit data used. France, Spain, Finland, Portugal, Belgium and Austria have similar frequency of arrear levels with a limited use of credit data. The United Kingdom, the Netherlands and Germany also have comparable frequency of arrear levels with a very high use of different credit data. On the other hand, countries such as Poland have very high arrear levels while the use of credit data is high; Cyprus has a very high arrear levels while the use of credit data is relatively low.

It would seem that the level of arrears is much more dependent on other variables such as employment, income, social policies (unemployment benefits, social benefits...) than the depth and breadth of credit data used.

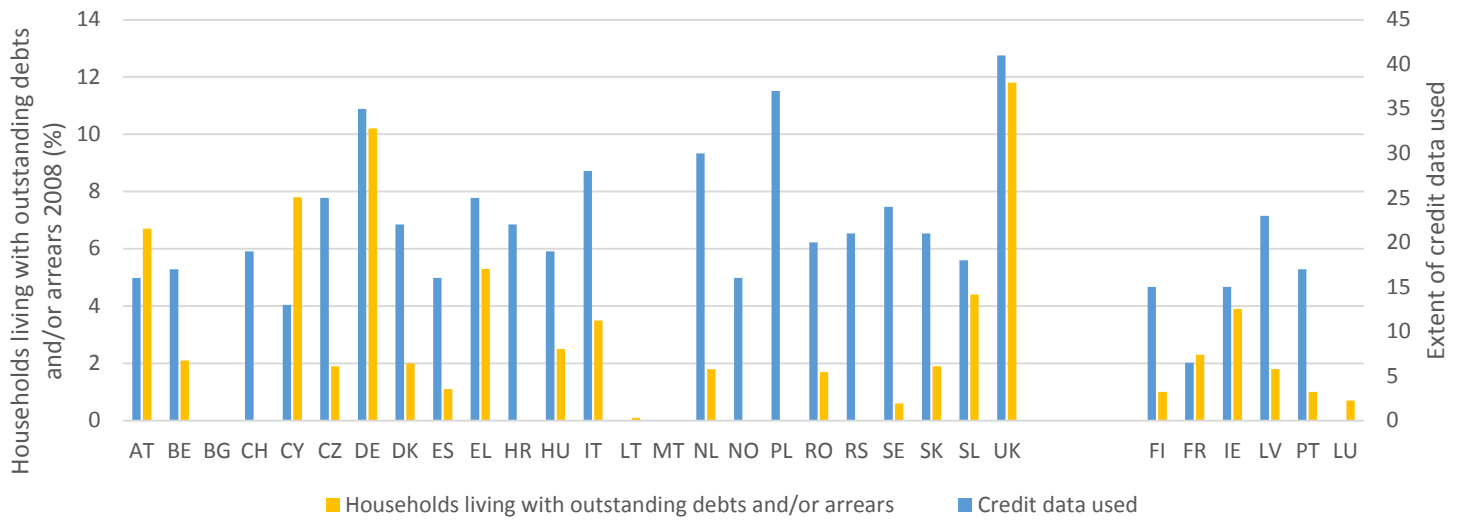


Comparing subjectively perceived risk of over-indebtedness<sup>10</sup> and the depth and breadth of credit data used, we can see that there is no apparent link either. The Netherlands, Germany, the UK and Poland, all of which use a comparable extent of credit data, have very different subjective perceptions of risk of over-indebtedness. The UK and Poland having high level perceptions of risk of over-indebtedness, Germany and the Netherlands having a low level. Countries like France or Luxembourg which use virtually no credit data still have a lower subjective perception of risk of over-indebtedness than the UK which uses the highest amount of credit data.

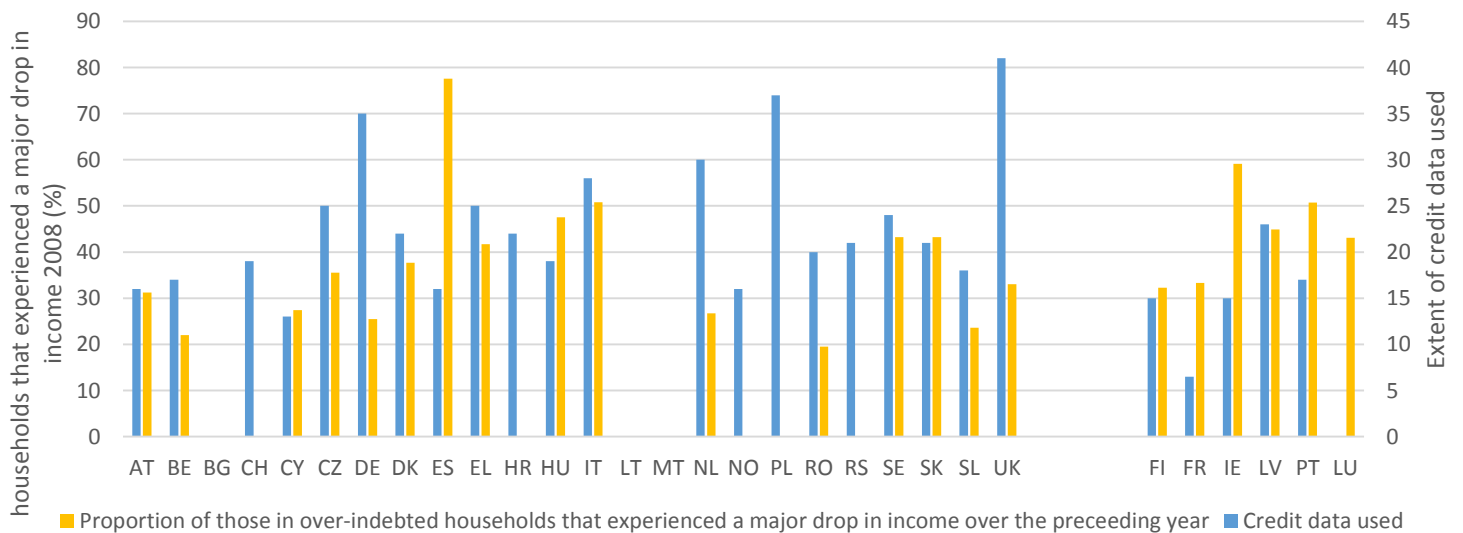
For countries using less credit data, the levels of subjective perception of risk of over-indebtedness varies greatly also, with Belgium, Austria, Slovenia, Slovakia, Cyprus, Portugal and Ireland having comparably low levels and Hungary, Romania and Latvia with extremely high levels.

<sup>10</sup> Eurobarometer: poverty & social exclusion reports, asking “how much you feel you are at risk of being over-indebted” (percentage of total respondents)

Households living with outstanding debts and/or arrears (SILC 2008) vs. extent of credit data used



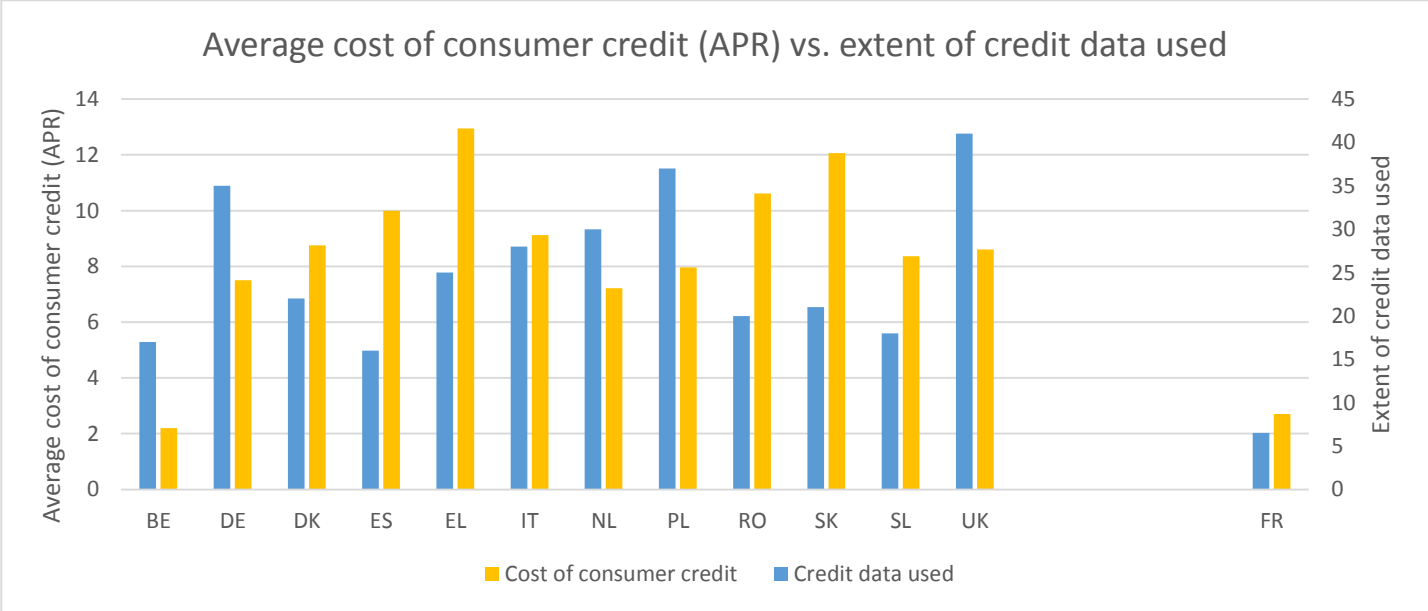
Proportion of those in overindebted households that experienced a major drop in income in the preceding year (SILC 2008) vs. extent of credit data used.



The two additional charts above look at households living with outstanding debts and/or arrears and at the proportion of those in over-indebted households that experienced a major drop in income over the preceding year. Again, we can see that an extensive use of credit data is unrelated to both. For countries like Germany and the UK in the first chart, which use credit data extensively, the number of households living with outstanding debts and/or arrears is higher than many other countries.

Regarding the second chart, countries using a high amount of credit data do not have much lower proportions of over indebted households that experienced a major drop in income over the preceding year. Germany, the Netherlands and the UK have comparable levels to countries like Cyprus, France, Austria, Finland, Belgium, Slovenia and Romania, all of which use comparatively lower amounts of credit data.

2) Do credit registers and the use of credit data contribute to a better access to credit at a more affordable cost?<sup>11</sup>

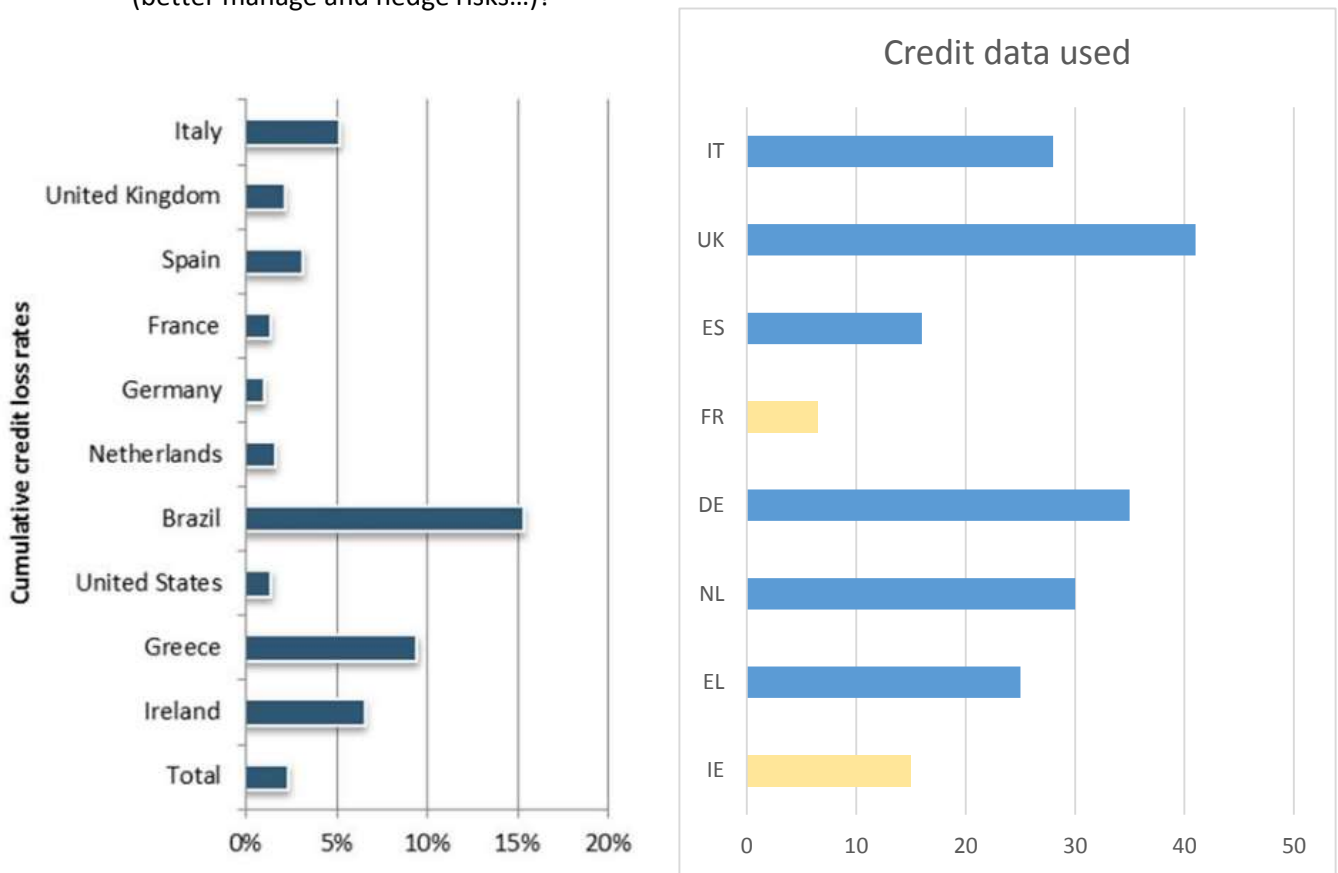


Looking at the relation between the cost of credit and the extent to which credit data is used, there is no link between a higher use of credit data and cost benefits for consumers. In some countries like the UK, this seems to have the opposite effect. One possible explanation is that due to the fact that banks have access to more data and especially, more **personalized** data about their clients, they can apply much more precise **individual risk based pricing** which of course enables the richest and least at risk of accessing credit at a much cheaper rate and the most vulnerable to pay extremely high risk premiums.

In countries with less credit data, it can be argued that banks have to carry out some form of **mutualisation of risk** to ensure that they hedge the risk of default on a more "global" scale rather than an individual scale. Comparing Germany and the Netherlands to France and Belgium, this seems to hold true. While these countries enjoy a relatively similar economic and social situation, cost of credit in Belgium and France is much cheaper than in the Netherlands and in Germany.

<sup>11</sup> Data source: FSUG retail market integration data collection 2015.

3) Do credit registers and the use of credit data help fulfil prudential regulation objectives (better manage and hedge risks...)?



Cumulative credit losses (impairments of financial assets other than instruments designated at fair value through P&L) relative to December 2013 exposure and coverage of defaulted exposures with provisions 2016 in the adverse scenario – by regulatory exposure class and for selected countries of the counterparty.

As we can see above, there is no apparent link between credit loss rates and the depth and breadth of credit data used by credit bureaus. France has credit loss rates comparable to the Netherlands and Germany while it collects virtually no data at all. Spain has comparable credit loss rates to the UK, while it collects much less data. Finally, Greece collects as much data as Italy but has very high credit loss rates.

Again, other factors such as the general economic context may be more useful in explaining credit loss rates rather than the availability of credit data. However, only limited conclusions can be drawn from this graph as in order to assess properly the impact of credit data on prudential regulation, we would also need to distinguish between credit registers which are mandated by the government to have a prudential regulation role and those that do not have such a mandate.

## Conclusion:

The business of lending money has existed for over three millennia now. The banking and insurance industries have been developing risk hedging models for most of that time, relying on global data. One of the first insurance schemes was used in Rhodes (Greece), where merchants used the average number of boats capsizing or being looted to insure the value of lost goods. Of course, systemic risk has always been an issue, but in general, global averages of accidents happening sufficed to hedge risk.

Credit registers, on the other hand, are a more recent phenomenon. The first credit registers were developed in the middle of the 19<sup>th</sup> century and were rather limited in scope. The trend to individualize risk assessment has been accelerating in recent years, and the question of whether it has had a positive impact on consumer protection, responsible lending and borrowing, prudential regulation or access to credit or insurance is unclear.

The FSUG found no evidence that increased credit data availability has helped prevent over-indebtedness, support prudential regulation or facilitate access to affordable credit. What is certain, however, is that individualized risk based pricing has introduced new forms of discrimination. Examples can be found in health or car insurance where characteristics like age or gender are a source of discrimination. The business of lending is heading in the same direction, with lenders using a broad set of information to assess risk. Such data might include age, socio-economic background, level of education, gender, a history of genetic diseases or disabilities such as allergies or diabetes, and evidence about past and present behaviors (practice of dangerous sports, eating and drinking habits, smoking, money management, gambling habits). There is even a trend to ‘scrape’ individuals’ data from wider sources, including social media, and to use psychometric testing as a predictor of risk. This very wide use of information is generally referred to as ‘big data analytics’.

This individualization of risk means that vulnerable consumers, or those with thin credit files, can obtain credit, but only at very high prices, and at considerable loss of privacy. The use of large data sets also opens up possibilities for social discrimination based on factors that may, in practice, have little bearing on actual risk of default. As with investments, the past is not a good guide to the future.

Debates over increased demutualization of risk continue. The recent European Court of Justice judgment on gender discrimination in car insurance premiums represents a push back towards mutualisation of risk. At present, there is a discussion in France about the possibility of former cancer patients that have not had any further complications in the last 15 years not being required to declare their former disease when applying for credit or a mortgage loan<sup>12</sup>. This is a social policy initiative that considers that risks that are outside of an individual’s control should not lead to exclusion from products such as life insurance and credit, or excessive fees.

Developing a single market for retail financial products has also been used to justify the need for more credit data use to encourage cross-border lending. The data examined above, however, shows that basic creditworthiness checks should suffice to manage risk and such data is available in all countries except Luxembourg.

As the FSUG, we do not support more extensive use of credit data, unless the benefits to consumers can be demonstrated conclusively. We would also note that credit registers and creditworthiness

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<sup>12</sup>[http://www.lemonde.fr/sante/article/2015/03/24/s-assurer-apres-un-cancer-un-parcours-humiliant-et-absurde\\_4599985\\_1651302.html](http://www.lemonde.fr/sante/article/2015/03/24/s-assurer-apres-un-cancer-un-parcours-humiliant-et-absurde_4599985_1651302.html)



checks are of public interest, since European law<sup>13</sup> now mandates creditworthiness checks. The way that credit registers operate and the data they contain are therefore also of public interest.

Data protection is a further consideration. Credit data is invariably highly sensitive personal information, which is subject to data protection laws. The misuse of such data may also go against fundamental rights such as human rights and anti-discrimination laws (*Test-Achat v Council of Ministers*). Individuals may be prepared to sacrifice privacy in order to obtain credit, but may not appreciate the consequences of doing so.

### Policy recommendations

The FSUG's policy recommendations are directed at policymakers in the Member States, and the European Commission.

### *Policymakers*

The FSUG urges policymakers to make explicit the objectives of credit registers (for example, reducing over-indebtedness, financial stability, or better access to credit), and to examine whether credit data is used fairly and proportionally to achieve those objectives. Policymakers should also determine whether the way financial institutions use credit data is compliant with data protection and anti-discrimination legislation.

The FSUG also recommends that policy makers should develop an explicit national policy on the mutualisation of risk, based on the costs and benefits to consumers, and on social goals. This should be an active policy decision, similar to taxation and redistribution policies.

To assist with these tasks, the FSUG recommends that the Member States should establish a credit register expert group with representatives of civil society, consumer organizations, data protection authorities, public authorities, financial industry representatives and credit register representatives. The expert group should be responsible for assessing the way credit registers operate, whether their activities serve the stated public policy objectives. Ideally, the expert group should also be granted executive powers to decide which data should or shouldn't be included in the register. It should also be able to make recommendations about the adequacy of data protection legislation.

Some of these governance principles have already been adopted by credit data registers in the various Member States among which the Belgium and Dutch credit data registers.

### *European Commission.*

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<sup>13</sup> Mortgage Credit Directive and Consumer Credit Directive.

The FSUG calls on the Commission to encourage the Member States to adopt the recommendations above.

The FSUG also recommends that the Commission should carry out further research and gather better quality data on how lenders make decisions about whether to lend, and at what price. Does the use of more data in fact lead to better lending decisions (i.e fewer non-performing loans)?

The FSUG calls for the adoption by EU institutions of **high-level principles** framing the activity of credit registers:

- *Governance*: as explained above, credit registers should be subject to a mixed governance body supervising their activities composed of public authorities, data protection authorities, consumer/user organisations, civil society, financial industry representatives and credit register representatives. This governance body would have the mandate to ensure the respect of the principles below.
- *Access of data*: the data in credit registers should be free and easy to access for consumers. It's access by private entities should be subject to strong privacy protection standards and can only be shared with the explicit consent of the consumer (for instance, upon a visit to a local branch of a bank)
- *Right of redress*: consumers should have the right to an easy redress procedure in case of a mistake inside the credit register.
- *Use of data*: the data contained inside the credit register should be limited by the governance body above upon consensual decision and be proportional the aim of assessing creditworthiness, preventing over-indebtedness and ensuring responsible lending/borrowing. Consumers should have the right to know which entity consulted their data, when, and for what purpose.