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NEWS

Developments in the field of data protection

The European Commission renews its interest in the field of data protection. On one side, it seems very likely that a specific directive concerning data protection in the field of credit will complement the future up-date of the consumer credit directive. On the other side, there is the recent agreement on the directive on data protection in the telecommunications sector. New efforts are directed to the assessment of the 1995 Data protection directive.

The Commission was to ensure that the movement of data necessary to accomplish the functioning of business activities in the internal market does not hinder privacy protection. Recognising the need of financial institutions and insurers to keep data on their customers to carry out correct risk assessment, the Commission wants to know wants to know the view of those affected on the working of the data protection.

Accordingly, the Commission has made available two questionnaires, for business and consumer to express their views.

For more information see:
<http://europa.eu.int/comm/privacy>

Credit due for transparency

FT, Tuesday May 28 2002

Upheaval has arrived to the Mexican credit card market. Serfin bank has doubled its share in the market in the last few months by

launching an aggressive campaign to sell cheap credit. Its success is related to the reduction of interest's rates from the usual 40 percent to 24 percent. Despite the reduced size of the credit card sector, the effort of Serfin has not served to expand the market, and positive results come from the transfer of balances, not from new credit cards users.

Competitors in Mexico have quickly reacted reducing interests rates and exploiting the wariness of Mexicans to credit card after the 1995 banking difficulties.

Source: FT 28 Monday 2002

Change of approach in US financial privacy law

Financial privacy has become an important issue in the US. Recently, voters in the North Dakota state voted in favour of more restringing law providing them with more control over their personal financial data. Other states have defeated similar privacy bills. All eyes are directed to California, if the new provisions are approved that will represent a change of direction in the regulation of financial privacy in the US.

Up to present the Gramm-Leach-Bliley allowed institutions to share information freely within a group. If the proposed bill is approved in California it will force banks to ask customer's permission, or "opt-in", before sharing their personal data with third parties, and allow customers to "opt-out" from a bank sharing information with affiliates. The local Chamber of Commerce has already warned that it would

lead to large information processing and management problems, and would end a lot of normal business practices.

Stringent privacy codes are the norm in Europe, but would not fit in the US credit society, which has based the “democratisation” of credit (particularly credit card type products) in the existence of comprehensive databases of financial information collected by credit bureaus. The limitation in the exchange of data will impose changes in strategic areas such as marketing and risk management practices.

Source: FT, 27 June 2002

Distance marketing to consumers of financial services

In 1997, the EU adopted the Directive 97/7 on distance selling of goods and services, excluding from its scope financial services, as the European Commission considered necessary to have specific legislation to allow the development of an internal market for retail financial services. In 1998, the European Commission decided to present a proposal for Directive on distance marketing to consumers of financial services (credit cards, investment funds, pension plans sold by telephone, fax or e-mails).

Due to their intangible nature, financial services are indeed particularly suited to distance selling. An offer by an *e-mail*, an *e-signature* and an *e-payment* and the contract is celebrated... with all the risks involved for consumers. In this context, the main objective of the proposal was to adopt mechanisms designed to enhance consumers and investors confidence

In 1999, Council and the European Parliament ask the European Commission to put forward a modified proposal, bearing in mind the full harmonisation level of the proposal and the need to ensure a clear alignment with existing provisions. The main features of this new initiative are:

- **Broad definitions covering all kind of distance contracts**, including those in which the supplier exclusively employs means of distance communication;
- Prohibition of abusive marketing practices aiming at selling unsolicited services. Members States are free to choose between the "**opt-in**" option (prohibition of cold calling and spamming without the consumer authorisation) or the "**opt-out**" option (prohibition of cold calling and spamming after the consumer objection);
- Sellers' commitment to provide consumers with a **package of information** prior to the conclusion of the contract. The information is based on a list of requirement and is in line with others sectoral Directives (e.g. prospectus, ISD);
- Communication of the **contractual terms and conditions** in writing and on a durable medium before the signature of the contract;
- Provision of a **consumer right of withdrawal** within 14 to 30 days after the contract signature, without having to indicate grounds and without penalty. Several exceptions are addressed by the Directive;

- Performance of the contract and payment of the service provided prior to withdrawal is a case specially protected;
- Maximum time limit for reimbursement in case of unavailability of the service;
- Payment by card and cancellation in case of fraudulent;
- Judicial, administrative or out-of-court redress for the settlement of disputes.

For more than 2 years, the Council had major difficulties in finding a Common Position on the proposal. Disaccording points were mainly the list of information items to be provided to consumers. In practice, the Council was totally divided between a minority of Members States in favour of maximum harmonisation (UK and Netherlands), whereas the majority supported minimum harmonisation. Finally, the Council agreed to a high level of harmonisation of information requirements and the abandonment of the principle of minimum harmonisation. The text also provides the possibility of amending or further harmonising the provisions of the Directive in light of experience gained.

The EP approved the directive on the 2nd Reading. Two small amendments were adopted with the industry support: introduction of a termination date for the withdrawal and exclusion of mortgage credit contracts from the right of withdrawal. On 21 May, the Council adopted the Common Position as revised by the EP. Members States will from now have 2 years after the entry into force of the Directive (date of the publication in the Official Journal) to transpose it into national law.

http://europa.eu.int/comm/consumers/policy/developments/fina_serv/fina_serv07_en.pdf

European Commission Communication on Contract Law

Up to present, the EU has followed a selective approach of harmonising only certain types of contracts or marketing techniques where a particular need for harmonisation was identified. Despite being successful, the Communication recognized that this sectoral approach ("*case-by-case approach*") is not sufficient to bring down inconsistencies amongst the EU. The Commission launched a Communication on contractual law to debate the risks of barriers to the functioning of the Internal Market associated to the divergence of national legislations. In April 2002, the European Commission published the synthesis

on the feedback of the contributions submitted during the consultation process. More than 160 comments were received from all the parties involved.

Amongst the business industry, Financial Services are one of the more critics about remaining obstacles to Internal Market due to the differing transposition of EU rules. Businesses are more discouraged from cross-border transactions by differences in the details of different consumer protection regimes than by diversity in the overall level of protection afforded. On the other hand only a minority of governmental contributions mentions specific and concrete problems seen as obstacles to the Internal Market (information costs for cross-border contracts, costs of litigation, legal uncertainty, unwillingness of individual companies to participate in cross-border activities due to differences between mandatory rules, ...). Concerns were mainly focused on the minimum harmonisation approach in consumer law.

Several concrete problems were mentioned about the lack of uniformity of application of EU law (e.g. inconsistencies between e-commerce Directive and ISD Directive, differences in concept definition such as consumer or seller). Those inconsistencies are exacerbated by differences in the implementation of EU rules into national law. Contributions suggested the inclusion of areas such as information requirements, tax law and company law in the harmonisation process.

The Communication proposed 4 regulatory options:

- To let the market forces deal with any problems that may occur, no intervention at all;
- To develop non-binding common principles of European Contract Law,
- To review and to amend all relevant legislation in the framework of a simplification and improvement process;
- To create a new legal instrument at EU level, being used as an option in case where contractual parties haven't foreseen any solution.

The results of the consultation period show that an important majority of comments did not considered reliance on the market (option 1) sufficient to solve existing problems. This solution is unclear, non transparent and contributes to the fragmentation of the contract law.

Option 2, the development of non-binding rules is the preferred option for the Financial Services sector. The industry supports the validity and

superiority of codes of conduct, the mortgage code of conduct is seen as an example to further work in the area. Other sectors are not that supportive of this option unless it is complemented by option 3 or 4.

On the other hand there is a overwhelming support for option 3, which demands greater precision in the drafting of the EU law, avoidance of overlapping legislation, simplification of general rules and exceptions. The Financial Services sector sustains that the improvement of quality of legislation already in force will support the drive towards an internal market.

EU governments are divided about the results of adopting a new EU instrument on contract law (option 4). In opposition to the business industry, Financial Services sector sees option 4 only suitable as a long-term objective and there are various suggestions about the appropriate approach: a general legislative framework, a Directive or civil Code consisting of mainly non-mandatory rules. An opt-in system has been suggested.

Other conclusions are the following:

- Other instruments of harmonisation such as private international law or international agreements present limits;
- There is need for a better coherence and improvement of the *acquis communautaire*;
- Harmonisation through Directives is often insufficient because of the significant variations between national implementing measures;
- The lack of uniform definitions for general terms and concepts in EU law;
- Harmonisation of contract law allows the uniform classification of contracts for tax purposes, avoiding distortions of competition.

It's highly probable that the European Commission will present a **White or a Green Paper** before the end of 2002, as suggested by the EP and the Council. The future initiative will identify areas undermining the Internal Market and the uniform application of EU law, describe in details options of preference, and develop an Action Plan for the chronological implementation of the Commission's policy conclusions.

http://europa.eu.int/comm/off/green/index_en.html
http://europa.eu.int/comm/consumers/policy/developments/contract_law/comments/index_en.html
http://europa.eu.int/comm/consumers/policy/developments/contract_law/comments/summaries/sum_en.pdf

SPECIAL ECRI SEMINAR on “the role of credit bureaus in today’s credit markets”, 12 June 2002

Speakers and attendants debated the role of credit bureaus in the economy in terms of access to credit, over-indebtedness and rights to privacy protection. Presentations clearly exposed the links of credit bureaus with these three elements, which makes them active parties in credit markets.

The revision of the consumer credit directive foresees a more decisive role for credit bureaus in the assessment of borrowers’ creditworthiness. The Commission considers credit bureaus an essential tool in the screening of applicants, and therefore, demands consultation of existing databases prior to the granting of credit. The importance of credit bureaus to pick out bad payers is evident and all participants agreed on the necessity of black information, however, the relevance of positive information to fight over-indebtedness was questioned at the seminar.

Europe can also learn from the experience of the US, where credit is more extended in the economy, but also where the number of individual bankruptcies has grown more dramatically during the past years. In this context, it is important to remember that the credit market is not only composed by lenders and borrowers, but also other factors that impact their functioning, such as the legal framework for privacy, the existing systems for the settlement of over-indebtedness and the functioning of credit bureaus.

Keynotes from the speech of Rosa María Gelpi, Cetelem

Credit risk management is a core competitive asset for credit institutions, starting as early as the borrower applies for credit and ending when the credit is fully repaid. The screening of applicants, the application of credit scoring models, monitoring of the evolution of payments and lastly the recovery of unpaid debts determine the success of a credit institution in the market and its profitability. It is clear therefore that the minimising of over-indebtedness is an objective intrinsic in all credit providers; the goal is shared with consumers and public policy authorities.

However, credit bureaus are just one element in the assessment of the capability to repay of the borrower. Indeed, the absence of a black entry in a registry is crucial to the consideration of further credit. But it is also essential to complement the assessment with a thorough budgetary study that shows the financial status of the applicant, the monthly income and the monthly expenses to which the consumer is confronted will be the definitive factor for the underwriting decision.

An important part of the risk lies in the intermediaries. Consumer credit institutions dedicate vast resources to the management of intermediary risk related to retailers and brokers. Retailers and consumer credit finance houses often work together, however with different objectives. Credit is not the business of retailers, but an instrument for the sale of goods, their real business. This secondary role might result in a lax approach of retailers to the granting of credit, reinforcing even more that only credit grantors that excel in the management of risk (including the monitoring of retailers procedures) will survive and succeed.

Recognising the role of credit bureaus, credit institutions demand from them to be well managed, reliable and to offer competitive costs. Past experiences have shown that abuse of the system is possible in the case of both, positive and negative registries. Credit institutions would praise a non-interventionist approach to their assessment procedures, as they are one of their most valuable know-how competences.

Keynotes from the speech of Mr. Van Lysebettens, European Commission

The Commission is working on a revision and updating of directive 87/102/EEC. The current directive pasts its sell by-date, since it is based on hire-purchase, straight loans, and some credit cards accounts. The recent booming of credit reaches further beyond with many new products that are not regulated. The Commission regards this directive as an opportunity to pursue further harmonisation and contributing to the optimisation of the single market and the removal of existing barriers.

The consumer credit directive will be transformed into a general directive on credit offered to consumers, whatever the form or amount, whether for property or not, whether secured by mortgage or not, and will have specific provisions on certain aspects, such as information. The proposal includes provisions on the Annual Percentage Rate (APR) and borrowing rate for 25 different examples of products, specific provisions on guarantors, and remains open about the inclusion of mortgage credit.

Regarding credit bureaus the directive will not regulate the status of credit bureaus, the information collected or the form in which cross-border exchanges should take place. However, provisions related to solvency information and responsible lending will directly or indirectly affect them. The key provision on responsible lending implies that the creditor cannot grant a credit unless he has verified beforehand, on basis of the information at his disposal, whether the consumer and the guarantor will be able to reimburse the credit. The novelty is the inclusion of the guarantor in the consultation to credit bureaus. The implications are the following:

- The creditor, or the credit intermediary when applicable, should request the consumer and the guarantor only the precise and complete information necessary to assess their ability to repay;
- They shall provide the consumer with exact and complete information on the agreement;
- They shall seek the most appropriate type and total amount of credit, taking into account the financial situation of the consumer.

A provision in the consumer credit directive will ensure that personal data collected in the framework of the directive can/shall not be collected for purposes other than assessing the risk of non performance by the consumer and the guarantor. The Commission recognises the limits of the consumer credit directive regarding the protection of privacy and foresees a future directive dealing with the issue of privacy protection in the context of credit.

The main ideas on credit bureaus are:

- A central database for the purpose of registration of consumers and guarantors who have defaulted should be operative in each Member State;
- Access to central databases will be refused to credit-intermediaries and recovering agencies;
- Access to a central database in another Member State shall be ensured under the same conditions as for creditors in that member state;
- The processing operations connected with transactions covered by the central database shall be undertaken solely for the purpose of assessing the risk of non-performance by the consumer or any guarantor for the purpose of the discharging legal obligations. Any processing of personal data on the side of credit institutions shall be forbidden and the destruction of the data will take place immediately after the conclusion of the credit agreement or the refusal;
- Creditors shall be obliged to consult the central database before they accept any undertakings from the consumer or the guarantor;
- Possibility of extension to include the registration of credit agreements.

Keynotes from the speech of Mr. Wulf Bach, ACCIS

The first and foremost responsibility of credit bureaus in Europe is to reduce the imbalance of information between credit recipients and credit providers. Credit providers only grant loans after a careful and thorough assessment, and monitoring of borrowers continuous as long as the loan obligation exists. Indeed, accurate screening of applicant is essential for lenders, which according to statistics by the Bundesbank earn an average of approximately €365 on every successful credit transaction, whereas loans that are not repaid result in an average loss of €2,980 per transaction.

The scope of data directly available to the credit provider about a given credit applicant depends primarily on

- the geographic proximity of the applicant
- the duration and intensity of the specific customer relationship

Developments in recent years indicate that both of these factors are declining in significance over time. Consumers are becoming more mobile, tendency that is encouraged by the advent of the euro and the use of marketing channels such as internet, which facilitates the contracting and delivery of credit services. Credit bureaus find themselves compelled to respond to this broadening of the market by offering foreign credit providers the same information they make available to domestic providers.

During the year 1995, ACCIS members discussed the basis for the exchange of information between different countries. The outcome, respectful with the different European standards of data protection, was a solution by which the bank or credit institution should require only one connection to its national credit bureau and the use of only one clause in dealing with its customers. This meant that credit data would always be maintained in the home country of the credit provider. In the case of a foreign reference to a given consumer, the credit bureaus in question would inform one another and incorporate corresponding entries into their databases. The agreement is

also based on reciprocity, which means that providers of only negative information would not have access to other type of data held in the register.

Once the legal basis was established the idea of the “Key factor system” was developed. Key factor implies the objective of converting (legally and linguistically) highly diverse data held by credit bureaus. At present Italy and Germany have already implemented the system, with the Dutch BKR joining soon. Further adoption of this European standard will come in the future.

Ultimately, given the differences on national legislations concerning data protection, one should remain sceptical that within the framework of the consumer credit directive, the EU can achieve the necessary harmonisation to solve the differences causing severe disruptions in the EU credit market. As long as data protection provisions are not uniform, complete equality of treatment is not feasible. Harmonisation does not only concerns the collection of either positive or negative data, but also the information content underlying data, which must be converted into a form that is appropriate to the respective national laws and language.

A final recommendation for EU lawmakers should be to approach the regulation on credit information slowly and with great sensitivity, and for now at least, only on the basis of a minimum standard.

Key notes from the speech of Dr. Staten, Credit Research Centre

The “Fresh Start” approach of the bankruptcy provisions in the US supposes economic tradeoffs. One the one hand, bankruptcy is always a form of social insurance, where the insured, the consumer, knows that if worse come to worst he would be able to keep a minimum of assets and be charged off his/her debts in order to have a fresh start thereafter. On the other and, as any insurance, its existence changes incentives and creates moral hazard, meaning that borrowers and lenders alter their behaviour if the borrower has a legal right to bankruptcy.

Consequently, any bankruptcy law requires a balanced approach; on one side if it is too punitive for borrowers it might discourage borrowing, entrepreneurship and risk taking, on the other, if it is too easy on borrowers they might be less cautious leading lenders to reduce the supply of credit or driving up costs. The challenge is to bank on the benefits of the expansion of credit to the socio-economic spectrum (including the lower income households) while minimising the risk of an upward spiral in personal bankruptcy.

The sharp increase on bankruptcy filings has taken place, surprisingly, during prosperous economic times. If it is not the event of real insolvency of individuals or household, it is possible to consider as a decisive factor the expanded access to credit, facilitated by the broad access to personal credit and the flexible rules for the use of it, both factors might have contributed to the use of “pre-screening” of applicants as an aggressive marketing technique. Collectively, these factors brought more competition, lower prices and more products. Hence, it is certain that US credit bureaus have played a decisive role in the expansion of credit.

Looking into the broader accessibility to credit, figures show that the largest proportional growth has taken place within the population with lower incomes. This democratisation of credit has lead to greater exposure for consumers and lenders, which can be observed on the delinquency rates for bankcard borrowers, significantly higher during the five past years. From the observation of the market it can be concluded that delinquency rates will never return to previous levels and the industry has learnt to work in this environment.

However, underwriting decisions are not the only factor behind the growth in bankruptcy filing. High bankruptcy safety nets make consumers less cautious about borrowing and also make the efforts of repayment less rewarding, together they lead to the consideration of bankruptcy as a strategic financial solution instead of a last result solution. It seems that Chapter 7 and 13 of the US bankruptcy laws together with generous exemption levels play an important role in the growing resource to bankruptcy. Recent studies have proved that a significant part of individuals filing for bankruptcy could have paid part of the total of the debts contracted.

The final factor driving filings is the declining stigma attached to bankruptcy, and also the increasing availability of credit after bankruptcy.

These developments have risen concerns on the adequacy of US bankruptcy provisions and the debate has reached the political class, supported by many academics. However, since political intervention to bring down the numbers of bankruptcies is an unpopular measure, the initiative lies with the private sector. Creditors are now more and more proactive, using early-detection mechanisms associated to credit scoring-systems and promoting credit-counselling alternatives.

Keynotes from the speech of Mr. Ya Ping Yin

Over-indebtedness lacks of a common definition within the EU. Three approaches can be used for its study: an objective, a subjective and an administrative model. The administrative model, based on the occurrence of bankruptcies and defaults, cannot be used in the EU due to the absence of comparative data and the difference amongst legal concepts. The objective model, based on the construction of different rates comparing indebtedness against income or assets, makes indicators largely misleading. The subjective model, based on banking data and expenditure surveys, and takes into account self and external judgement of the financial situation of households, offers the best way forward.

The underlying definition implies that households having difficulties in repaying debts are judged to be over-indebted. The results of the study are the following:

	Households that have loans other than mortgage		Households that are over-indebted		Proportion of households with loans other than mortgages that are over-indebted	Individuals over-indebted
	1		2		3	4
	'000	%	'000	%	%	'000
A	475	15	391	12	79	871
B	739	18	599	15	64	1 306
DK	1 022	43	464	19	45	889
D	7 873	22	4 872	13	72	10 035
EL	321	9	1 850	49	96	4 104
E	2 326	19	2 770	23	94	7 516
F	7 657	33	3 623	15	42	7 845
IRL	340	29	295	25	77	743
I	1 784	8	2 364	11	88	5 916
L	56	35	19	12	29	36
P	412	13	445	13	84	1 164
FIN	671	29	472	21	65	876
UK	8 135	34	4 482	18	50	9 210
EU-15	34 212	23	23 944	16	68	52 720

The study allows concluding the following:

- Among the households with debt other than mortgages, from one third (in Luxemburg) to 96 percent (in Greece) had difficulty with debt servicing.
- The proportion of over-indebted households is significantly higher in countries with less developed financial / consumer credit markets.
- There is evidence to suggest that liquidity constraint is significant in a number of countries, and the low-income and young households are particularly constrained in their ability to use the debt instrument effectively.
- Over-indebtedness is particularly a problem among high-income households.
- There is evidence that the subsistence of over-indebted households is threatened.

Keynotes from the speech of Planpraktijk

There are 250,000 families in the Netherlands with urgent financial problems, with an average debt of 7,000 € per household due to debt of different origin, including utilities, rent, or credit.

Debt settlement arrangements in the Netherlands vary. One is amicable settlement between debtor and creditors, the other, legal settlement based on a tribunal verdict. The definition of over-indebtedness in which Planpraktijk bases its work is the following: “There is a problematic debt situation when the financial problems and debts have increased (or are increasing) to such an extent that households are no longer able to fulfil their financial obligations on their own”.

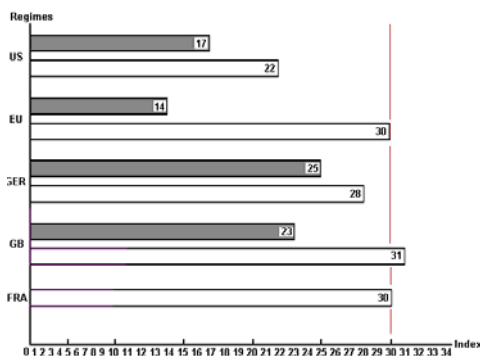
The most important organisations that implement debt settlement procedures are Municipal loan banks (i.e. recovery loans), municipal social services providing security benefits at a social minimum level, local agencies of welfare work that treat psychosocial problems, and the Planpraktijk service, contracted by local agencies to offer full services concerning debt.

However, the “fresh start” of the Netherlands’ policy differs from the American one. The legislation dates from 1998 and gives every citizen a once in a lifetime possibility to force a definitive solution in case of over-indebtedness in a court of justice. The court of justices appoints a trustee to handle the case, whose cost is very low, around 30€ The length of a legal settlement, meaning the schedule for the repayment of debts, will mostly be 36 months.

Keynotes from the speech of Nicola Jentzsch

Europe and the US have different approaches to privacy protection, whereas in Europe the focus on the protection of privacy as a human right by comprehensive data protection acts and centralised supervision, the US approach the issue as a more pragmatic balance of interests enabled by targeted legislation for different areas where the protection of privacy is at stake, equally, supervision is carried out by several functional regulators.

The degree of privacy protection of regulatory regimes in the field of finance can be measured by a model that includes the following four variables: supervision, property rights to information, obligations by credit bureaus and enforcement possibilities and remedies. The following chart compares country regimes before and after the implementation of the EU data protection directive:



Concerning credit bureaus one of the main characteristics are mandatory registration in the files of the supervisors as credit bureaus entities, explicit security measures and the collection of comprehensive data. The method used for this study shows surprising results, such as the higher degree of protection in the UK than in France, considered the more strict regulatory regime of Europe.

Regarding property rights to information, the US counts with an opt-out system versus the European opt-in practice.

