30.09.2019

ACCIS response to EBA's draft Guidelines on loan origination and monitoring.

Response to Selected Questions

Established in Dublin in 1990, the Association of Consumer Credit Information Suppliers (ACCIS) represents the largest group of credit reference agencies in the world. ACCIS brings together 42 members across 28 European countries and 8 associate and affiliate members from all other continents.

Key points

1. Accurate creditworthiness assessments are a fundamental component of responsible lending and consumer protection. As the EBA noted, "*the excessive household borrowing in the pre-crisis era, caused inter alia by **poor creditworthiness assessments**, has resulted in high levels of arrears as well as outstanding debt*"[1]. A European Parliament study on consumer credit concluded that "*poor creditworthiness checks, particularly when selling high-cost credit products, have been one of the major causes of consumer detriment across the EU, especially for more vulnerable consumers and even when the initial loan amount is small*"[2].

2. It is well established that creditworthiness assessments that use **more comprehensive data** are more accurate in predicting credit risk and affordability, thereby increasing financial inclusion and the supply of credit while simultaneously lowering the rate of non-performing loans[3].

3. It is also well established that data sharing among lenders through credit data infrastructures such as credit register (public) and credit information bureaux (private) is one of the core components of successful credit markets. Over the last 20 years, the positive impact of this mechanism has been proven by international institutions such as the World Bank and several relevant academic articles[4]. **European legislation is not neutral** in this regard: in line with recital 59 of the Mortgage Credit Directive and recital 28 of the Consumer Credit Directive, credit registers and credit information bureaux should receive **priority attention** as sources of information or for verification purposes, compared to other third-party sources.

4. We welcome that the draft guidelines align the requirements of the Consumer Credit Directive and the Mortgage Credit Directive's (MCD) in relation to the consumers' creditworthiness assessment. This alignment enhances consumers' protection from over-indebtedness and supports their financial inclusion. The alignment concerns:

[1] https://eba.europa.eu/documents/10180/1720738/Consumer+Trends+Report+2017.pdf
[2] http://www.europarl.europa.eu/RegData/etudes/STUD/2018/618997/IPOL_STU(2018)618997_EN.pdf
[3] See, for example, CEPS, Centre for Credit Risk Studies, and European Credit Risk Institute (2019) Data sharing in credit markets: Does comprehensiveness matter?; Bank of England (2014) Should the availability of UK credit data be improved? Djankov, Simeon, Caralee McLiesh, and Andrei Shleifer (2007) Private Credit in 129 Countries. Journal of Financial Economics 12 (2): 77-99.
[4] World Bank (2019) Credit reporting knowledge guide 2019; World Bank (2011) General principles for credit reporting (English); Turner, MA. & Varghese, R. (2010) The Economic Consequences of Consumer Credit Information Sharing: Efficiency, Inclusion, and Privacy

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- the requirement to have a sufficiently **comprehensive view** of the borrower's financial position (paragraph 85)
- the requirement to consider not only **negative but also positive financial information** about the borrower (paragraphs 105, 118, 239, 241 among others), and
- the **requirement to verify** the borrower´s information (paragraph 96 at alia)

We think, in particular, that the reference to a "*sufficiently comprehensive view*" encompasses the need for data for creditworthiness assessments to be relevant, accurate, timely and proportionate (paragraph 86).

5. We also welcome the explanation in paragraph 96 of the draft Guidelines that creditworthiness assessments should include both the **credit risk for the lender** and **the affordability risk for the borrower**. This means that lenders should assess not only whether a borrower is likely to repay (i.e. the "prospect" of repayment) but also whether he or she can do so without "*inducing undue hardship and over-indebtedness*[5]") (i.e. their "ability" to repay).

6. We welcome the clarification of the type of information that can be considered by the lender when carrying out creditworthiness assessments listed in Annex 2.

7. However, we think that certain aspects of the consumers' creditworthiness assessment merit further clarification (as explained in detail below).

Responses

What are the respondents' views on the requirements for collection of information and documentation for the purposes of creditworthiness assessment (Section 5.1)?

Section 5.1.1 General requirements: <u>Paragraph 86</u>

86. Information and data should be accurate, timely and relevant to the asset class and specific product, and proportionate given the purpose, size, complexity, and potential risk associated with the loan.	86. Information and data should be accurate, timely and relevant to the asset class and specific product, and proportionate given the purpose, size, complexity, and potential risk associated with the loan. ***Whenever relevant, categories of data used for the creditworthiness assessments should be observed for a sufficient number of historical series and projected in the future.***
Comments: The "time dimension" of the data used for creditworthiness data should also deserve attention. In the World Bank's "*General principles for credit reporting*", the lack of a sufficient number of years of relevant data is described as a sign of suboptimal quality of data and is considered to reduce the ability of creditors to make informed decisions. As with the reference to future projections, it reflects for example the idea expressed in paragraphs 107 and 119.	

[5] Paragraphs 105 and 118 of the draft Guidelines.

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Section 5.1.1 General requirements: Paragraph 88

88. Institutions and creditors should assess the plausibility of any information and data provided by the borrower, and should make any necessary checks to verify the authenticity of information. When verifying a borrower's prospect to meet its obligations under the loan agreement, institutions and creditors should make reasonable enquiries to the borrower or third parties (e.g. employer, public authorities, credit register bureaux) and take reasonable steps to verify the information and data collected. Where, for the purposes of these guidelines, institutions and creditors make enquiries regarding borrower's personal data, institutions and creditors need to ensure that the requirements, in particular to inform and seek permission from the borrower, of Regulation (EU) No 2018/1725 are met, before making such enquiries to third parties.	***88. deleted***

Section 5.1.1 General requirements: (NEW) paragraph 88a and 88b

	88. a. The information and data used by institutions and creditors to assess a borrower´s creditworthiness should be obtained from relevant internal or external sources, including the borrower. ***88. b. Institutions and creditors should assess the plausibility of any information and data provided by the borrower and should make any necessary checks to verify the authenticity of information. The information and data collected from the borrower or otherwise should be verified by making reasonable enquiries to the borrower, credit registers/ information bureaux or other third party (such as employers or public authorities). Where, for the purposes of these guidelines, institutions and creditors make enquiries to third parties regarding borrower's personal data, institutions and creditors need to ensure that the requirements of Regulation (EU) No 2016/679 are met before making such enquiries.***

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Comments:

The NEW paragraphs 88a and 88b:

- Clarify the distinction between sources of information (reflected in the NEW paragraph 88a) and the person or entity with whom the information can be verified in light of article 20 of the Mortgage Credit Directive (MCD) (reflected in the NEW paragraph 88b). The source can be the borrower or a third party, and the verification can also be made with the borrower or with a third party.

- Clarify that the assessment should encompass “the consumer’s creditworthiness”, which includes both the borrower’s “prospect” to meet its obligations under the loan (i.e. the credit risk for the lender) and, also, the affordability risk for the borrower, as stated in paragraph 96.

- Distinguish between credit register (public) and credit information bureaux (private). This difference is consistent with the formulation used in Annex 2 (“credit registers and credit information bureaux”).

- Recognise the relevance of external databases. In line with recital 59 of the Mortgage Credit Directive and recital 28 of the Consumer Credit Directive, credit registers (public) and credit information bureaux (private) should receive priority attention as sources of information or for verification purposes, compared to other third-party sources (e.g. employers or public authorities). Credit databases exist in all EU Member States and the information they held is considered a “primary factor” by lenders when evaluating creditworthiness assessments – as recognized by the World Bank. Consulting external credit information is also an important step in counter fraud and anti-money laundering checks.

- Correct a wrong reference to the EU General Data Protection Regulation (GDPR), that is Regulation (EU) No 2016/679 (and not Regulation (EU) No 2018/1725).

- Are consistent with the requirements of Regulation (EU) No 2016/679. This Regulation includes six legal grounds under which processing of personal data by a third party is permitted, including (i) the person’s (the borrower) consent (or permission), and (ii) the existence of legitimate interests for the processing to be pursued by the third party, except where such interests are overridden by the interests or fundamental rights and freedoms of the borrower.

  It is up to each organisation to show that the processing activity is permitted under one or more of these legal grounds.

  In the context of creditworthiness assessments, it is widely accepted that organisations process personal data for the legitimate interest of promoting responsible lending, help to prevent over-indebtedness and help prevent and detect crime and fraud. Therefore, the collection of the borrower’s permission would not be required for data that credit bureaux collect on the ground of legitimate interests[6].

[6] The UK data protection regulator uses credit reference agencies processing data for a loan as an example of a legitimate interest, see ICO (2019) How do we apply legitimate interests in practice?

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Section 5.1.2 Specific requirements for lending to consumers – Reference to Annex 2 – Information collection and verification - Lending to consumers

6. Evidence of income (including annual bonus, commission, overtime, where applicable) covering a reasonable period of time, including payslips, current bank account statements, audited or professionally verified accounts (for self-employed persons)	6. Evidence of income (including annual bonus, commission, overtime, where applicable) covering a reasonable period of time, including payslips, current bank account statements, audited or professionally verified accounts (for self-employed persons) ***and assets (including saving account statements, evidence of real estate)***
7. Information on financial assets and liabilities, e.g. savings accounts statements, loan statements indicating outstanding loan balances	7. Information on financial ***liabilities***, e.g. loan***, credit card, mortgage*** statements indicating outstanding balances
8. Information on financial commitments such as child maintenance, education fees, alimonies	8. Information on ***other*** financial commitments such as child maintenance, education fees, alimonies, ***insurance, utilities, telecoms***

Comments:

- We suggest including 'assets' together with 'income' in current Point 6 as they are both possible sources of repayment. Assets should, therefore, be deleted from current Point 7.
- In order to differentiate and avoid confusion between the 'financial commitments' covered in current Point 8 and the 'financial liabilities' included in current Point 7, we propose to use "other financial commitments in the amended Point 8. These should cover non-discretionary expenses like alimonies but also other committed expenses such as insurance or telecoms as they are all regular outgoings of the borrower that are likely to be paid from the same source of income on which the creditworthiness assessment is based. This would also be in line with paragraphs 109 and 118 of the draft Guidelines.

What are the respondents' views on the requirements for assessment of borrower's creditworthiness (Section 5.2)?

Section 5.2.2 Lending to consumers relating to residential immovable property: <u>paragraphs 103, 104 and 105</u> and Section 5.2.4 Unsecured lending to consumers: <u>paragraphs 116, 117, 118 and 121</u>

- We believe the requirements for mortgages set out in **paragraphs 103 and 105** should be consistent with the requirements for consumer credit set out in **paragraphs 116 and 118**.

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- While we understand that paragraphs 103 and 116[7] relate to a borrower´s **prospect to repay (i.e. the credit risk for the lender),** we note that there are some differences in the wording. For the sake of consistency, we suggest using **similar wording** in both paragraphs in light of Article 20 of the MCD and paragraphs 85, 91 and 98 of the draft Guidelines: creditworthiness assessments should be based on information about the borrower´s sources of repayment, and financial position / situation. This includes in particular information about the borrower´s financial commitments which gives an insight into what kind of borrower the applicant is and how much money he or she already owe (thereby constituting a primary factor for lenders to determine the borrower's credit risk).

- Likewise, while we understand that paragraphs 105 and 118[8] relate to the borrower's **ability to repay the loan (i.e. the affordability risk**), we note that there are some differences in the wording. To ensure consistency, we suggest deleting 'living expenses' from para. 118 and include a new paragraph after paragraph 120 similar to paragraph 109[9].

- A reference to **credit scoring** should also be mentioned in the mortgage credit and consumer credit sections (as in paragraphs 126-127 for lending to professionals).

- We believe that the requirement in **paragraph 104[10]** to include third party verification documenting the borrower's income should also be included in **paragraph 117**.

- We note that the requirement to carry out sensitivity analyses for consumer credit set out in **paragraph 121** does not appear in Section 5.2.2 for mortgages (despite being a general requirement under paragraph 101). To avoid confusion and unnecessary duplication, we would suggest that requirements that are mentioned under the general section do not appear again in the specific sections.

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[7] Para. 103. *When verifying a **borrower's prospect** to meet obligations under a credit agreement as referred to in Article 18 of Directive 2014/17/EU, the institutions and creditors should make reasonable enquiries and take reasonable steps to verify the borrower's underlying income capacity, income history and any variability over time.*

Para. 116. *When assessing a **borrower's prospect** to meet obligations under the loan agreement, the institutions and creditors should make reasonable enquiries and take reasonable steps to assess and verify the borrower's repayment capacity, including the borrower's ability to keep up repayments without a significant adverse impact on their overall financial situation.*

[8] Para. 105 *When assessing the **borrower 's ability** to meet obligations, institutions and creditors should take into account relevant factors that could influence the present and future repayment capacity of the borrower and without inducing undue hardship and over-indebtedness. The factors should, where relevant, include other servicing obligations, their remaining duration, their interest rates, and the outstanding amounts, evidence of any missed payments as well as directly relevant taxes and insurance, where known.*

Para. 118 *When assessing the borrower 's prospect to repay the loan, the institutions and creditors should take into account relevant factors that could influence the **borrower's ability** to meet obligations and without inducing undue hardship and over-indebtedness. The factors should include living expenses, other debt obligations, the interest rates, and the outstanding principal on other loan obligations; evidence of any missed payments; as well as any outstanding cost of relevant taxes and insurance, where known*

[9] Para. 109. *When assessing the borrower's ability to meet obligations under the loan agreement, the institutions and creditors should account for committed and other non-discretionary expenditures, such as the borrower 's actual obligations, including appropriate substantiation and consideration of the living expenses*

[10] Para. 104. In the case of borrowers that are self-employed or have seasonal or other irregular income, the institutions and creditors should make reasonable enquiries and take reasonable steps to verify information that is related to the borrower's ability to meet obligations under the loan agreement, including income capacity **and third-party verification documenting such income, such as tax declarations.**

Para. 117 In the case of borrowers that are self-employed or have seasonal or other irregular income, the institutions and creditors should make reasonable enquiries and take reasonable steps to assess and verify information that is related to the borrower's ability to meet obligations under the loan agreement, including income capacity

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