28 August 2020

ACCIS' feedback: Inception Impact Assessment on the Review of the Consumer Credit Directive (2008/48/EC)

ACCIS welcomes the Inception Impact Assessment (IIA) on the Review of the Consumer Credit Directive (CCD) and agrees with the conclusion of the evaluation report that the Directive has not fully achieved its objectives. A review of the text is, therefore, needed. That review should in the least touch upon the following two elements:

- Principle of full-file credit information sharing
- Creditworthiness assessments

ACCIS would also like to provide some comments in relation to the cross-border provision of consumer credit.

a) Principle of full-file credit information sharing

The treatment of credit data during the COVID-19 pandemic or any similar exceptional situation has potential impact on the integrity of the credit reporting system and ultimately the financial markets. Inadequate and untimely data reduces the reliance placed by credit providers on the credit reporting system and can lead to credit rationing, increase in the cost of credit and exclusion of borrowers. It is for that reason that the International Committee on Credit Reporting (ICCR) - the only recognised international standard setter in this field - recommended policy-makers to promote "*continued full (file) sharing of credit information, including reporting of missed payment data arising due to the crisis, with the necessary safeguards*". For the ICCR, *"[continued full (file) sharing of credit information with the necessary safeguards] ensures that there is minimal or no effect on the data subject´s credit history and score*"[1]. The principle of full-file sharing of credit information - that combines both positive and negative information from both banks and nonbank lenders and has the highest predictive power for credit risk assessments - should be enshrined in the review of the CCD as a cornerstone of credit information markets during the crisis as in normal times.

b) Creditworthiness assessments

ACCIS agrees that one of the main problems of the CCD is that the safeguards to ensure responsible lending/borrowing are "insufficient"[2]. Even before the pandemic, 21% of EU citizens were at risk of over-indebtedness, with single parent families and low-income households among those most at risk[3]. Accurate creditworthiness assessments are a fundamental component of responsible lending and consumer protection. In assessing how to reinforce the provisions on assessing creditworthiness, ACCIS would like to share with the European Commission the following considerations:

[1] In adhering to this international guidance, European banks, non-bank lenders and credit reference agencies are processing the information related to the granting of loan moratoria in a way that it does not negatively impact credit files nor has an automatic impact on the credit rating (or equivalent measure of risk) of consumers. See Best practices in relation to relief measures offered to consumers and businesses in the context of the COVID-19 crisis.
[2] As the EBA has 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*". 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".*
[3] Eurofound (2020), Addressing household over-indebtedness, Publications Office of the European Union, Luxembourg. https://www.eurofound.europa.eu/sites/default/files/ef_publication/field_ef_document/ef19044en.pdf

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i) **Credit risk and affordability risk**. The assessment of a consumer's creditworthiness includes two aspects: credit risk and affordability risk. Credit risk focuses on the risk to the lender of the customer not making repayments. Affordability risks focuses on protecting consumers from over-indebtedness[4]. In the context of mortgage loans, lenders must already conduct an affordability test, looking at consumers' income and expenditure to ensure that they can afford the mortgage (see recital 58 and Articles 18 and 20 of the Mortgage Credit Directive). Similarly, paragraph 96 of the EBA's loan origination guidelines (part of the General provisions for lending to consumers, which includes consumer credit) state that "*institutions and creditors should […] assess the borrower's ability and prospect to meet the obligations under the loan agreement"*. So, the CCD needs to be amended to require that lenders providing consumer credit also make a reasonable assessment not just of whether customers will repay (credit risk), but also of their ability to repay both affordably and without this significantly affecting their wider financial situation (affordability risk).

ii) **All necessary and relevant factors**. As stated in the EBA guidelines on loan origination (paragraph 98), lenders should use in creditworthiness assessments "*relevant factors that could influence the present and future repayment capacity of the borrower, and should avoid inducing undue hardship and over-indebtedness*". The same idea is expressed in recital 55 of the Mortgage Credit Directive which states that "all necessary and relevant factors that could influence a consumer's ability to repay the credit" should be taken into consideration. The CCD should, therefore, evolve from an approach currently based on 'sufficiency of information' as the only criteria to an approach focused on 'relevance of information', more closely mirroring the test set out in the EBA guidelines. In this respect the following aspects should be observed:

- **Positive information**. As recommended by the World Bank' 2011 General Principles for Credit Reporting, credit reporting systems should have relevant data - including positive information - as its use is empirically associated with lower incidences of extension of credit to bad debtors and, at the same time, the successful extension of credit to debtors with little previous credit experience. Positive information - one of the main factors to estimate consumer's over-indebtedness - is already included in the Mortgage Credit Directive (Article 20) and in the EBA Guidelines on Loan Origination as relevant factors for verifying the prospect and ability of the consumer to meet his credit obligations. This reference is, however, missing in the CCD. The CCD should be amended to require that lenders use positive information in their creditworthiness assessments (see also above, in relation to the principle of full-file credit information sharing).

- **Comprehensive credit data**. In addition to credit data on financial services products (e.g. loan re-payment history data), there are other types/sources of information and data of an economic or financial nature (e.g. bank account data, payment data from utility and telco companies, rental data, data held by governments and public bodies) that contribute to better risks evaluations and are already widely used in a number of EU countries to foster more financial inclusion and responsible lending. 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[5]. The use of those other types/sources of information and data is even more necessary for consumers who have no or very little credit history. The importance of those data for creditworthiness

[4] For more on the differences between credit risk and affordability risk, see for example Cherednychenko, O.O., Meindertsma, J.M. Irresponsible Lending in the Post-Crisis Era: Is the EU Consumer Credit Directive Fit for Its Purpose? J Consum Policy 42, 483–519 (2019). https://doi.org/10.1007/s10603-019-09421-4

[5] 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.

assessments is recognized in Annex 2 of the EBA Guidelines on Loan Origination. The CCD should be amended to require lenders the use non-traditional data when those data would be relevant and more appropriate to perform adequate creditworthiness assessments.

iii) **Data to be used in creditworthiness assessments**. The IIA considers the idea of specifying what data is to be used for creditworthiness assessments. Whilst we think that the framework for consumer credit should provide indications in this regard - including on the obligation to use positive data - specifying the list of data would go against the principle of proportionality as referred to in the EBA guidelines on loan origination. Also, paragraph 85 of the EBA guidelines already refer to broad categories of key data. In this context, ACCIS notes that the specific relevant data inputs to be used in creditworthiness assessments, should be based on the circumstances of each case. In that regard, lenders should be able to access the most complete picture of a borrower's background. This does not, however, mean that lenders will need every single piece of available information in every credit application. Different data is required depending on the type of credit being applied for. But without being able to access the whole picture of a consumer's financial position, it is not possible to establish which pieces of information are the most appropriate and insightful.

iv) **Role of credit databases.** Credit databases exist in all EU Member States and the information they held is considered a "primary factor" by lenders when evaluating creditworthiness assessments. The World Bank Principles on Credit Reporting recognised that "*credit reporting systems are very important in today´s financial systems. Creditors consider information held by these systems as a primary factor when they evaluate the creditworthiness of data subjects and monitor the credit circumstances of consumers. This information flow enables credit markets to function more efficiently and at a lower cost that would otherwise be possible*". In a digitally transformed world, external databases are becoming more and more important as borrowers today have multi-entity relationships. Lenders also use external sources to help keep the application process as smooth and efficient as possible avoiding manual steps, such as requesting and validating information provided by the borrower, which reduce operational overheads and fraud risks. The CCD refers to access to (external) databases (recital 28 and Article 9). In our view, the revised CCD – following the MCD – should expressly mention the importance of external databases as a primary, validated and impartial source to support lenders to comply with their legal obligations and predict the ability of the consumer to repay the loan.

c) Access to credit databases / Cross-border provision of consumer credit

The European Commission is of the view (see consultation on a New European Consumer Agenda) that rules on access to credit databases giving information on consumers' credit history vary across Member States. And that such divergence would "undermine" the cross-border provision of credit. That is, however, not the experience of ACCIS. There are various means by which lenders can have access to a foreign database, including direct and indirect access. Direct access means that the lender makes an inquiry about a consumer´s credit history directly to the foreign database. Direct access to databases is non-discriminatory i.e. any lender that contributes data - including lenders established in jurisdictions different to that of the database - can check the database. Indirect access means that the lender makes such an inquiry but by via the local database, which in turn contacts the foreign database. ACCIS has created a contract model for this type of indirect inquiries that is available for credit reference agencies to use amongst themselves as needed. The level of use of this mechanism depends on the level of demand for cross border credit, which we understand is currently low.

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