

Federico Ferretti, The Law and Consumer Credit Information in the European Community – The Regulation of Credit Information Systems, London: Routledge 2008, 244 pp.; ISBN 978-0-415-46073-6. GBP 70

Previously published in: 46 CML Rev 6 (2009) 2140-2143

[2140] This book deals with the role of Credit Reference Agencies (CRAs) in European consumer credit. CRAs collect, file, process, manage and disseminate financial data of borrowers. In doing so, they collect, combine and sell information on trustworthiness of individuals in their role of debtors. In other words, CRAs are ‘registers of reputation’. The economic rationale for the existence of CRAs is that they help countering detrimental information asymmetry and consequential risks of adverse selection. Not knowing the reputation of their debtors may leave lenders defrauded or with uncollectible debts. Hence, by sharing information between banks and other professional money lenders, CRAs contribute to lowering the overall cost of credit.

[2141] The central purpose of this book is to identify and examine the legal framework and compliance in the EC of CRAs and to establish to what extent the right to informational privacy is respected by CRA arrangements (p. 1-2). One of the main concerns of the author is whether at present consumers are satisfactorily protected. Ferretti is sceptical of the economic rationale for CRAs. He fears that fundamental rights, e.g. the right of privacy, are easily neglected by CRAs. Against this background the author embarks on a positive analysis of law, but he also sets out to weigh the economic rationality of obtaining and using ever-increasing numbers of data in consumer credit decision making against “civil liberties, freedom and the respect of rights of profit seeking at all costs and greed, supporting the view that market forces do not necessarily have to override or squeeze the fundamental rights of individuals” (p. 2).

Ferretti’s book consists of an introduction, seven chapters and an appendix. It also contains a number of tables in which European countries and their consumer credit arrangements are compared. I note that Ferretti was unable to include the (later) final text of Directive 2008/48/EC on consumer credit agreements, although he does refer to earlier drafts (p. 122 ff). The adopted text of the Directive does not throw a fundamentally new light on the crux of Ferretti’s book.

Chapter 1 paints a picture of the CRA landscape by examining the relevance of credit reporting and the interests and roles of the actors involved in the credit process.

Chapter 2 offers a summary of the economic literature on CRAs. Most of the material available deals with the situation in the USA and developing countries. Ferretti concludes that the literature does not address the issues of abuse of consumer rights and civil liberties, and that the legal dimensions – such as the compatibility of CFA practices with EC Data Protection Directive 95/46/EC and the ECHR – are neglected. A good example of the issue of protection of personal data is offered by so-called *credit scoring* techniques. For instance, there may be a statistical correlation between postal code and over-indebtedness. Hence, an applicant’s postal code may be indicative of his ‘reputation collateral’: living in a poor neighbourhood may predict future debtor failure. Therefore, scoring techniques can be equally or even more interesting to lenders than (expensive) information on the individual credit applicant – especially if that applicant has little credit

history to signal. The problem with scoring techniques, however, is that they may be discriminatory. Postal codes may for instance also be strongly correlated to race. This raises the issue of compliance of scoring techniques with anti-discrimination regulation. Chapter 3 describes the rise of consumer credit in the late 19th and early 20th century consumer society through the development of consumer hire purchase agreements. With the expansion of consumer credit arrangements came the surge of CRAs as 'registers of reputation'. Ferretti emphasises that CRAs are of American origin (simply because that is where CRAs were introduced first) and that the regulatory background in the USA was different in many ways from the European scene, where interested rates were capped by means of usury laws. In the 1970s, federal regulation of CRAs contributed to the structured use of credit reports in the USA. Conversely, in Europe there was, and still is, no specific legislation on the operation of CRA business. Moreover, there was and is no single European consumer credit culture. This leads Ferretti to argue that the American CRA model does not sit well with the European credit culture (p. 75).

Ferretti shows that the structure and relevance of CRAs in the consumer credit process differ considerably from one country to another. In some European countries these CRAs are commercial sellers of information that constantly search for new ways of using their data, innovating their products and making themselves indispensable to the operation of consumer credit markets (in short: the Anglo-Saxon model). For instance, a CRA might not only want to sell information on 'bad debtors' and fraudsters but also on 'excellent debtors'. In other countries, CRAs may take on the form of publicly regulated authorities (the interventionist model) or non-profit foundations designated by self regulation (the corporatist Rhineland model). Moreover, the extent of the information gathered by CRAs differs from country to country. In [2142] some, court judgements (insolvency procedures, debt collection procedures) and information on mortgages are included. In others, these sources of information are not included. Understandably, these differences bring about diverging roles for CRAs in the various member states.

Chapter 4 reviews the European legal background: what EC rules apply to CRAs and does EC law support a European system of cross-border exchange? Ferretti convincingly shows that the European consumer credit market is far from integrated, that credit information systems and structures differ considerably between the different member states, that cross-border information services hardly exist with little prospect of growing European, and that there is much national variation and little co-ordination under the umbrella of Data Protection Directive 95/46/EC.

Chapter 5 investigates the protection of privacy rights of borrowers under the Data Protection Directive. Unsurprisingly, Ferretti concludes that the Directive is the proper benchmark for assessing the legal framework of consumer credit reporting. This allows the author in Chapter 6 to focus on scrutinising the compatibility of CRA practices with the Directive and on assessing the level of compliance of national legal systems with the Directive. Sharing personal data via CRAs is on many occasions problematic, Ferretti concludes. He rightly draws attention to the need for unambiguous consent of the consumer, and to contested practices in consumer credit such as profiling, redlining and blacklisting (p. 179 ff.).

The author is to be congratulated on his successful attempt to bring together the relevant legal and economic material on CRAs in Europe and to present a broad picture of an important part of the financial industry. My appreciation does not imply, however, that the author has succeeded in convincing me in all respects. At first blush it would appear

that CRAs are beneficial to both consumers and lenders – in the sense that the information contained therein helps lenders assess the risks of default of individual consumers and protects consumers against irresponsible borrowing. The author, however, is rather sceptical of the benefits to consumers. In a nutshell, he argues that CFAs centralise private information, standardise and profile people (p. 44-45). In doing so, they merely serve the profit maximising strategies of lenders and hence do not serve a public but a private function (p. 30, p. 143). The use of credit reporting corresponds to a justifiable interest of the credit industry, “but it is not a right and is not mandated by law to satisfy a public interest” (p. 177).

Indeed, occasionally the author seems to consider the right to privacy to be a non-negotiable fundamental right that cannot be balanced against other interests. I doubt this is a desirable way of approaching consumer law issues. What Ferretti seems to downplay is that it is not merely in the interest of banks to have access to ‘registers of reputation’. Lending money without reputational information comes at a price. Without this information, consumer credit fraud is difficult to combat and early signs of over-indebtedness are less easily detected. If these costs cannot be contained, they will have to be distributed. In the end, the costs of fraud and default will have to be borne by someone. Moreover, if consumers cannot signal reputation with information on their past performance, lenders will typically want additional guarantees (e.g., collateral, sureties), which in turn will raise the costs or diminish the availability of credit. To Ferretti, lending money in exchange for a profit is perfectly possible and most probably lucrative even without the intervention of CRAs (p. 175).

I think this begs the question: if we were to prohibit CRAs, would consumer credit still be as widely available (and under similar conditions) as it is now? Ferretti seems to think it would, as he argues that credit without information is also available to first-time borrowers without any prior reputation (p. 183). I think that this example does not unequivocally demonstrate that the consumer credit industry can or should work without ‘registers of reputation’. The fact that first-time borrowers may be charged higher interest rates, may be required to find a surety with a known reputation, or may simply be given no unsecured credit, shows that information is a central instrument of risk-differentiation in the credit business. Therefore, in my view, the economic rationale for [2143] ‘registers of reputation’ remains extremely convincing. Information systems operated by CRAs allow lenders to minimise costs by helping to prevent fraud and over-indebtedness. In a market for consumer credit that is functioning properly, this objective is also beneficial to consumers at large. I am happy to acknowledge to the author that we should heed the risks of lenders accumulating information without proper safeguards of accountability in respect of privacy issues and fair access to credit, but I do not see a readily available, credible and efficient alternative for ‘registers of reputation’. Notwithstanding these comments I recommend this book for reading: Ferretti’s book offers a much-awaited in-depth legal analysis of CFAs that persuasively shows that ‘registers of reputation’ need a certain level of oversight.

Willem H. van Boom
Rotterdam