

# **Re-thinking the regulatory environment of credit reporting: Could legislation stem privacy and discrimination concerns?**

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## **Abstract**

**Keywords: Credit Reference Agencies, consumer credit, privacy, discrimination, regulation.**

This paper examines the activities carried out in the UK by Credit Reference Agencies, current business practices, and the legal standing of credit reporting. It suggests areas and issues for further legal debate and policy consideration.

Ultimately, this study puts forward the case for specific legislative intervention to strike a balance between privacy rights, discrimination concerns, and the needs of the credit industry.

## **Introduction**

This paper focuses on the activities carried out in the UK by private sector Credit Reference Agencies (CRAs) that compile databases on consumers' financial transactions, borrowings, payment behaviour and other aspects of household finances. This information, together with

information from other sources, is disseminated to their member clients, i.e. third party lender organisations<sup>1</sup>.

CRA's store and process information about almost every adult who lives, or has lived, in the United Kingdom<sup>2</sup>. They maintain a full data sharing mechanism based on the collection of data from the various lenders of information about their customers and, at the same time, provide those same lenders with consumer credit reports.

Consumer information sharing has become the most extensively used tool to underwrite decisions on borrowings or the supply of goods and/or services to customers. Lenders, in fact, access credit reference databases in order to evaluate a consumer's credit application and his/her creditworthiness.

However, despite the copious economic literature on the importance of sharing consumer credit information by a wide source of lenders, little attention has been paid either to privacy concerns or to the discriminatory consequences of credit reporting.

Such concerns seem particularly relevant today because of the growing type and number of personal data collected and disclosed to third parties, as well as the expanding use of data. These aspects are exacerbated by the sophistication and advances in computer technology and information systems.

To this purpose, there has been scant debate, especially amongst lawyers and legislators, concerning the legal framework of such information systems and the uses of credit reporting data.

In an attempt to provide a comprehensive description and analysis of the activities carried out by CRA's and their legal standing, this article aims at suggesting promising areas and issues for further consideration and debate, particularly as far as it concerns legal issues and policy considerations.

As such analysis leads to more questions than it answers, this work puts forward the case for *ad hoc* legislative intervention for credit reporting to strike a balance between legitimate individual privacy rights, discrimination concerns, and the needs of the credit industry.

## **1. Credit Reference Agencies**

CRA's are private companies that compile databases that (potential) lenders can access to help them evaluating a consumer's credit application<sup>3</sup>. They provide information to potential lenders about an applicant's credit record, producing a 'Credit Report' that contains details of the payment and credit history of an individual, financial accounts and the way they have been managed, as well as other information of interest to the credit industry.

The consumer's credit data collected and processed by CRA's are supplied to the agencies by the lenders themselves, which builds the CRA's' databases to share the information about their customers.

It must be noted from the outset that the CRA's usually integrate their databases with data from other sources, such as, for example, electoral rolls, Court judgements, bankruptcies and voluntary arrangements, and other private information provided by other organisations (such as, for example, the Council of Mortgage Lenders), which compile additional information referring to an individual thus forming a single file.

Such files are then made available in the form of a Credit Report which is provided to the (potential) lenders for a fee paid to the one or more CRA's which they have decided to interrogate each time someone applies for credit or hire purchase.

CRA's often claim that the information is supplied by the lenders on a reciprocal basis, i.e. the lenders are able to access the databases only if they contribute to it for the benefit of all the other contributing member lenders<sup>4</sup>.

However, this mechanism - based on what has been called the 'reciprocity principle' - relies on agreements between private parties and there is no *ad hoc* cogent law or regulation in place to date. As it has been reported in recent years, in fact, a number of lenders themselves have become concerned that such arrangements on 'reciprocity' were gradually breaking down. Moreover, there are considerable doubt concerning the different interpretations of what exactly would constitute the 'reciprocal supply and use of data', since personal data are now processed, communicated, and analysed with sophistication that no one imagined when data sharing schemes were first established 25-30 years ago<sup>5</sup>.

In addition, the technological change and growth in the number and range of techniques used today, such as consumer risk scoring (including behavioural and sociological customer scoring), loan or mortgage rating, risk screening, monitoring, propensity modelling, debtor tracking and support to debt collection, were not in place when the industry first began to consider data sharing as a valuable instrument built for lending purposes.

Finally, it may be worth noting that it is not always easy to draw the line and make a distinction between the use of consumers data for credit risk management and its use for marketing purposes, nor is there a law or regulation specifically designed to restrict new business sectors or government agencies as potential future data users and suppliers as client members of CRAs.

## **2. The stated role/function of Credit Reference Agencies**

The financial industry and the economic literature claim several justifications for credit reporting systems and their consequent use.

a) CRAs are meant to provide to the credit industry and the market organised information on the performance of borrowers. They gather information on the payment history and accounts of borrowers and issue a credit report prior to the underwriting of a borrowing or the supply of goods and/or services which would be paid at a later stage. Thus, CRAs are often cited as providing instruments and services in the evaluation of the creditworthiness of an individual applicant and his/her ability to repay the debt. Credit reporting systems, therefore, would provide lenders with credit management tools helping them to master and manage their own business risk, as well as to set loan terms according to the level of risk of the individual borrower as determined by his/her credit history and accounts<sup>6</sup>.

Economic theory has long stressed the importance of information in credit markets. Theorists have devoted a large body of analytical studies aimed at demonstrating that asymmetric information between borrowers and lenders poses problems of bad debts, moral hazard and adverse selection<sup>7</sup>.

The theory suggests that the lack of information on borrowers can prevent the efficient allocation of credit in a market and that one way that lenders can improve their knowledge of borrowers is through their observation of clients over time<sup>8</sup>.

A study commissioned and published by the World Bank stresses “since one of the best predictors of future behaviour is past behaviour, data on how a potential borrower has met obligations in the past enables lenders to more accurately evaluate credit risk, easing adverse selection problems. At the same time, credit reports strengthen borrower discipline and reduce moral hazard, since late or nonpayment with one institution can result in sanctions by many others. (...) A borrower’s ‘good name’ (reputation collateral) provides an incentive to meet commitments much the same way as does a pledge of physical collateral, thus reducing moral hazard”<sup>9</sup>.

As the theory goes on, CRAs play a pivotal role as a borrower discipline device as he or she would know that a default in re-payment compromises his/her reputation with all the other potential lenders on the market, cutting him/her off from credit or obtaining it at more costly terms<sup>10</sup>.

Although lenders would lose the exclusivity of data in terms of competition one versus the other, they would ultimately gain by sharing information as this accumulation of data enables them to distinguish the good borrowers from the bad ones. Information sharing would make it easier to predict with a certain degree of confidence the future payment behaviour of applicants allowing lenders to attract good borrowers and offering them better terms and conditions, thus promoting market competition that could ultimately result in benefit to consumers<sup>11</sup>.

According to the economic literature, thus, the adverse selection problem indicates that should lenders fail to distinguish the good borrowers from the bad ones, all accepted borrowers would be charged at a higher rate an average interest rate that mirrors their pooled experience<sup>12</sup>.

Therefore, the distinction between good borrowers from the bad ones would allow lenders on the one hand to offer more advantageous prices to lower-risk borrowers (i.e. those with an immaculate or good credit history) while, on the other hand, higher risk borrowers would be offered high interest rates or would be rationed out of the market because of the lenders' unwillingness to offer these borrowers accommodating rates<sup>13</sup>.

b) Credit reporting systems are valued as instrumental tools in expanding the breadth and depth of financial markets and in strengthening the financial system.

They are reportedly said to:

- (i) reduce transaction and loan processing costs and time required to process applications;
- (ii) improve the lenders' client portfolio quality by monitoring it and identifying potential problems;
- (iii) provide cost-efficient standardised and objective criteria for credit analysis;
- (iv) increase competition in the sector: credit data would promote transparency and reduce the information advantage that a lender has over its existing clients, which in turn could lead both to lower prices offered to consumers and greater access to credit;
- (v) facilitate distant transactions (such as, for instance, e-finance or internet transactions and banking);
- (vi) provide opportunities for new financial products to consumers and enable lenders to serve consumers who were otherwise underserving or ignored (such as, for example low-income consumers). This, in turn, results in the development and sale of new products, accurate tailored pricing, targeting and marketing, which ultimately would contribute to the lenders' profitability<sup>14</sup>.

Thus, access to up to date, accurate and instant information on potential borrower customers makes it easier and more cost efficient to assess and manage risk, reducing the engagement in bad business and resulting in improved client portfolio quality and profitability<sup>15</sup>.

c) A third reason for the industry's interest in CRAs – shared by the House of Commons Treasury Committee - is that through an extensive detailed collection and sharing of personal data they are considered to provide useful services in the fight against the growth of over-indebtedness of a borrowing individual.

By sharing information, lenders are able to identify those (potential) borrowers who, although they fall within the definition of ‘good borrowers’, are already over-committed. The use of credit reporting systems would confer to the credit industry the tools for responsible lending policies, protecting individuals from running up significant borrowings beyond their means<sup>16</sup>. Likewise, consumer protection groups currently agree that full-data sharing should represent the way forward to stem the problems of consumer over-commitment by hampering responsible lending.<sup>17</sup>

d) Fraud prevention is a further function of CRAs.

Consumer credit data, in fact, can be used to compare a current credit application with previous ones by matching the application details. Thus, it would be possible to detect omissions, the data an applicant would like not to disclose, or inaccurate or untrue details within the applicant's history. Similarly, these databases would be used to detect multiple applications in the applicant's name within the same timeframe, or the use by the applicant of different names for the same banking details or other patterns of fraudulent behaviour<sup>18</sup>.

e) Finally, although CRAs are more closely associated with their role in supporting the consumer credit market, their use in the economy extends to other private transactions, such as, for example, commercial transactions, property rentals, telecom subscriptions, insurance contracts, and employment screening.

### **3. What information is collected, processed, and disclosed to third parties?**



CRA's store, process, and disseminate consumers' files containing data on their previous and existing accounts, which normally include detailed information about mortgages, bank accounts, store cards, charge cards, credit cards, loan accounts, and even mail order accounts. Each file contains the name of the borrower, his/her date of birth, current address, previous addresses, linked addresses, marital and employment status, people that have a financial relationship with him or her, number of accounts, amounts, types, stage (loan under approval, withdrawn, denied) and terms of the accounts, amount of monthly instalments, amount of residual instalments, historical data, number of defaults, amount of arrears, name of granting institutions, payment history (both regulars and in default), dates<sup>19</sup>.

Each personal file, then, has status codes assigned to it by the lender, showing whether it is up to date, in arrears, by how much in arrears, if the account is in default and how many times the repayment has been late. Closed accounts show the status codes for up to three years prior to closure<sup>20</sup>.

A survey carried out by the World Bank indicates that a large majority of CRA's worldwide also collect information on taxpayer IDs (75%), loan rating data (70%), and type and value of collateral used to secure loans (around 50%)<sup>21</sup>.

On the consumer's credit files there is also a record of the searches, including the dates and the reason for the search, together with the identity of organisations that have accessed or amended the file.

In addition, CRA's usually collect and make use of public record information to integrate each consumer's file.

Such information include data from the following sources:

- (i) the electoral or voters' roll (which is used to match the address on it with the address provided in the current and previous applications, thus verifying in addition how long the applicant has lived at a given address for);
- (ii) County Court Judgements entered for sums of money in the county courts of England and Wales (in Scotland judgements are called decrees and are issued by the small claims and summary causes sheriff courts) - in most cases CRAs are informed about judgements as soon as they are entered by the courts;
- (iii) bankruptcies;
- (iv) county court administration orders<sup>22</sup>.

Data from the Council of Mortgage Lenders' Repossession Register is also held by the CRAs, which show whether an individual has had a property repossessed or has given it up voluntarily<sup>23</sup>.

Moreover, credit reports may also contain data from the Credit Industry Fraud Avoidance System (CIFAS), which contains information regarding situations which occur when a fraud has been previously detected or it has been attempted. It allows member organisations to exchange details of applications for products or services which are believed to be fraudulent because the information provided by the applicant fails the verification checks (it should be stressed that the information filed may not directly relate to the individual concerned but could indicate that someone else has tried to impersonate him)<sup>24</sup>.

Finally, it is common to include in the databases information from Gone Away Information Network (GAIN) that contains details of individuals who have moved home leaving behind debts without notifying a forwarding address.<sup>25</sup>

It has to be additionally pointed out that CRAs' databases may also contain in the file of an individual information about one or more persons other than the relevant individual.

The circumstances in which information about another person(s) may appear on someone's credit reference file relate to situations where

- (i) the name(s) is(are) the same or similar and the address is the same;
- (ii) the CRA knows beforehand that such other person(s)' information applies to such individual;
- (iii) those other person(s) has(have) the same surname as such individual and they have been living at the same time either at the current or at any other previous address contained in such individual's file (this aggregate information enables CRAs to include information on the applicant about family members and their payment history)<sup>26</sup>.

It is worthy of note that it is the duty of the individual to request the CRAs to eventually create a dissociation in the occurrence that a financial connection does not in fact exist<sup>27</sup>.

By way of example, the sophistication of today's information systems has made available to lenders functionalities which provide them with summarised data relating to the same family individuals or aliases who live, or have lived, at the same address declared by the applicant. These databases are normally utilised when a lender has minimal information on the applicant upon which to base the lending decision.

CallCredit, a CRA in the UK, reports that if the applicant opts-in, information will be returned on same family individuals regardless of whether or not a financial association exists between them and the applicant<sup>28</sup>. Unfortunately, no mention is made about the other family individual being informed and if he or she has provided consent - arguably a very unlikely circumstance<sup>29</sup>.

Information about transient associations (a temporary association between two individuals, for example two students who purchase goods together while at the University) is also in place. To this end, there is a flag in the individual file which indicates the transient association and, if selected, details of the credit agreement will appear on the applicant's credit report individually (although an association will not be created)<sup>30</sup>. Even under the latter circumstance, no reference is made about the other individual being informed and if he or she has provided his/her consent.

An important distinction to be drawn when referring to the type of data collected and distributed by CRAs is the one between the so-called 'black' information and 'white' information.

'Black' information usually refers to negative consumer data, (information about defaults on payments, delays, delinquencies, bankruptcies etc). That is, information with a negative connotation on the payment history and the financial behaviour of the data subject.

'White' information, by contrast, refers to positive consumer data, i.e. information about the financial standing, payments and other details which do not indicate a default or a late payment.

Attempts have also been made to classify 'off-white' or 'grey' information, which would refer to data on accounts which demonstrate some signs of problems but have not yet proceeded to the state of being 'black', i.e. accounts which are in acceptable time arrears with no warning to the customer being yet issued by the lender<sup>31</sup>.

Whatever classification one prefers to draw, CRAs in the UK collect, store, and distribute both 'black' and 'white' information (including, of course, 'off-white' or 'grey' information as mentioned above).

It has to be added, finally, that CRAs are currently lobbying for more information to be made available, so that increasing amounts of data can be brought into play in lending decisions.<sup>32</sup>

#### **4. The trends in the use (or misuse) of credit reference data**

##### a) Credit Reports, creditworthiness, and ID verification

As mentioned above, the principal use of the CRAs databases is for the assessment of the creditworthiness of credit applicants.

CRAs persistently assert that they do not hold blacklists, nor do they provide any opinion about whether or not an applicant should be given credit.

Agencies believe that in these circumstances they cannot be held responsible for rejections as they do not make lending decisions<sup>33</sup>.

As it has already been reported, further uses of credit reference data include ID verification of credit applicants, fraud prevention, and the other uses listed above.

So far, this work has focused on the core activity carried on by CRAs.

It should be taken into consideration, however, that CRAs take decisive advantage of their ability to provide first-hand information and knowledge by offering additional services to the industry. Such additional services include, among the others, credit scoring services (which include scorecards design, development, set-up, analysis, and training), consulting, application processing, small business information reports, market and consumer research, debt collection, and marketing services<sup>34</sup>.

The following are just examples to highlight the trends in the use (or misuse) of CRAs' databases:

b) Credit Scoring

CRAs are normally the providers of credit scoring systems to lenders.

Credit Scoring models, otherwise also known as 'Scorecards', may be described as mathematical algorithms or statistical programmes that determine the probable repayments of debts by consumers, thus assigning a score to an individual based on the information processed from a number of data sources.

New technological advances, however, have made it possible for lenders to make extensive use of sophisticated credit scoring techniques.

It is well known in the consumer credit sector, as well as being explicitly declared by the UK Information Commissioner's Office, that most, if not all, lenders use credit scoring systems which give points to various pieces of information on the customer's application form, such as age<sup>35</sup>, job, income level, marital status, etc. as well as data taken from the credit records processed by the CRAs.

It is nowadays widely accepted by lenders that scoring (potential) customers helps the lender to predict whether the applicant is an acceptable risk, i.e. credit is normally granted if the score is above the lender's pass mark, while if the score is below such mark the applicant is more likely to be turned down (although the credit score that lenders give to the applicant will not form part of the files that the CRAs keep about the data subjects)<sup>36</sup>.

For example, the scores given to an individual may depend on the number of changes of address, in addition to other account records. In fact, the more times someone changes address, no matter the reason(s), the more it may be likely to lead to a lower score as it could signal that the applicant might be unreliable and a high risk<sup>37</sup>.

Another controversial example of the use of scoring techniques provided by CRAs and used by lenders is represented by assigning points to predict fraud risk to the type of house owned or rented by a data subject, as well as the postcode data where the property is located.<sup>38</sup>

Although credit scoring systems have traditionally been used to predict risk, they are also more and more widely used to assess affordability. In the words of a spokesman of a major CRA in the UK, “although a prospective borrower may have a range of existing credit facilities all of which are being paid on time, he or she may be so heavily committed that one more facility may result in that individual becoming over-indebted across his/her total borrowings”<sup>39</sup>.

A recent trend practiced by most lenders is the one of scoring their existing customers every month, thus ensuring that they are one of the first lenders to contact the customers when an early delinquency sets in, not only to renegotiate the repayment but also to better secure the credit and limit exposure.<sup>40</sup>

#### c) Marketing

Most large organisations now use credit reference data at the marketing stage to screen out prospect customers that have significant levels of defaulted accounts with other lenders.<sup>41</sup>

As consumers increasingly spread their financial relationships to more than one supplier, most lenders use credit information to assess the risk of new customers and to help decide what products and facilities to offer them.<sup>42</sup>

#### d) Government tapping databases

Recently, it has been reported that in the attempt to thwart bogus applications for UK passports in an effort to fight terrorism, “the data sharing provisions of the draft identity cards

bill are to allow the UK Passport Service to tap into the databases of CRAs and other commercial organisations”<sup>43</sup>.

Thus, the use of credit reference data will be a likely part of the new proposed national ID cards and will be an integral element of ‘biographical footprint checking’ of applications. To this purpose, the UK Passport Service is already engaged in a data sharing project with a CRA, the Home Office immigration and nationality department, the Department of Work and Pension and the Driver and Vehicle Licensing Agency<sup>44</sup>.

Even the Department for Constitutional Affairs, which also has access to the Police National Computer to locate defaulters, has signed a contract to use the database of a CRA to track fine-dodgers. According to a recent report, magistrates will use the 500 million records kept by such CRA to pursue a total of £276 million in unpaid court fines in England and Wales<sup>45</sup>.

e) Expanding areas

The use of CRAs is expanding. For example, a CRA has recently delivered its findings to the UK Water Industry and Government bodies after conducting pioneering research into water indebtedness<sup>46</sup>. As the company reports, with its comprehensive databases and expertise it "was able to help the water industry better understand and profile its own debtor data, building the foundation for future industry research and individual company debtor understanding”<sup>47</sup>.

A further situation representing an example of the expanding use of credit reference data is for employee monitoring. Employees’ private life is increasingly monitored through the use of information held by CRAs (for example to verify that they live where they declare to live, as well as to verify the data on their *curriculum vitae*/job application form or their



creditworthiness, particularly if they work in the financial services sector). The UK Information Commissioner simply advised that businesses should, in addition to providing the workers with the notice that checks are made on them, ensure that if CRAs are asked to provide such information on workers, the agencies must be told of the use to which the information will be put<sup>48</sup>.

Whether a private company that is the repository of the type and amount of such information should be allowed to carry on such other activities and provide those services is debatable. In any event, it is not surprising that the entire business carried out by CRAs raises key privacy concerns, as well as the question of whether the core activity of CRAs coupled with their mentioned additional products and services represent a legitimate use, or rather a misuse, of credit reference data.

## **5. Institutional and legal standing of credit reporting**

The examples provided above about the uses of credit reference data show that in the absence of specific legislation there exists almost limitless potential utilisation of CRAs' databases and services.

In Great Britain there is no law that specifically regulate credit reporting activities.

There are, however, two laws that have a significant impact on consumer credit reporting activities:

- (i) the 1974 Consumer Credit Act (which will be modernised and reformed by the Consumer Credit Bill), and

- (ii) the 1998 Data Protection Act transposing EU Directive 95/46/EC.

Other laws, regulations, or codes of practices to be taken into account would also include:

- (iii) Bank secrecy/confidentiality laws; and
- (iv) the Banking Code of Practice.

(i) The 1974 Consumer Credit Act established the early regulation of the credit reporting industry. The Act contains a number of provisions available to consumers to remedy the main mischief that may occur.

Under Section 25 of the Act all CRAs must be licensed by the Office of Fair Trading (OFT), the latter having the right to revoke such licence, *inter alia*, for deceitful or oppressive business practices, or unfair or improper conduct. These powers available to the OFT are commonly said to ensure that CRAs disclose credit information about individuals strictly for the purposes intended. Section 157 puts the lenders under a duty to disclose to the consumer at his/her request the name and address of any CRA to which the lender applied for information. Section 158 then goes on to oblige CRAs to provide the consumer with a copy of the file relating to him/her, together with a statement<sup>49</sup> of his/her rights to have mistakes corrected under section 159.<sup>50</sup>

The Consumer Credit Bill will reform the Consumer Credit Act 1974. The aim of the Bill is to protect consumers and create a fairer and more competitive credit market.

There have been some pressure from the industry to use the Consumer Credit Bill as a vehicle for addressing the issue of data sharing.

However, such issue has been considered wider than just those covered by the Consumer Credit Act. Data sharing does not therefore feature in the Bill and the Government does not propose to make any changes relating to CRAs.<sup>51</sup>

(ii) It should be noted from the outset, however, that the 1974 Consumer Credit Act does not address the issues of data collection, processing, and dissemination thus ignoring privacy concerns.

Thus, today the primary mechanism for regulating the activities of consumer credit reporting in the UK is the 1998 Data Protection Act (DPA) transposing EU Directive 95/46/EC<sup>52</sup>. The Act includes a notice of purpose of the data collection, the types of data that are collected, basic rights of access, as well as principles of good practice in which data have to be processed fairly and lawfully, and for only limited purposes and a limited time. The Act also provides that a data subject has the right to prevent the data controller from taking evaluation decisions concerning him or her by automated means alone<sup>53</sup>.

For the provisions of the Act, CRAs are data controllers. This is so because they decide why and how they process personal data<sup>54</sup>.

Thus, in accordance with the DPA, a lawful credit transaction involving CRAs should be construed as follows:

- 1) At the time a person makes a credit application, lenders should inform and obtain the consumer's consent in order to carry out a search at a CRA at the time he or she makes the credit application. As already pointed out above, such search refers to data of past transactions of the data subject.

- 2) As each search generates new data (i.e. the search flag and the related information in the CRAs databases), the data subject should be informed and provide his/her consent about such new data being generated, processed and passed to CRAs, as well as the other lenders for future eventual applications, including notice as to the scope and length of time of such data processing.
- 3) Once the lenders have agreed to grant a credit line, thus entering into a credit contract, they should inform and seek the consumer's consent to pass the relevant information to CRAs for future (eventual) searches relating to new and different credit applications, including notice as to the scope and length of time of such data processing.
- 4) In the event a lender decides to refuse the grant of a credit line to the applicant, it should inform and seek the data subject's consent to generate and communicate such new data (i.e. the application being refused) to CRAs.

Each instance of consent, as a general rule, should be the free choice of the individual.

It could be suggested, finally, that the above notices and consents should be separate from the notice and consent which a customer gives for the processing of his/her data for the specific purposes of the credit relationship with the lender at stake. Such separate notice, in addition, should already contain the specific name and address of the CRA which will become data controller, as well as the third parties to whom the data will be disclosed which, in turn, will eventually also become data controllers in accordance with the provisions of Section 1(1) of the DPA<sup>55</sup>.

By contrast, according to current practice, it is the data subject who has the burden to make a written request to the lender asking for the name and address of any CRA to which the lender

applied for information as to his/her financial standing at any antecedent time<sup>56</sup>. The issue concerning the right of an individual to access personal data in relation to the name and address of all third parties that have had, or will have, access to such information through CRAs, however, proves certainly more difficult and not supported by practice.

It seems the case, however, that consumers do not have much choice if they do not want to be refused credit. The consumer's consent with regard to the searches to be carried out in the CRAs' databases, in fact, seems to be viewed both mandatory and assumed (i.e. implied consent). Lenders say that the lack of such consent would impede them from taking the credit application any further. No consent, no credit (i.e. enforced consent).

Moreover, lenders make it a condition of the credit contract that at a later stage they have the right to pass the information concerning such specific credit line to CRAs, which in turn have the right to disseminate the same to their client members, such clause seeming to be not negotiable (no consent, no contract).

(iii) and (iv) As it has been pointed out above, lenders not only subscribe as client members to CRAs for the use of the information of the databases but also contribute information to them. This is where questions of potential breaches of bank secrecy/confidentiality may arise. It has been already accepted for some time through banking practice that lenders reveal the so-called 'black' information to CRAs. By contrast, banks have stated in the Banking Code of Practice that no 'white' information would be passed to CRAs without the consent of the customer (the Banking Code of Practice March 2005, para 13.8)<sup>57</sup>.

However, whether there is a legal justification for such practices (concerning both 'black' and 'white' credit data) is problematic.

In fact, nothing is said in the Banking Code of Practice about its legal status and there is no suggestion that it confers legal rights on customers, although it purports to impose liabilities on them. As it is expressly stated that it is 'voluntary', it may well be suggested that it has no legal effect at all (but, as subscribing banks advertise that they adhere to it and make it available to customers, its provisions may not be treated as implied terms in the banking contract)<sup>58</sup>.

In addition, there is no statutory law relating to the bankers' duty of secrecy and the rules as set by precedents and terms implied in the contract between a bank and a customer.

The duty of confidence by banks raises difficult questions and complex legal issues which are beyond the scope of this article.

To summarise, the leading case is *Tournier v. National Provincial and Union Bank of England*<sup>59</sup>, in which it was established that the bank owed its customer a legal, and not merely a moral, duty of confidentiality and could not lawfully disclose to third parties information concerning the customer's affairs. This duty is not absolute but it is qualified by four exceptions, namely:

- (a) where disclosure is under compulsion by law;
- (b) where there is a duty to the public to disclose;
- (c) where the interests of the bank require disclosure;
- (d) where disclosure is made by the express or implied consent of the customer.

Legal scholars mainly assume that banks have been relying on either exception (c) the interest of the bank; or exception (d) consent of the customer; but it is arguable that banks have no entitlement to divulge customers' credit information under the common law and that the

safest and proper course of action would be to ensure that they have the consent of the customer, either express or implied<sup>60</sup>.

To this purpose, moreover, it is worth going back a little in history to look at the 1998 'Jack Report on Banking Service: Law and Practice' that looked at many aspects of the banker-customer relationship<sup>61</sup>.

It should be stressed from the outset that the Jack Report was never implemented, but its findings are nonetheless interesting.

The recommendation in relation to CRAs and the possible disclosure of confidential information by banks was made that the extent of permitted disclosure 'in the interest of the bank' without customer consent should be clearly limited by statute, and that in any event exception (c) should not really be used other than in the narrowest of situations<sup>62</sup>.

Therefore, this would leave a bank disclosing a customer's information having to obtain consent from him or her or be able to imply it.

To what extent could a bank argue that a customer knew or ought to have known of all the uses of his/her personal data as outlined above in this work to justify arguing for implied consent?

One suspects, therefore, that in such situation there would be ground to exclude the application of exception (c) and that consent should not be implied.

The main barrier to the sharing of consumer data seems to be the interaction between the DPA and the common law duty of confidence. The DPA, in fact, requires that any processing of personal data must be 'lawful'. Legal advice sought by the Information Commissioner about historic data concluded that "the above exceptions could not be used to justify the sharing of positive information without consent. This legal advice also raised doubts as to whether these exceptions to the duty of confidence could be used to justify the sharing of negative information".<sup>63</sup>

Under all these circumstances, thus, there could be a challenging ground for further legal analysis, in particular with reference to the issues relating to:

- (1) 'extortionate or enforced consent' (the same consideration first above written relating to the consent for processing under the 1998 Data Protection Act would apply);
- (2) if the *Tournier* Case could also apply and relate to lenders which are not banks (as it has been stressed elsewhere, in fact, a number of lenders are not banks);
- (3) the adequacy of case-law referring to a case heard in 1924 as compared to banking practises as applied in modern technological advances and sophistication.

As far as the institutional point of view of credit reporting is concerned, finally, there is in place a complex system of enforcement and supervision. According to the 1974 Consumer Credit Act, the Department of Trade and Industry issues regulations, while the Office of Fair Trading has the duty to supervise the enforcement. According to the DPA, however, the Home Office issues regulations and the Information Commissioner is the enforcement authority<sup>64</sup>.

Secondary legislation on CRAs in the UK includes the Consumer Credit (Conduct of Business) (Credit References) Regulations 1977 No. 330, amended by the Consumer Credit (Conduct of Business) (Credit References) (Amendment) Regulations 2000 No. 290, and the Consumer Credit (Conduct of Business) (Credit References) (Amendment) Regulations 2000 No. 291.

## **6. Issues for further consideration and debate**



As it has already been stressed above, whether credit reporting practices comply with the DPA or the common law duty of confidence is open to discussion and would require a more detailed legal analysis and debate.

Above all, however, it would be worthy to determine if the DPA or the Banking Code of Practice are adequate and relevant to the sophisticated and highly technological mechanisms of credit reporting, where data from different sources are easily and quickly aggregated, new data are automatically created (for example, the searches), and are disclosed to a potentially unlimited number of third parties for a growing number of expanding purposes.

Moreover, previous research has already stressed that further consideration should be given to what constitutes the 'essential information' which allow the credit assessment process by lenders.<sup>65</sup>

In this respect, it would certainly be a useful exercise to assess the necessity and scope of all the information provided by CRAs for the purpose of predicting the future behaviour of a borrower, matching them with the nexus about the likelihood of repayments with the contracted interests. Does the provision of all such information and the consequent intrusion into one's private life find a justification for the carrying on of a profitable historical commercial business such as banking? It should not be forgotten, to this purpose, that it is the lenders' business to provide credit to borrowers and that they make their profit out of it, the risk being part of the business and yielded by further higher interests in case of defaults and arrears.

For instance, in an analysis of what constitutes 'essential information' one of the main questions refers to the distinction between 'black' and 'white' data. Whereas most people may accept the value of sharing 'black' data as a disciplinary instrument, at least where customers are informed and where they provide consent, the issue of sharing 'white' information proves more difficult.<sup>66</sup>

In any event, whatever the answer may be in relation to the technicalities above and far from underestimating them, the heart of the debate and the fundamental question referring to credit reporting is how far a consumer should be forced to sacrifice his/her own privacy in the interest of the credit industry (the general interest?), bearing in mind that the ‘utilitarian’ concerns of the credit industry cannot necessarily prevail over civil liberty and fundamental human rights concerns.

Likewise, the above mentioned current consumer protection arguments supporting full-data sharing seem to neglect or sacrifice crucial consumer rights such as data protection.

This raises the question about what the perception of consumer protection in this sector should be, i.e. whether protecting consumers from privacy intrusions and profiling in the technological era or, rather, paternalistically protecting them by making lenders responsible to impose limits to the access to credit.

If the answer is that the latter circumstance should prevail, then another consequent issue to be raised next would be to what extent such perception of consumer protection should override the established right to privacy of individuals.

To these ends, it should be taken into account that all privacy rights now benefit from, and should be interpreted in light of, Art. 8 of the European Convention for the Protection of Human Rights and Fundamental Freedoms, incorporated into English Law by the Human Rights Act 1998<sup>67</sup>.

As already outlined, the entire credit reporting business is based on statistical considerations and there is no scientific evidence, nor a causal nexus, as to the certainty of the future behaviour of a human being<sup>68</sup>.

In fact, the major factors behind the creditworthiness or over-indebtedness of individuals were found to be unforeseen life events, such as sudden illness, loss of job, death of someone close, etc. rather than a mismanagement of resources<sup>69</sup>.

Moreover, it could be argued that someone who has had problems in the past does not necessarily have problems at present or in the future.

Last but not least, an individual may well also have a low profile credit record from failing to make payments which are either undue or in conflict with the service provider<sup>70</sup>.

What strikes someone attention is that information about defaults are passed on to CRAs (and then, in turn, disseminated) simply by the lenders so affirming, regardless of any judicial hearing having taken place, thus rising questions as to whether is there any respect for the certainty and rule of law.

Is someone guilty for failing to pay a lender back because the lender simply says so or because a judge has taken a decision by law accordingly?

The number of uses of consumers credit data raises concerns not only about privacy but also about discrimination.

If it is certainly true that “no one has a right to credit”<sup>71</sup>, it is also almost certainly indubitable that no one should suffer discrimination, especially by mean of instruments that do not have a causal connection with the activity carried out nor a basis of conclusive evidence.

When people are refused credit they should not become more vulnerable to either getting credit at more expensive rates and disadvantageous contract terms (sometimes to the point of extortionate credit deals) or, even worse, to being the victims of usury in the black market.

## **Conclusion**

All such concerns may open the debate on how far private organisations should go and if the use of credit reporting data for an indefinite number of products and services is legitimate or not.

In fact, it seems that the expanding use of credit reporting, coupled with the many different activities that CRAs carry on, does not find limits in today's law, thus being open to further new technological advances and findings.

Ultimately, it would be worth exploring whether specific regulation of this market is necessary to avoid the arbitrary use of credit reference information and the arbitrary positioning of privately owned CRAs in the modern society.

As this work has attempted to point out, an attentive analysis of credit reporting leads to more legal questions and concerns than the positive law answers.

A fair balance would most certainly be required between legitimate individual privacy rights, discrimination concerns and the needs of the credit industry.

If the smooth operation and further development of an efficient financial market is important for the economy, at the same time there is a duty to preserve the right of the individual to the privacy of his/her transactions as well as a fair and legitimate use of his/her personal data.

The task of the law would be arguably to provide a response to concerns and to strike a balance between different interests: thus, it could be put forward that there is a case for credit reporting not to be an exception.

## References

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<sup>1</sup> 'Lenders' may be defined as those organisations that have the potential to provide credit facilities to consumers in the form of loans, mortgages, hire purchase, supply of goods and/or services billed upon use etc. They include, for example, banks, building societies, finance houses, leasing companies, telecom providers and ISP,

- high street retailers, credit card issuers, the home shopping sector, utility companies, estate agents, etc. Lenders are normally client members of one or more CRA.
- <sup>2</sup> Information Commissioner's Office, "No Credit?", [www.informationcommissioner.gov.uk/cms/document/uploads/common%20complaints%20about%20credit%20reference%20file%20information.pdf](http://www.informationcommissioner.gov.uk/cms/document/uploads/common%20complaints%20about%20credit%20reference%20file%20information.pdf)
- <sup>3</sup> Section 145(8) of the Consumer Credit Act 1974 defines a Credit Reference Agency as "a person carrying on a business comprising the furnishing of persons with information relevant to the financial standing of individuals, being information collected by the agency for that purpose".
- <sup>4</sup> Experian, Official Website, <http://www.experian.co.uk>; Equifax, Official Website, <http://www.equifax.co.uk>; CallCredit, Official Website, <http://www.callcredit.co.uk>.
- <sup>5</sup> Hurst P. (1998), "Sharing performance data through credit reference agencies – levelling the playing field", *Credit Management*, Nov. 1998, Stamford, p. 28
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See also Miller M.J. (2003), "Credit Reporting Systems around the Globe: The State of the Art in Public Credit Registry and Private Credit Reporting Firms", in Miller M.J. (2003), *Op. cit.*, p. 25-79.
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- <sup>9</sup> Miller M.J., (2003), "Introduction", in Miller M.J. (Ed.), *Op. cit.*, p. 2.  
See also Miller M.J. (2003), "Credit Reporting Systems around the Globe: The State of the Art in Public Credit Registry and Private Credit Reporting Firms", in Miller M.J. (2003), *Op. cit.*, p. 25-79.
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- <sup>11</sup> Ibid.
- <sup>12</sup> Alary D. and Gollier C. (2001), "Strategic Default and Penalties on the Credit Market with Potential Judgment Errors", *EUI Working Paper*.
- <sup>13</sup> Barron M. and Staten M. (2000), "The Value of Comprehensive Credit Reports: Lesson from the US Experience", *Research Paper, Credit Research Centre*, Georgetown University, Washington D.C., also in Miller M.J. (Ed.), *Op. cit.*, p. 273-310
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- <sup>16</sup> House of Commons Treasury Committee, "Credit Card Charges and Marketing", *Second Report of Session 2004-05*, 4 February 2005, The Stationery Office, London. See also Amparo San José Riestra, (2002), *Op. cit.*; Bradford M., (2004), "Full data-sharing could stem over-indebtedness concerns", *Credit Risk International*, Nov, p. 11.
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- <sup>18</sup> Warwood A. (1995), "How Do Lenders Decide Who To Lend To?", *Quarterly Account*, 37, 3-5, p. 4.
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- <sup>23</sup> Ibid.
- <sup>24</sup> Ibid.
- <sup>25</sup> Credit Report, Equifax, *cit.*
- <sup>26</sup> Callcredit, Consumer Credit Referencing, Compliance Area, "Third Party Data (TPD)", [http://callcredit.plc.uk/corporate\\_scripts/compliance\\_tpd.asp](http://callcredit.plc.uk/corporate_scripts/compliance_tpd.asp) See also Information Commissioner's Office, "Credit Reference File Info: Common Complaints: Feb 2000", [www.informationcommissioner.gov.uk/cms/document/uploads/common%20complaints%20about%20credit%20reference%20file%20information.pdf](http://www.informationcommissioner.gov.uk/cms/document/uploads/common%20complaints%20about%20credit%20reference%20file%20information.pdf)
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- <sup>28</sup> Callcredit, Consumer Credit Referencing, Compliance Area, “Household Override (HHO)”, [http://callcredit.plc.uk/corporate\\_scripts/compliance\\_tpd.asp](http://callcredit.plc.uk/corporate_scripts/compliance_tpd.asp)
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- <sup>30</sup> Callcredit, Consumer Credit Referencing, Compliance Area, “Transient Associations”, [http://callcredit.plc.uk/corporate\\_scripts/compliance\\_tpd.asp](http://callcredit.plc.uk/corporate_scripts/compliance_tpd.asp), on 10 April 2005.
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- <sup>47</sup> *Ibid.*
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- <sup>49</sup> As prescribed in Consumer Credit (Credit Reference Agency) Regulations 1977, S.I. 1983/1571.
- <sup>50</sup> See also Alqudah F. (1995), “Bank’s Duty of Confidentiality in the Wake of Computerised Banking”, *Journal of International Banking Law*, 1995 JIBL, 50-55, p. 54; Harvey B. V. and Parry D. L. (1996), *The Law of Consumer Protection and Fair Trading*, London, Butterworths, p. 312-313.
- <sup>51</sup> Department of Trade and Industry, “Consumer Credit Bill, Full Regulatory Impact Assessment”, available at [www.dti.gov.uk/ccp/creditbill/pdfs/creditbillria2.pdf](http://www.dti.gov.uk/ccp/creditbill/pdfs/creditbillria2.pdf); Experian, Official Website, <http://www.experian.co.uk/corporate/compliance/consumercredit/consumercredit.html>.
- <sup>52</sup> OJ L 281, 23/11/95, p. 0031-0050.
- <sup>53</sup> See Carey P. (2000), *Data Protection in the UK*, London, Blackston; Lowe R. and Woodroffe G. (1999), *Consumer Law and Practice*, London, Sweet and Maxwell, s. 26.04.
- <sup>54</sup> See the Information Commissioner Guidance notes under the Data Protection Act, [www.informationcommissioner.gov.uk](http://www.informationcommissioner.gov.uk).
- <sup>55</sup> This is so because they would eventually decide why and how they process such personal data.

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- <sup>56</sup> Lowe R. and Woodroffe G., (1999), Op. cit., p.395-399.
- <sup>57</sup> See Campbell A. (1999), “Bank Confidentiality and the Consumer in the United Kingdom”, in Cartwright P. (Ed.), Consumer Protection in Financial Services, London, Kluwer Law International, p. 93.
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- <sup>66</sup> Ibid.
- <sup>67</sup> Article 8 of the European Convention for the Protection of Human Rights and Fundamental Freedoms provides that:
1. Everyone has the right to respect for his private and family life, his home and his correspondence.
  2. there shall be no interference by a public authority with the exercise of this right except such as in accordance with the law and is necessary in a democratic society in the interests of national security, public safety or the economic well-being of the country, for the prevention of disorder or crime, for the protection of health or morals, or for the protection of the rights and freedoms of others.
- <sup>68</sup> While it could be understandable that lenders want to know who are they dealing with thus gathering information about people (i.e. information referring to the past), it would be also helpful to understand the necessity, purpose, and nexus of the processing of information relating to the future relationship between them (i.e. the life of the credit contract and the credit line).
- <sup>69</sup> Such consideration has also been expressly stated by the director of data protection and regulatory affairs at Credit Reference Agency Experian UK, see Bradford M. (2004), cit.; See also Amparo San José Riestra, (2002), Op. cit.
- <sup>70</sup> Brignall M., “Total History of Your Dealings”, The Guardian. Jobs & Money, Saturday 30 October 2004, for instance, reports examples of such incidents.
- <sup>71</sup> The Information Commissioner, “No Credit?”, cit.