Financial Inclusion Europe Policy Brief
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Proposal for an European Banking Authority CONSUMER CREDIT DATABASE

for an efficient supervision and a reinforced consumer protection

In the context of the upcoming revision of the Consumer Credit Directive, Financial Inclusion Europe is proposing the introduction of a specific article, aimed at improving the quality of the monitoring of the EU consumer credit market. The goal of this proposal is to provide essential information for regulators to ensure proper impact assessment of EU regulation in the area of consumer credit.

The proposed article:

"The European Banking Authority shall design and collect indicators to measure the quality of consumer credits market and carry out precise Non-Performing-Loans monitoring, including information on default rate by type of credit, by lender and by sales channel. "

Financial Inclusion Europe

The proposal and the rationale

The EBA Consumer Credit Database proposal aims at creating an EU-harmonized database of EU consumer credit market indicators. Even if several similar initiatives currently exist on a national level, EU policymakers are missing the consolidated information they need on the credit market at EU-level.

This proposal aims at providing regulators, consumers, and market participants with a single, easy-to-use, reliable database. As of now, there is a lack of granular data and information on the EU consumer credit market. EU policymakers currently do not have access to the necessary data to deliver timely monitoring that will enable informed decision-making in the fulfillment of their mandates. Such a database will bring benefits and improve the overall quality of the EU consumer credit market. This will provide policymakers with the right indicators to ensure informed and evidence-based policy measures. Moreover, it will also enable policymakers to identify predatory lending, take action to prevent financial exclusion, increase the overall transparency and competition in the market.

This proposal follows Chapter 5 of the Better Regulation Guidelines[1], which deals with monitoring. In fact, as stated in the European Commission document, monitoring generates evidence on an intervention's activities and impacts over time in a continuous and systematic way. A monitoring system is a necessary and integral part of better regulation, helping to identify whether a policy is being applied on the ground as expected, addressing any implementation problems of an intervention and identifying whether further action is required to ensure that it can achieve its intended objectives. The EU currently lacks this kind of monitoring in the context of consumer credit, and this proposal aims to fill that gap.

The Indicators

The indicators to be collected are the following:

- Default rate by type of credit
- Default rate by type of lender
- Default rate by sales channels

These indicators are aligned with SMART criteria. They are **specific**, since the measured changes would be expressed in precise terms, **measurable**, since the indicators are related to things that can be measured in an unambiguous way, **achievable**, since all responsible lenders should already be collecting this information for their own management functions, **replicable**, since measurements can be the same when made by different people using the same method and **timebound**, since there should be a time limit within which changes are expected and measured (that can be set by EU policymakers).

[1] Commission Staff Working Document, Better Regulation Guidelines (2017)

These indicators, which could be easily collected by national competent authorities, would make it possible to quickly identify lenders whose business model is based on a higher rate of repayment accidents. They have been selected because they are limited in number, comprise a mix of both quantitative and qualitative, are practical to collect and not dependent upon experts and, most importantly, tell us a lot about the state of the consumer credit market.

The consumer credit market is diverse in term of providers: credit institutions are not the only ones active on the market. Across all member states credit providers include non-banking companies, cooperative organisations, credit unions and microfinance institutions. Introducing the requirement for this reporting across all these organisations would ensure that consistent record-keeping is conducted across all these diverse types of lender.

Measuring rates of default is a critical element in banking sector monitoring and can use the definition of default from existing EBA guidelines . Moreover, NPL tracking and reporting is of key relevance for creditors and supervisors, as highlighted by the ECB Guidance on NPL . Although stricter requirements apply to high-NPL significant institutions, there is room to draw lessons from these practices and apply them to consumer credit providers.

The role for the European Banking Authority

The European Banking Authority is the best candidate for the management of such database, as it would act in fulfilment of the EBA's mandate set out in Article 9 of the EBA Founding Regulation , which requires the Authority to take a leading role in promoting transparency, simplicity, and fairness in the market for consumer financial products or services across the internal market.

Moreover, the current work of the EBA on NPLs largely builds on the EU Commission Action Plan and covers risk analysis, policy and consumer protection perspectives. The current work focuses on NPL data standardisation, data infrastructure and transparency in NPL markets, and sharing supervisory practices in the monitoring of banks' NPL management and resolution, with a specific focus on balancing prudential objectives with consumer protection obligations.

[2] Guidelines on the application of the definition of default under Article 178 of Regulation (EU) No 575/2013

[3] ECB, Guidance to banks on non-performing loans, March 2017

[4] Consolidated text: Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 Nove 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC

[5] EBA website, Risk analysis and data, NPLs

The EBA should collaborate with the existing NCAs across the EU in order to develop a single taxonomy to define the types of credit, lender, and sales channels. In practice, the EBA would be in charge of the data collection and analysis. Using the default rates, it would be possible to quickly identify lenders whose business model is based on a higher rate of repayment incidents. In addition, the specification on the type of credit, lender, and sale channel will give the policymakers the possibility to ensure that all sales methods are safe and guarantee the proper information and decision-making of both the seller and the buyer. These indicators will be studied in order to assess the overall quality of regulation and supervision, address the most urgent regulatory concerns, and better target mystery shopping exercises. Following on from this, an interesting cross-analysis could be performed, namely, the EBA could analyse a specific type of loan sold via a specific type of sale channel, by specific types of credit providers.

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Illustration and usage

This would allow the EBA to identify practices where default ratios differ significantly from the average. Reduced default rates should signify possible best practices, with possibly lessons to be learned from additional targeted investigations on the causes of this low ratio. On the contrary, significantly higher default rates might, after additional targeted investigations, shed light on issues in the regulation implementation (compliance) or regulation efficiency (loophole in the legal framework).

The EBA could use the information received on the default rate in order to identify which credit supplier is showing a higher than average default rate. Identifying predatory lenders would be made easier. If a particular company is showing high default rates, there are two possibilities: either the company is losing money, or the company is still financially sound and profitable. A problem could arise in the second scenario, as there might be grounds to think that a particular credit supplier is profiting from the high defaults of its loans, its business model might be put under investigation.

The database could be used at an EU level to assess the compliance and the efficacy of APR caps across the EU. Trend analysis could be performed in order to understand the impact of these caps on the number of loans issued or the average default rates. Under a non-disclosure agreement, EBA would not publish the names of the banks or their financial information. On the other hand, EBA could be required to publish the results of the data analysis in an aggregate and anonymous way via an annual report. Moreover, in this way client providers will benefit from understanding the state of the market, its trends, and their respective positions with respect to their competitors. A committee could be established with the particular task of drafting the report and deciding the follow-up actions In order to provide reliability to the database, random checks would be made on the quality of the data submission, and sanctions need to be imposed in case of wrong information.

The way forward

The steps required to implement this proposal can be summarised as follows:

- **Harmonization of databases (since some countries are already collecting and analysing these types of data at national level, an EU-level database needed to understand the EU market as a whole)**

- **Definition of a stable typology defining the types of credit and sales channels (this could be done by leveraging on already existing typologies created at a national level)**

- **Set up a secure and reliable way to transfer data as a mandatory reporting requirement, making use of the newest technology, reducing the risk of cyber incidents and based on already existing supervisory reporting mechanism)**

This proposal would ensure that policymakers can fulfill their mandate, in line with the EU Better Regulation agenda.