

DATA QUALITY ISSUES EXACERBATE CREDIT CRUNCH

by Alasdair Warwood FICM

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Synopsis

The challenge for the consumer lending industry is to find a way to lend responsibly whilst protecting bottom line profitability and maintaining positive customer relationships. Alasdair Warwood, a credit industry specialist with particular expertise in the area of information, believes that central to achieving this goal is improved standards and attitudes to data quality in the consumer lending sector.

This article is submitted by Credit Professionals Limited (CPL), with which the author has an association as a Senior Consultant.

Alasdair is also an expert panelist for Debt Management Today.



The Author

Alasdair Warwood FICM has worked in the IT and credit industries for more than thirty years and has specialist knowledge of both the credit industry and of data protection legislation. His roles have included Assistant Secretary of the Finance Houses Association and the Equipment Leasing Association (now merged as the Finance and Leasing Association) and Director - Consumer and Legal Affairs at Experian Limited. He has also held the position of Secretary General of ACCIS - The Association of Consumer Credit Suppliers - which represents the European credit reference agencies and Alternate Director - Registry Trust which runs the register of county court judgments. He is former Chairman of the Sussex and Surrey Branch of the Institute of Credit Management (ICM). Author of the BSI's Guide to the Practical Implementation of the Data Protection Act 1998 and a member of the BSI Data Protection Editorial Board, Alasdair contributes and speaks regularly to specialist publications and conferences in the field of data protection and credit.

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End of low rate deals spells misery for many

Historically borrowers with an adverse credit history have generally still been able to borrow - albeit at a price. However the knock-on effects of the sub-prime crisis in the US, the unravelling of the securitisation market as supposedly blue chip lenders found themselves holding massive amounts of dodgy securities, and the aftershocks from the Northern Rock and Bear Sterns affairs have had a major and dramatic impact on the UK mortgage market for anyone who is not a prime quality risk.

It has been impossible to read the papers or watch the news recently without some aspect of this issue featuring heavily. Some recent headlines include:

- **“Mortgage products disappear”** The Bank of England’s recently published Credit Conditions Survey noted that mortgage lenders have been withdrawing products in recent months as a result of the credit crunch and a lack of availability of funds and expects things to get worse.

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- **“Rents rise 2.4% in one month”** Rents are rising as borrowers are pushed out of the mortgage market into the rental market..
- **“Big name quits new mortgage market”** Britain is reported as facing a "mortgage famine" with the announcement that First Direct is temporarily quitting the market after receiving five times the usual volume of applications because of the withdrawal by rivals of so many products.
- **“Credit problem customers could pay a fortune on their mortgage interest rate”** Homeowners that have entered into an Individual Voluntary Arrangement could end up paying a fortune on their mortgages as they seek to refinance at the end of the IVA term in order to release the equity they are required by the conditions of their IVA to put towards paying off a proportion of their debt. Not only are mortgage rates higher than when they bought their houses, but they could well be classified as sub-prime.
- **“Pleas for mortgage help surges by a third as debt fears grow”** Debt problems are surging according to Citizens Advice, which reported that the number of people appealing for help with mortgage arrears in January and February was more than a third higher compared with 2007. Up to one in 10 home owners admitted they were likely to miss a repayment during the coming year, according to research by moneynet.com, the financial website.
- **“Credit crisis: the cracks are opening in UK's debt mountain ...”** Lenders have withdrawn many deals offering more than 90 per cent of the value of a property, and only nine lenders still offer 100 per cent mortgage deals. As competition between lenders for these types of deals shrinks, the interest rates increase. The number of mortgages on offer has more than halved from about 13,000 in July last year to 6,100 today. As a result, borrowers will have to pay more to secure a new deal, or go onto their lenders' more expensive standard variable rate.

A new era in consumer lending

But what is the reality of this situation – once you get beyond the media headlines? With the ending of many historically low rate fixed rate mortgages, existing borrowers are now facing an average £210 hike in their monthly repayments. Naturally they have been seeking, but many have been failing to find, alternative sources of finance.

The shelves have been virtually cleared of products for those with even modest arrears positions. They have also been virtually cleared for those with less than 15% equity in their properties because of fears over the direction of house prices and the associated risk of the return of negative equity. In this climate the message is clear “ Have a good track record or else”

Problem exacerbated by inaccurate data

But this isn't always that easy. The problems which borrowers who are or have been in difficulty face are exacerbated by the credit reference agencies being supplied with inaccurate or incomplete information by creditors.

As creditors increasingly turn to debt collection agencies or the sale of debts to third parties, so it becomes increasingly difficult to ensure that borrowers' records accurately reflect the payments they are making - making it increasingly likely that their accounts are showing erroneous arrears positions. And this information gets passed onto the credit reference agencies.

Problems occur too for borrowers who are trying to get themselves out of financial difficulty. This might be by using an informal debt management arrangement directly with their creditors or, more formally, with the help of a voluntary sector organisation such as their local CAB or Money Advice Centre or with a commercial debt management company.

Each of the credit reference agencies has created the facility to record such debt management programmes on client files. However evidence suggests that many of these programmes – it might even be most of them - are not being recorded accurately or recorded at all, according to the rules of the bureaux.

In such circumstances the borrower may be paying according to the agreed revised repayment schedule but their file may not show that a debt management programme is in place. In fact it might actually show ever-increasing arrears as the creditors continue to report payments against their originally contracted terms. And this situation may be particularly severe for those whose accounts are in the hands of debt collection agencies.

If those agencies are not reporting payments back to creditors and/or are not reporting them directly to the bureaux on behalf of their principals then the information on an individual's credit file is going to have a hugely negative impact on their future ability to obtain credit.

Debt Sale – a particular challenge

If the account has been sold to a third party - an increasingly common scenario - it can be almost impossible for the bureaux to maintain an accurate record. And this is particularly likely if the debt seller and buyer do not actively co-operate to ensure the data that each of them holds is accurate. This problem is exacerbated by the different bureaux having different ways of showing such accounts. In some cases what is really the same account may look like two different accounts - one reported by the original creditor and one by the debt buyer.

Where a creditor regards an account as being in default - and whether they manage it in-house, send it to a debt collection agency or sell it - they must ensure that they follow the guidance laid down by the Information Commissioner for the treatment of defaults.

A further problem that borrowers may encounter is that they may have paid off a defaulted debt but the satisfaction of the debt is not reflected on their file because, internally, the creditor had previously written off the debt and is unable to link later payments to the account to which they relate.

Similarly borrowers with County Court Judgments or Sheriff Court Decrees may not be aware that in order to have a Judgment or decree shown as satisfied they need to obtain a Certificate of Satisfaction form the Court. In order to do this they need to obtain, and provide to the court, confirmation from the creditor that the debt has been satisfied.

A further problem that occurs is that there is inconsistency in the treatment of payments made via different debt collection and debt management organisations. In many cases the full amount paid by the borrower is reflected as paid to their account with the bureau, even though the creditor may have only have received a percentage of that payment - with the balance having been retained by the debt collector or by the debt management organisation as a voluntary contribution for the provision of their services.

However where the borrower has used a fee-charging debt management company to help them resolve their difficulties only the net amount paid to the creditor is reflected on their credit record. The anomalous treatment of such payments, despite the creditors having agreed to such debt management programmes, means that the borrowers' file under-reflects the payments they have made and may have adverse consequences when they are ready to re-enter the credit market.

A downward spiral

A final compounding problem for borrowers with adverse history or low equity is that the withdrawal of credit offerings from the market means that more enquiries may have to be made before they can find re-financing facilities. The recording of multiple enquiries when only one facility is being sought may itself lead to further credit declines - turning the situation into a vicious downward spiral.

Each of the bureau has sought to deal with the problem of multiple searches by creating systems which distinguish between enquiry searches and application searches. Application searches are seen by other enquirers and by the individual when applying for and receiving a copy of his or her file. Enquiry searches are generally seen only by the organisation that made them and by the individual when applying for and receiving a copy of his or her file. However the system only works properly if the enquirer uses them properly. If they do not, then multiple application searches are likely to appear on their file and be visible to other enquirers.

The legal and regulatory implications

Errors on borrowers' files, as well as being unfair to the borrower, may also have legal or regulatory implications for the lender, the debt collection agency or the third party debt purchaser. This following section looks at the variety of legal, regulatory and industry standards to which organisations should comply in order to support accurate and fair data recording. In the extreme, failure to maintain correct records could call into question whether they were able to meet that requirement and could, at the very least, have the OFT or the relevant Trading Standards Authority investigate them.

- **FSA** - Where the creditor is regulated by the FSA, data errors which adversely impact the borrower are arguably a breach of the FSA's Treating Customers Fairly (TCF) requirements.
- **OFT** - Where the creditor is regulated by the OFT, data errors which adversely impact the borrower are arguably a breach of a number of OFT regulatory requirements. For example, *the licensing requirements of the CCA 1974 and 2006* Creditors are required to show that they are fit to hold a licence: *"The OFT has a duty under the Act to ensure that applicants for licences are fit to engage in the activities for which they wish to be licensed, and to monitor the continuing fitness of those to whom licences have been granted. In considering fitness the OFT is able to take account of any circumstances which appear to be relevant, and in particular, any evidence that an applicant or licensee, or any of its employees, agents or associates, has engaged in business practices appearing to the OFT to be deceitful or oppressive or otherwise unfair or improper (whether unlawful or not)"*¹
- **Debt Collection Guidance**

The OFT has published guidance on debt collection² which sets out its view of proper and improper debt collection practices. Of particular relevance in respect of maintaining accurate records are the following excerpts -

1.9 If consumer credit licence holders choose to do business or continue to do business with third parties engaged in questionable fitness behaviour, then their own fitness will be called into question...

2.6 Examples of unfair practices are as follows:

... not ensuring that an adequate history of the debt is passed on as appropriate resulting in repetitive and/or frequent contact by different parties

... ignoring and/or disregarding claims that debts have been settled or are disputed and continuing to make unjustified demands for payment

2.8 Examples of unfair practices are as follows:

... failing to investigate and/or provide details as appropriate, when a debt is queried or disputed, possibly resulting in debtors being wrongly pursued

- **Data Protection Principles**

The Data Protection Act 1998 requires compliance with the eight data protection principles. Failure to maintain accurate records in a way which may adversely impact on the borrower, whether by denying him access to credit or by causing difficulties with collections action, is likely to breach at least four of the principles viz:

1. *Personal data shall be processed fairly and lawfully ...*
2. *Personal data ... shall not be further processed in any manner incompatible with that purpose or those purposes*
3. *Personal data shall be adequate, relevant and not excessive in relation to the purpose or purposes for which they are processed.*
4. *Personal data shall be accurate and, where necessary, kept up to date.*

- **ICO Guidance on defaults**

The Information Commissioner has published guidance³ in the form of a technical guidance note on the filing of information in relation to defaults and arrangements to pay, including DMPs which includes the following:

“Debt management programmes

A debt management programme (DMP) is when a customer enters a programme of repayment of all or a number of their credit agreements that has been negotiated by a third party, ‘not for profit’, debt adviser. By entering the programme the customer shows that he is acting more responsibly than someone who makes no effort whatsoever to pay what is due. However, in financial terms, DMPs include markedly different situations. Repayments vary from a level acceptable to a lender to those where the sums repaid are only nominal amounts which a socially responsible lender agrees to accept because it recognises that in entering a debt management programme the customer is trying to act responsibly but cannot afford to pay more, and this is the only way to recoup any of the debt. Consequently the record filed on a credit reference file should discriminate between these situations so that an adequate reflection of the financial standing of these customers can be shared with other lenders.

Moderate to high levels of repayment

If the payment set out in the DMP is at a level of repayment that a lender considers at least adequate, the agreement should be marked as included in a DMP. A lender may be willing to reschedule the agreement at a later stage at which point the record should be changed to reflect the agreed rescheduling. “

Failure to follow this guidance, or the general guidance on defaults is likely to lead to breaches of the principles outlined above. And whilst the guidance refers to DMPS created by “not-for-profit” organisations this is merely historical and the same principles would apply to DMPs created by “for-profit” organisations.

- **Credit bureaux rules**

In association with the trade associations representing lenders the three bureaux have created rules for the filing of information with their data-sharing schemes viz. Share (Callcredit), Insight (Equifax) and CAIS (Experian). As a general principle the ICO expects trade association members whose trade association has signed up to some form of standard to comply with those standards. Failure to do so is likely to be a breach, at least, of the first data protection principle.

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- **The Banking Code**

The Banking Code requires adherent to “Treat Customers Fairly” and to lend responsibly. Maintaining inaccurate records breaches the former and may lead other creditors to not lend responsibly, thereby indirectly not treating borrowers fairly.

- **DBSG guidelines**

The Debt Buyers and Sellers Group (DBSG) which represents organisations operating in the third party debt purchase market, whether as principals selling debt or buying it, requires members inter alia, to:

Conduct business lawfully

Conduct dealings with debtors in a fair and reasonable manner

Maintain a high standard of business practice ...

Handle transactions in a fair and reasonable manner

Failure to ensure that borrowers’ record accurately reflect their payments is clearly not compatible with these requirements.

Communication is the key

The key to ensuring that credit reference agencies, creditors, debt collection agencies, third party debt purchasers and debt management companies comply with their legal and regulatory obligations is communication.

Each of the parties to any relationship with a borrower must ensure that they understand their part in that relationship. They must also understand and comply with the different legal and regulatory regimes that govern them - whether they are laid down by their regulators, their trade associations, by contract or by the bureaux they deal with. They must ensure that their information systems link seamlessly with those of the other parties in the relationship to ensure that the information they provide to the bureaux, directly or indirectly, is accurate, complete and up-to-date.

Just as MALG has developed a protocol for dealing with debtors who suffer mental impairment there may be a case for developing a protocol which takes full account of the current “market” to manage the relationship between all parties to cover the filing of DMPs with the bureaux.

In the current difficult climate there is also a case for the Notice of Correction (NOC) facility provided by the bureaux to provide prospective creditors with a fuller, more rounded picture of the borrower’s current circumstances and future prospects. At the end of the day borrowers want to borrow and lenders want to lend - in classical economics perfect information leads to a perfect market.

Reference Material

1. *OFT - DEBT Management Guidance (OFT366)* but of general relevance in licensing matters
2. *OFT - Debt collection guidance; Final guidance on unfair business practices - July 2003 (updated December 2006) (OFT664)*
3. The Information Commissioner has published guidance in the form of a technical guidance note http://www.ico.gov.uk/upload/documents/library/data_protection/detailed_specialist_guides/default_tqn_version_v3%20%20doc.pdf on the filing of information in relation to defaults and arrangements to pay, including DMPs.



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About Credit Professionals Ltd. (CPL)

Credit Professionals Limited (CPL) provides strategic consultancy, recruitment, M & A and facilitates outsourcing solutions to companies throughout Europe. Formed in 1997, the company services the needs of companies where hands-on experience is vital, utilising the knowledge of over 50 senior qualified consultants.

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