

## **The valued client – credit scoring and privacy**

Credit rating is a method of utilizing available information in such a way that future payment behaviour can be predicted. Credit scoring is a form of profiling. It can be exercised on or applied to both companies and individual citizens. This report focuses on credit scoring for consumers by third parties such as information or credit rating agencies. In this case it is the privacy interest that is the pressing issue.

### **Operating procedure**

The report describes the operating procedure of two trade information agencies that provide suppliers of services and products with information on the creditworthiness of customers. Generally the information agency analyses the clientele of the supplier concerned. They can identify important indicators and determine the mutual relationships between them. In this way a 'score card' can be made and used to establish whether or not a potential client is eligible for acceptance.

In the credit scoring process there are three levels of research applied to a target. Combining the results determines whether a recommendation regarding the potential client is positive or negative. Information can be collected on a socio-demographic level (a general statistical approach). Data on the residential environment (often a postal code area) such as percentages of rented and privately owned houses, the division of labour in the area, average income etc are collected. It is also possible to score on the address level. With these keys the database can be searched for the address and house number of the potential customer. In this way any negative payment experiences can be verified. It is also possible to search for name and address. These key words are used in the database to search for bad payer experiences. A combination of all these results determines the final score. If this score is above a particular acceptance level, the customer will generally be considered acceptable. If the score is below the limit, the customer will generally be turned down.

### **Difficulties**

With credit scoring, difficulties can occur. Information agencies utilise personal data that has been acquired for other purposes. By linking the databases a lot can be found out about a consumer. It may also happen that a claim from a mail-order company can end up in the database of an information agency and be used for the score calculation regarding the request for a mobile phone. It is even possible that after moving, the payment history data can stay linked to the old address. In this way the new residents may be confronted with the default of prior residents. This has already led to credit scores that in turn caused rejection of potential clients. Some databases don't discriminate between house number suffixes. The consequence of this is that all the inhabitants of a house (for instance 13a through 13g) may be rejected. There have also been incidents where whole postal-code areas were excluded from delivery/supply (redlining). Not one of the potential clients in this postal code area comes into consideration for credit. In this manner the social and economic interactions of consumers can be severely restricted.

Also of relevance is the way weak or illogical relationships between the data used can also cause problems. A past founder and managing director of a company made a complaint to the Dutch Data Protection Authority after he had sold the company and had no further authority in its management, when it went bankrupt. The information agency (only) made the link between founder/manager and the bankruptcy. The credit score was actually required for a mobile telephone subscription for private purposes. Whether the information agency made the relevant link here is debatable.

In the case of all complaints it is striking that the consumer does not even know that a credit score has been made of them, let alone know how it had been made and on what terms the score was established. In the verification process for an application for a mobile telephone subscription, it is only clear that a sort of test has been done when a person is actually rejected. Often it is not clear

why someone is not accepted as a client. The sales people often do not know either. They will only know when a score is below for instance the arbitrary figure 35 and he or she is not permitted to make a sales agreement with the client. The client is often just sent off empty-handed.

### **Legal context**

The report broadly explains the legal context with and within which the responsible parties (credit rating or other information search agencies) have to give consideration.

There are various laws that apply to credit scoring, in particular the Civil Code, the Consumer Credit Act, the Equal Treatment Act and the Protection of Personal data Act (WBP).

The WBP applies to personal data. Is a numerical figure such as a credit score or rating of 35 a personal item of data? Yes, every item of data that gives information about a certain person is one of personal data. This data is, certainly when evaluating credit worthiness, typical for the way a person is judged or treated in the social domain. This also applies in the case of profiles that are associated with a client.

The WBP talks about processing personal data. The concept entails every use of personal data in the credit scoring process. A credit score that is calculated on-line or real-time and not actually recorded still counts as processing. An information agency will usually (being responsible for it) be the one to process the data. Only if the credit score is exclusively brought about by data that is supplied by the client, can the agency be seen as the processor of the credit score. The information agency will then not be permitted to make use of the outcome for its own purposes.

The relevant foundations for the processing of personal data for credit scoring are:

- Taking pre-contractual measures as a result of a request from a person involved (article 8, sub b , WBP)
- Unambiguous permission from the person involved (article 8, sub a, WBP) or
- necessarily connected to a justifiable concern of the person responsible (article 8, sub a, WBP).
- The making of a credit score on request of a customer hardly ever happens (article 8, sub b)

The processing of personal data according to article 8, sub f, requires the person responsible to answer several questions. Hereby the demands of proportionality and subsidiarity play an important role. The interests of the client and supplier have to be compared. In general the interest of the client requires that he have the opportunity to object to the credit scoring calculation (opt-out). The consequences that this may have on a contract have to be made clear to him beforehand.

Obtaining unambiguous permission from a customer to establish a credit score is clearly preferable. Unambiguous permission means that a client can express his or her wishes in total freedom. The client must have enough information to be able to make a well thought through decision. The expression of the clients will must refer to a specific clearly formulated data process.

### **Legal context and its application to the difficulties**

Assuming that unlawfully acquired data may not be used, most difficulties signalled have to do with the further processing of personal data. Personal data may be used for other purposes than the purpose they were gathered for, as long as these purposes can be united with the original purpose for which they were gathered. When answering the question whether there is a united

use for these purposes, there are a number of factors that influence it. These are named in article 9 of the WBP.

An information agency is, under certain circumstances, allowed to use data in calculating a credit score that was gathered when producing a credit report (a survey on the financial position of a consumer). That has to do with who is and who is not allowed to use the personal data. The original supplier that requested the agency to put together a report may make use of the personal data regarding that specific person, especially if this person has been informed beforehand. The kinship is strongest here. A Same Service Group (a group of companies that sell the same kind of product as the supplier) may also make use of personal data under certain conditions. An extra careful approach is mandated here. The nature of the data and the (drastic) measures it can have for a person involved prevent Other Service Groups (a group of companies that offer different types of product) from using the data. A client that has a debt with a telecom provider does not expect (and should not have to expect) that a mail order company is aware of that debt.

The question whether a profile may be made of a customer depends on the purpose of the profile. In the case of making a profile for direct marketing purposes, it is less drastic than for credit score or fraud detection purposes. For a credit score on a personal level, the client's permission is required (opt-in). When it comes to fraud detection and tracing, the announcement of it taking place is usually sufficient. The weighing of interests is to the supplier's advantage. When presenting oneself for direct marketing purposes, the client has the opportunity to withdraw from such a processing of personal data (opt-out).

The use of personal data from public sources for credit scoring purposes is confined by the original purpose the public source was put there for. This restriction of use is often included in the specific legislation. Enforcement of this restriction is not easy in practice.

The use of personal data for the optimisation of the credit score system (the feed back loop) is just, if the person involved has unambiguously given his permission. Processing can take place on the grounds of 'just interest of the subject involved' (article 8, sub f) if it meets certain conditions. The subject involved must be informed about the processing objective and must have the opportunity to oppose this (opt-out). Data may be used in a non-deductible form for the optimisation of the scoring system.

If socio-demographic data are used in a credit score calculation, the presence of ethnic data must be taken into consideration. If this is the case, the processor must take the Equal Treatment Act into consideration. If the subject in question acts in violation with this Act, the processing is also in violation with article 6 of the WBP.

An honest and justified processing of personal data is transparent. The person responsible is obliged to inform the person involved in the processing, also if the data has been obtained from a third party. Refraining to do so can lead to unlawful processing. The person involved must know the identity of the person in question and the purposes of the processing. The nature of the data, the circumstances under which the data is collected and the use of the data, determine that additional information is necessary with credit scoring.

The WBP mentions exceptions on the information collection obligation. Generally these are not applicable to credit scoring.

An important new regulation that has been taken up in the law is the right not to be subjected to a decision that is connected to legal consequences or that affect a person in a significant fashion if that decision is taken on the basis of automatic processing of personal data which is meant to draw a picture of certain aspects of the personality (article 42 WBP). The goal of this item is to breach the apparent objectivity that is attributed to automated decision making. The consumer has the right to a reasoned explanation behind the final decision. The consumer has the right to

bring his individual situation into the decision making process. His view must be taken into account in the final decision.

Consumers have the right to insight in the background of the data processing. If requested, the person responsible is required to explain how a decision was made.

If a credit score is calculated, it must be clear what data (roughly) has been used, what factors were of importance in the process and the (decision making) logic that laid the foundations for the score. A notice to the consumer that the system has made a calculation of general and more specific data, with a negative result that the consumer does not meet the criteria for acceptance, is insufficient.

### **Recommended procedure for processing data to a credit score**

Example - the request for a mobile phone subscription.

The potential client enters a store and supplies information about himself to enter into a contract/subscription with a telephone company. The supplier is required to inform the client as to the acceptance procedure first. If a credit score is required, it is preferable to ask the client for his permission for this. The processing grounds are situated in article 8, sub a of the WBP. If the client does not give his permission, the supplier can still initiate a credit score, but the client must have the opportunity to object to this (opt-out). The processing grounds are situated in article 8, sub f of the WBP. If the client still has objections and does not want a credit score to take place, alternatives should if possible be offered. In this case an alternative contract/subscription could be offered with less risk (for instance a pre-paid contract/subscription).

The supplier then provides the information agency with the personal data. This is often done by an on-line connection. The score calculation usually happens real-time and is with the supplier within seconds.

Information agencies must investigate whether personal data in databases is rightfully allowed to be used in credit score calculations and if so to what extent. That research will possibly clarify that the processing cannot or in certain circumstances can take place without the clients consent. The report thus also pays attention to the contract between suppliers and clients. The contract is a good way to inform the client of the purposes of processing but also of the sub-purposes as for instance creating a profile of the client for direct marketing, credit scoring or combating fraud. Depending on the weighting of interests between the supplier and the client, a processing can take place with or without the consent (opt-in) of the client. Sometimes the client will have to be offered the opt-out possibility. If certain data are for example processed for optimisation of the credit score system (feedback loop) then first it will have to be researched whether personal data needs to be used. If this is the case, processing of a clients personal data will not be possible if the client has not given permission to use the data or if he has not been given the opportunity to withdraw from such a process. The optimising of the system without using personal data is the preferred method. If the processing has (rightfully) taken place, the information agency sends the supplier the score. In combination with the score card, it will supply a positive or negative recommendation.

### **The supplier decides to accept, or conditional acceptance or rejection from the client.**

In accepting a client must be clear in what way the data will be processed (the processing reach) and by who (the processing area/domain). It should be pointed out to the client what the procedure and consequence are of refraining to pay the bill. In the case of a 'black list' of defaulters, one preferably should report this 35 (35 see Rommelse, A.F. (1995). Black lists. Interests and effects of warning systems. A&V 4. Rijswijk, Dutch Data Protection Authority). In appendix 3 the checklist from the report Black lists is taken on and processed. In contrast to Black lists a trend of 'white lists' is becoming visible. Clients that pay their bills on time are valued clients. These clients can be offered the opportunity to build up a positive 'credit rating'. A good payment behaviour can lead to a positive assessment at a personal level with all the advantages

for both parties that come with that. The client can also give permission for further processing by third parties (such as an information or credit agency).

When rejecting the supplier must inform the client as to his rights and the procedure he can follow. This entails the supplier offering an explanation on the right of perusal and correction that the client can exercise to both the supplier as the information agency.

The supplier must give an explanation on what grounds it is decided not to come to an agreement or conditional agreement with the client. The consumer can also be offered a second check whereby the client can add additional information. In this way the supplier can make a more personal assessment.

The client can also turn directly to the information agency. When requested they must supply an outline of the data sets used and inform the client as to the most important factors playing a role in the creation of the final score. An explanation is also required as to the processing methods used (announcement with regards to the logistics of the system)

A client that is aware of the manner in which 'his' personal data is handled, is a client who will have faith in the supplier. Such a client is often content and likely to become a regular and satisfied customer. This means that within the 'customer cycle' too great a client turnover (churn) can be prevented. Using customer care" will finally support retention management (the holding of a client) with all the positive consequences for all parties involved.