BANKING STAKEHOLDER GROUP

CONSULTATION ON EBA/DP/2016/01 ON

DISCUSSION PAPER ON INNOVATIVE USES OF CONSUMER DATA BY FINANCIAL INSTITUTIONS

General Comments and Replies to Questions

BY THE EBA BANKING STAKEHOLDER GROUP

London, 29 July 2016

Foreword

The EBA Banking Stakeholder Group ("BSG") welcomes the opportunity to comment on the EBA/DP/2016/01on Innovative Uses of Consumers' Data by Financial Institutions.

General comments

The EBA's paper aims at identifying benefits and risks of innovative uses of data, and elaborates a list of both benefits and risks, asking for feedback on its comprehensiveness. Such analysis poses a number of deeper, philosophical questions. For instance, what drives these innovative uses, or what consumer interest is, since many of the benefits and/or risks are based on this concept.

Beyond the debate on benefits and risks, the use of consumer data should first and foremost abide by very strict principles such as proportionality, accountability, transparency, lawfulness, loyalty, quality, consent, privacy, integrity, confidentiality, impact on discrimination and social exclusion. Most of these principles, which can be summarized in the idea of data ethics, are already included in the General Data Protection Regulation (GDPR) recently adopted.

The impact of Big Data and the importance of ethical use of data, however, go much beyond the scope of financial services alone. The GDPR is one of the most demanding frameworks of data protection in the world and is designed to directly address many of the concerns rightly identified by the EBA in its Discussion Paper.

The GDPR sets an appropriate regulatory framework for the use of consumers' personal data, and this should be relied on and leveraged as far as possible. The Article 29 Working Party (and in due course the European Data Protection Board) will be developing guidance on the GDPR; in the context of this WP29 there is a subgroup on financial matters, to which the EBA may provide guidance in the area of financial services and to assist these bodies to ensure that guidance is appropriate to risks and needs in banking services.

Cross-sectorial level playing field is also an important objective. It is essential not to establish sector specific guidelines that are only relevant for financial institutions falling within the remit of the EBA, as non-regulated market participants such as Fintechs, digital platforms or other market players with business models relying to a large extend on the use of data increasingly extend their value proposition to financial services. It must be guaranteed that these suppliers will not have competitive advantages regarding the innovative use of consumer data which would allow them to offer (integrated) financial products on more favourable conditions than regulated financial institutions. To this end,

the EBA should work with the relevant authorities as suggested above to ensure that guidelines apply to all market participants.

Moreover, we see potential in the use of consumer data for improving consumer and investor protection by putting financial decisions on a more accurate and data-based ground. In this context, there should be the consideration to facilitate the use of consumer data for regulated financial institutions so that they can improve consumer and investor protection. This would also contribute to the integrity of the financial system in general. The EBA work with Data Protection Authorities and the European Data Protection Board is to ensure that the GDPR is implemented in a way that mitigates the risks identified and meets data ethics considerations, while also ensuring that the potential benefits of consumer data use in financial services can be realised.

A thorough listing of all potential risks and benefits is not aimed to convey the message that risks outweigh benefits or vice versa, but rather to properly inform any further steps to maximize future benefits and minimize risks.

Replies to Questions

Question 1: In what capacity (i.e. consumer, financial institution, technology providers, etc.) have you had experience with innovative uses of consumer data?

The experience of innovative uses of consumer data provided below have been gathered from the perspective of the all EBA Banking Stakeholders Group different constituencies: consumers, financial services users, credit institutions, employees, SMEs and academics.

Question 2: Based on your knowledge, what types of consumer data do financial institutions use most?

The use of consumer data very much depends on the type of financial institution. “Traditional” retail banks use internal data about consumers coupled with external data from other sources such as credit bureaus. The data used depends greatly on a number of parameters including the type of credit bureau (for instance, in some countries like France only negative data is available to banks, whereas in other countries like the UK positive and negative data from credit providers as well as data about mobile phone payments and utility bills are included via private credit bureaus). On the other hand, some Fintechs and especially big digital players can often resort to a greater variety of data either collected about users directly via their services (transactions, investment patterns, product purchases, etc) or via access to other forms of data such as social networking, online behaviour etc. To the extent that the PSD2 forces banks to open their platforms to third parties, but not the opposite, there might be an uneven playing field in the competition between banks and these new players.

The most commonly used data also relates to the purpose, e.g. providing a particular product to consumers or fulfilling legal requirements (KYC, AML/CFT, reporting…). When providing a loan, for instance, the most commonly used data comprises information gained directly from the customer such as personal details, salary statements, or data collected during the identification (KYC) process. Also data from an existing contractual relationship is being used within legal limits. Where appropriate or necessary, personal data is also collected indirectly, i.e. from government sources such as land registers or commercial registers, from publicly available sources (for example from public directories) or by specialized information service providers such as credit bureaus. Data from credit bureaus can comprise so called "negative" data (defaults on a previous loan) and "positive" data (current financial commitments in the form of other loans) depending on the country (see above).

Question 3: Based on your knowledge, what sources of consumer data do financial institutions rely on most?

The reliance on data is also linked to the question above. The kind of consumer data financial institutions use and from what sources data comes, ultimately depends on the specific product and purpose of the data processing.

Question 4: Based on your knowledge, for what purposes do financial institutions use consumer data most?

Consumer data is used predominantly for:

- The fulfilment of the pre-/contractual relationship with the customer.
- Consumer profiling/market segmentation (e.g. creditworthiness assessment, execution of payment orders and security orders).
- The fulfilment of legal and regulatory requirements, e.g. KYC, anti-money laundering or responsible lending regulation.
- Fraud detection and prevention.
- Marketing and sales purposes.
- Personalized/customized services (budget management, robo-advice);
- Optimizing services (cost reductions, efficiency gains).
- Selling of transaction data or providing it to other developers to generate new applications (generating revenue for the financial institution or to promote the financial institution as being innovative).

In terms of quantity, today most consumer data banks use are processed in order to fulfill pre-/contractual obligations as an integral part of the customer relationship.

Question 5: How do you picture the evolution of the use of consumer data by financial institutions in the upcoming years? How do you think this will affect the market?

Financial institutions are clearly increasing their use of consumer data and there are many potential impacts on the market. The evolution of the use of consumer data by financial institutions depends on various factors, most importantly the willingness of consumers to share their data. With PSD2 becoming effective, third party payment service providers are able to access consumers' payment data on their payment account on behalf of the account holder. This will inevitably increase the innovative use of transactional customer data for providing new services, which is the intention of the European Legislator. Thus, financial institutions are likely to increase their use of consumer data with different potential impacts on the market. How these will affect the market overall is not yet possible to project with precision. However, by looking at markets such as the US or China, more advanced in some respects, some general observations can be drawn.

- There is a risk of imbalances between financial institutions which gather/hold a large amount of consumer data (such as traditional retail banks and payment/transaction data) and new market entrants. GDPR and PSD2 will contribute to reduce competitive asymmetries. On the other hand, the combination of GDPR and PSD2 puts banks at a disadvantage vis-à-vis big global digital players (the so called GAFAs) in access to data, since banks will be forced to open access to their platforms but global digital players will not be treated symmetrically.
- A better knowledge of customers may allow banks to perform a better and more accurate risk analysis.
- A potential further financial exclusion of the most vulnerable via increased market segmentation or creation of a parallel market for the "poor" with lower quality products/services. It is important in any case that increased or more new uses of data to assess customers' creditworthiness are consistent with responsible lending principles.

Related to this, there is an issue of tackling asymmetries of data sharing. The Big Data debate appears to rely primarily on new data being shared by consumers. However, there is little onus on banks and other financial institutions to offer commensurate exposure to their data on the quality, terms and conditions and costs of their products and services. There is a vast amount of 'hidden' information that consumers may find helpful in making informed choices about financial products. Because this information is not currently available it makes it very difficult for consumers to affect market power or take more responsibility in the market. Firms should be required to provide much more detailed information about their products in order to re-balance the asymmetry of power. Some financial institutions may be unwilling to do this if it leads to consumers being able to make better decisions and more easily identify that their current product is poor value.

Question 6: Do you consider the potential benefits described in this chapter to be complete and accurate? If not, what other benefits do you consider should be included?

As an additional benefit, transaction speeds can be greatly increased for consumers, as the time it takes to conclude a contract might be reduced. In addition, the use of consumer data offers the chance to bring the personal and individual element back into the digital customer experience which was largely marked by product and process standardization in the past years.

Moreover, a more data-driven approach can create new opportunities for enhanced consumer and investor protection, e.g. by better assessing the consumer's individual risk appetite and product suitability concerning investment decisions, or for an earlier detection of financial difficulties helping to find viable solutions before problems start. A more data-based approach has the potential to put consumer and investor protection on a more effective basis in comparison with existing instruments. A better knowledge of the customer's situation could also have a positive impact on the credit institutions' overall risk management and thus have a positive effect on financial stability.

The potential benefits identified in the paper deserve closer examination. This does not mean that the benefits listed by the EBA paper will not materialize, but rather that certain caveats are assorted to these benefits and help identify and understand potential risks. Broadly, the benefits identified by the EBA depend on the resolution of risks around data and algorithmic accuracy, inappropriate profiling and detrimental customer segmentation, and ensuring effective transparency for customers. These issues are set out in our response to Question 8, below.

Additional caveats that should be highlighted around the benefits identified by EBA include:

43: The degree to which increased cost-effectiveness is passed to consumers, investors, shareholders or an elite within the financial service provider depends, like in other similar cases, on structural characteristics of the financial services industry, in particular its degree of competition. Arguably, conditional to a genuine competitive market environment and market dynamics, part of the benefits would be passed on to consumers.

44-48: Tailored/customized products based on consumer data may have a similar effect as the "filter bubble" following the use of consumer data by online service providers (for instance reinforcing an existing behaviour which may not always be in the interest of the consumer).

45: Granting access to your personal data may be a benefit in the very immediate/short term (for instance, access to a financial product you need) but it is advisable that customers adopt a longer terms perspective in this regard to avoid any detriment.

46: Using more data from a variety of sources increases in principle the accuracy of risk assessments. There is however a risk that, if some sources are not used appropriately and taking account of their limitations, they may increase the likelihood of mistakes, errors and inaccuracies. Social networking data, for instance, cannot be deemed as reliable as income statements, since the consumer can actively shape social networking content.

52: Increased cost efficiency gains obtained through savings in marketing and other costs will not be automatically passed on to consumers in the form of lower prices. In the case of Big Data, although there may be some cost efficiencies for financial institutions, greater availability of data may also lead to a greater number of intermediaries in the market and longer chains of intermediaries between the consumer and their end product. This can lead to increased costs and conflicts of interest - particularly if intermediaries are remunerated through commission-based business models - where they receive payments for executing specific transactions and where the intermediary receives payment from the financial institution. Intermediaries may promote a course of action which pays them the most commission rather than that which is best value for the consumer. Although marketing costs may be reduced for financial institutions these may be offset by an increase in marketing costs for the new intermediaries which will help consumers interpret Big Data and compare products.

57: Selling data to third parties may not have only positive outcomes for banks. Certain retail banks have recently tried to change their terms of service to allow them to sell data to third parties and faced severe backlash from consumers, forcing them to backtrack. This shows that clients' trust is essential for financial services providers.

58-70: Consumer consent in the digital environment poses many problems. In order to access a service, consumers often tick boxes without reading terms and conditions. Even if consumers disagree with the content of terms and conditions, there is a general power imbalance between online service providers and consumers as consumers are the ones who usually want access to certain services and will therefore consent. This also applies to financial services. More user-friendly contracts, including those related to uses of data, should be apriority for financial institutions if they want to retain the trust of customers.

Question 7: Are you aware of any barriers that prevent financial institutions from using consumer data in a beneficial way? If so, what are these barriers?

Legal uncertainty, at the moment, is one of the biggest barriers that prevent the use of consumer data. In addition, there is, for the time being, an unlevel playing field between banks and other non-regulated financial services providers. However, with the upcoming GDPR, the opportunity is given to develop methods for using consumer data in a way that allows consumers to have more transparency and better control over the use of their data. This is an issue that not only concerns financial institutions but one that demands new solutions on a larger scale.

Question 8: Do you consider the potential risks described in this chapter to be complete and accurate? If not, what other risks do you consider should be included?

Novel risk assessment methods may pose prudential issues in case they have not been thoroughly tested, although they will be subject to responsible lending requirements. National supervisors are responsible for overseeing this. EBA has published guidelines on creditworthiness and affordability. A lack of understanding of how algorithms and artificial intelligence (AI) work may reinforce this risk.

Data sharing may result in data about consumers being used against their interest by certain market players by taking advantage of their situation (for example, vulnerable consumers in debt targeted by predatory lenders). For example, payday lenders may use information taken from a consumer's bank account to facilitate aggressive debt collection practices which take repayments shortly after a consumer has been paid, meaning that they have little money left for essential expenditure. Rather than encouraging responsible lending, if big data facilitates these kind of aggressive techniques it can actually lead to irresponsible lending. If predatory lenders are confident that they can recover the money at low cost then it reduces the incentives placed on them to conduct proper affordability tests before extending credit.

Extending data analytics to information generated by users themselves may pose new moral hazard risks. Some consumers may seek to artificially improve their "scores" via either paying online reputation management companies or by tampering with data generated about them directly. This is a risk linked specifically to Fintechs since several startups have developed lending models based on analysis of social networking data.

If the choice of the type of data used or the way algorithms are configured is badly designed, they may result in exclusion of certain types of clients from access to certain financial services. Depending on the datasets used for assessing creditworthiness, the lack of availability of certain types of data could mean, therefore, de facto exclusion from access to certain financial services. Taking the example of a consumer who has never resorted to credit before and has used his/her savings for all his/her purchases, he/she may face exclusion from access to financial services if the algorithm used to assess creditworthiness draws heavily on data of successful repayment of previous loans as opposed to analysis of spending patterns and ability to save. Of course, financial institutions are the first interested in having accurate tools to assess creditworthiness, but it cannot be excluded that an inappropriate reliance on techniques based exclusively on big data may lead some institutions to these types of mistakes.

There may be controversy regarding the liability of automated or semi-automated services making financial decisions based on data or providing advice based on data depending on how they are categorized. In essence, robo-advisers or robo-investors may not be

categorized correctly which could pose issues of unfair competition depending on their liability in case of a mistake/error.

Instant customization of financial products for consumers could include new dynamic pricing techniques which may prevent consumers from getting the best deal.

Customizing products will also dramatically increase product choice and may make it harder for consumers to compare offers. Experience shows that in general comparison tools develop rapidly to allow consumers to reap the benefits of more product choices, but of course this is conditional upon the emergence and availability of "new" comparison tools enabling consumers to compare customized offers.

Consumers may lack the ability to see redress if inaccurate data causes them financial detriment. Financial institutions may make use of inaccurate or incomplete data when assessing risk or determining price. It is not clear whether consumers would have a right of redress against the financial institution making use of the data. Competent authorities should analyze how to address this risk.

Question 9: Have you observed any of these risks materialising? If so, please provide examples.

Credit card details have been a frequent target for hackers. Moreover, theft of non-financial data has also been on the rise. It is not yet clear how data breaches may be monetized by hackers but there are several scenarios which can be envisaged: sale of the account details to third parties, sale of the data to third parties that may have an interest in the data set for data mining/analytics (advertising, predatory lending…), extortion (threatening victims to publicly release embarrassing data), impersonation (attempting to scam close friends and relatives). Despite the fact that GDPR requires strong security measures which are complemented in the financial sector with other measures like tokenization (to avoid sharing sensitive information), cybersecurity is a concern that should be high on the priority list of general and financial regulators, as well as of course financial institutions

Changing terms of service or user agreement to "force" users into consenting to share their data with third parties for a variety of reasons (for instance, advertising).

Online reputation management services have steadily developed over the last years, which may pose a risk to the quality/reliability of such data.

Although the US data protection regulation is admittedly weaker than that of the EU, some risks materialized in the US may be worth being analyzed in Europe as well, namely (i) consumers being excluded from financial services due to mistakes in credit data and therefore inaccuracies in the result of data analytics based on them, (ii) a credit bureau convicted in the US for selling consumer data to predatory lenders. It is important that EU

authorities follow closely developments in other jurisdictions to learn from potential risks being materialized.

Submitted on behalf of the EBA Banking Stakeholder Group

Santiago Fernández de Lis

Chairperson