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Legal and Regulatory Basis for a Private Credit Information Market in the Republic of Armenia

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Preliminary Note

The authors of this research paper are Monica Harutyunyan, Kate Lauer and Timothy R. Lyman. Ms. Harutyunyan is a lawyer in the Republic of Armenia. Ms. Lauer and Mr. Lyman are, respectively, members of the bar of the States of New York and Connecticut.

Ms. Harutyunyan has used her best efforts to identify and procure copies of the full universe of different Armenian legal acts that govern the topics covered in this paper and has reviewed all of the Armenian legal acts discussed herein. She has also reviewed the entire text of this paper in final draft form and confirmed all statements made about Armenian law and regulation and its current interpretation. Ms. Lauer has reviewed English translations of the Armenian legal acts as well as U.S. laws and the European Union directive discussed in this paper.

This paper is not intended to constitute legal advice, nor is it intended to be used as the basis for investment or legal structuring decisions. To the best of the authors' knowledge, the contents of this paper are current as of April 30, 2004.

Armenia Microenterprise Development Initiative
Legal and Regulatory Basis for a Private Credit Information Market in the Republic of Armenia

I. Introduction

In recent months, there has been much discussion of the development of a private sector credit information services market in Armenia. Among the questions that have received attention is whether Armenia has the necessary laws and regulations in place to permit private credit bureaus to operate effectively and to protect the privacy and data accuracy interests of the public. The USAID-financed Armenia Micro Enterprise Development Initiative (Armenia MEDI) has commissioned research on these issues, which is summarized in this memorandum.

Currently, Armenia has a public sector credit registry, maintained by the Central Bank of Armenia, that collects data from regulated financial institutions (specifically, banks, credit institutions and foreign bank branches) for use by the Central Bank in its supervisory and regulatory capacities. The data are also provided by the credit registry to the participating financial institutions (i.e., those that provide data to the credit registry). The establishment of a private sector credit information services market in Armenia would result in (i) the collection and processing by one or more private credit bureaus of credit and payment history data on individuals and businesses from Central Bank-licensed banks and credit institutions, other types of lenders (such as perhaps pawnbrokers (lombards) and microlenders) and from other sources (such as perhaps municipal tax authorities, utilities and landlords) and (ii) the provision by the credit bureau(s) of the processed data, at a price (either market-based or regulated by a government authority), to a variety of users. In providing all lenders with access to borrowers' and potential borrowers' credit- and payment-related information, a credit information market has the potential to improve the efficiency and effectiveness of credit assessment by all participating lenders, thereby improving borrowers' access to loans and credits, including, in particular, borrowers who currently are not served by the institutions who participate in the public sector credit registry. This particular category of borrowers includes small and medium enterprises and lower income individuals. Well-functioning private credit bureaus would also provide lenders with a tool to protect against lending to over-indebted borrowers.

For all the benefits that could result from the existence of private credit bureaus in Armenia, there are potential risks as well. In particular, the persons and legal entities whose credit information is supplied have privacy and commercial secrecy interests that require protection. Moreover, they face potential harm if the data supplied about them by credit bureaus is not accurate.

Balancing the creation of an enabling environment for the gathering and exchange of credit and payment information against the goal of protecting the public's interest in privacy, commercial secrecy and data accuracy is a challenge in any legal system. For these reasons, it is worthwhile to consider the relevant rules that have been put in place in countries with well-developed private sector credit information services markets. With this in mind, this memorandum begins by looking briefly at U.S. law (which is of interest as the U.S. has the most developed private sector credit information market) and at the E.U. directives which all E.U. member states must observe in adopting their own national laws on these subjects (and

which are particularly relevant in Armenia, in that Armenia has signed a treaty with the E.U. committing to harmonize its national laws with the E.U. directives). Next, this memorandum looks at current Armenian law, focusing first on potential legal obstacles to the establishment and operation of private institutions that collect and disseminate credit and payment information and then at the appropriateness of protections for persons and legal entities whose credit and payment information might be shared. Finally, changes to the existing legal rules are recommended to facilitate the development of private credit bureaus while preserving appropriate protections for the privacy and data accuracy interests of the public.

II. U.S. and E.U. Approaches to Legal Regulation of Collection and Dissemination of Credit and Payment Data

The approaches taken in the U.S. and the E.U. regarding credit bureaus and the issues of privacy and accuracy have certain similarities. Both U.S. law and the relevant E.U. directives have different, and generally speaking much tougher, rules for data collected about individuals than for the data of legal entities. However, the E.U. has given greater weight to privacy concerns of individuals than the U.S. and, within the E.U., some member states have protected privacy in their national legislation to a greater extent than is required by the relevant E.U. directives. In general, legislation in the U.S. and in E.U. countries (which must be harmonized with the E.U. directives) addresses the following issues: (i) the type of information that may and may not be processed, (ii) the right of access to information, (iii) the right to opt-out from having information available to third parties and (iv) correcting inaccurate information. However, there are also significant differences, as noted in the discussion below.

A. U.S. Legislation[1]

The credit information services industry in the U.S., for historical reasons, is divided sharply between credit bureaus that collect and disseminate information on individual consumers and those that collect and disseminate data on business legal entities. This division is reflected also to some extent in the relevant legal principles. Trade secret protection relates potentially to both individuals and legal entities. The larger body of relevant rules, however, relate to data on individual consumers.

U.S. law governing individuals' data privacy rights is spread across various pieces of legislation that address specific industries (for example, banking, telecommunications, cable television) and specific activities (for example, electronic fund transfers, computer fraud, telephone solicitations and identity theft). Two pieces of legislation are particularly relevant to the effective operation of credit bureaus: the Fair Credit Reporting Act and Financial Services Modernization Act.

The Fair Credit Reporting Act, as recently amended, is specifically addressed to cover individuals' credit reports produced by credit bureaus. The law restricts who may access such credit reports and how they may be used, and includes provisions for addressing problems of data accuracy and identity theft. This law also restricts the gathering and

[1] The research for this memo focused on the federal laws relating to privacy (which protect individuals but not generally legal entities).

reporting by credit bureaus of certain kinds of information, provides certain limitations on the parties who may access a credit report (although the categories of those who may access a report include anyone with a legitimate business purpose) and provides an opt-out mechanism for consumers who do not want their data sold by credit bureaus to financial institutions for marketing purposes.

The Financial Services Modernization Act, a fairly recent law, addresses privacy issues in the context of sharing of information by financial institutions with other parties. Specifically, the law protects the financial privacy of consumers by (i) limiting the instances in which a financial institution may disclose nonpublic personal information about a consumer to nonaffiliated third parties; and (ii) requiring a financial institution to disclose its privacy policies and practices to all of its customers. This law also applies to disclosure of nonpublic information received from a financial institution, thus subjecting credit bureaus to the same standards as financial institutions with respect to treatment of the information they receive from a financial institution.

B. E.U. Directives and Member States' Legislation

The E.U. guarantees very general, very strong privacy rights to individuals[2] in any of the E.U. member states. The E.U. has adopted a series of privacy-related directives related to the protection of privacy rights in connection with the processing of personal data under the legislation of the different E.U. member states. These directives, therefore, establish minimum standards that each member state is supposed to observe in its national legislation. Member states may in certain circumstances adopt laws implementing tougher standards.

The first of these directives established the basic E.U. framework for the protection of individuals with regard to the processing of personal data and free movement of this type of information and directed each member state to adopt the necessary implementing legislation. This directive remains the most important for the private credit and payment information market in E.U.[3]

The directive requires that personal data be collected only for specified and legitimate purposes and that such information be maintained only if it is relevant, accurate and up-to-date. The directive sets forth rules on the criteria for fair and lawful processing of data by so-called "data controllers" (parties, such as credit bureaus, that handle individuals' personal data), standards that data controllers must observe with respect to data quality, data security and data exports, and the rights of so-called "data subjects" (the persons with respect to whom data are collected). It also describes the obligations of member states, including the obligation to adopt compliant legislation.

[2] This memorandum does not address the application of the E.U. directives to business legal entities.
[3] The second directive in the series covers the processing of personal data and the protection of privacy in the telecommunications sector and the third the processing of personal data and the protection of privacy in electronic communications. The research for this memorandum did not extend to the second or third directive although they may be relevant on certain issues (for example, the right to use data to do telemarketing over the phone or the internet, which is not covered by the first directive).

III. Current Armenian Legislation

Various laws currently in effect in Armenia present significant practical and potentially legal obstacles to the effective operation of private credit bureaus. Among these, the Law on Bank Secrecy and Law on Personal Data are the most important, although provisions of the Civil Code could also present problems when read together with these laws, depending on how they are interpreted by Armenian courts. On the other hand, currently effective Armenian legislation seems to provide generally adequate protections for individuals and legal entities whose data are collected (although here, too, there are a few gaps that warrant attention).

A. Law on Bank Secrecy

The Law on Bank Secrecy prevents a bank from sharing bank secrets, unless the bank obtains the consent of the customer, with anyone other than: other banks and licensed credit institutions, the Central Bank of Armenia (in connection with its supervisory role), those performing work for or representing the bank, and certain other specific groups not directly relevant to the operation of credit bureaus (heirs of the customer in accordance with procedures set forth by law, and the following additional parties pursuant to a court order: criminal prosecutorial authorities, tax authorities, and the court itself). The term "bank secret" is defined in the law broadly enough to cover the types of information about a bank customer that are customarily gathered and disseminated by a credit bureau with respect to loans and credits; the prohibition relates to bank secrets of all customers of a bank -- that is, both individuals and legal entities.

Some have suggested that the provision of the law permitting banks to provide bank secrets to "those performing work for or representing the bank" would permit the provision of information about a bank's customers to private credit bureaus. This interpretation comports with the interpretation given to similar language used under U.S. law. However, in Armenia, this exception permitting disclosure by a licensed bank of customer information to "those performing work [for] or representing the bank" was apparently intended to allow a bank to deal with its outside vendors (such as its external auditors) and to conduct bank operations efficiently, and was not included in anticipation of the establishment of a credit information-sharing system.

Even if the provision in question were accepted as a legal basis for banks to provide bank secrets to private credit bureaus, disclosure by a credit bureau to any party (other than presumably a party to whom a bank is otherwise permitted to disclose the information, such as the Central Bank) without the customer's consent would violate the Law on Bank Secrecy. Thus, a private credit bureau would, at the most, be able to share such information with only those institutions that currently receive information from the public registry maintained by the Central Bank and would not be permitted to share information with the many other types of parties (such as microlenders and municipal tax authorities and utilities) currently excluded from the list of permitted recipients of customer information.

As noted above, the Law on Bank Secrecy does permit disclosure of customer information to third parties with the customer's written consent. Presumably, a bank could also seek its customers' written consent for the further disclosure of their information by a private credit bureau. However, written consent would have to be secured from each customer, which could present significant practical obstacles. Moreover, it is unclear if a customer could

subsequently withdraw its consent (for example, to avoid disclosure of the type of negative information which a private credit bureau and its clients would be most interested in having).

B. Law on Personal Data

The Law on Personal Data incorporates many of the provisions required by the E.U. directive on personal data, discussed above.[4] Like the E.U. directive, the Law on Personal Data regulates virtually all processing and use by third parties of individuals' personal data, and clearly covers the types of data gathered and disseminated by a private credit bureau. The law, however, imposes limitations on the ability of a credit bureau to process personal data that go beyond those required by the directive and may, in fact, prevent the effective operation of a credit information market.

Like the directive, the law permits "data subjects" (the individuals whose data it protects) to consent to have a "data controller" (such as a private credit bureau) disclose protected data to third parties. Obtaining individual consents from each data subject included in the data base of a private credit bureau would present similar practical obstacles to those identified above with respect to the Bank Secrecy Act. Moreover, the language in the Law on Personal Data permitting a person to withdraw his or her consent to the processing of personal data casts a pall over credit information gathering, as the exact circumstances under which a data subject can withdraw consent are not clear. In addition, there are other requirements of the law that would appear to require clarification in order to make the operations of a private credit bureau feasible in practical terms.[5]

In addition to requiring the consent of persons whose data are collected and disseminated, the Law on Personal Data also permits these persons to demand that data with respect to them be removed from the data controller's data base. This raises the possibility that persons on whom negative information is collected by a credit bureau could demand only this information be removed from the data base. This possibility could seriously compromise the reliability of the credit bureau's reports.

C. Civil Code

The Civil Code imposes damages on anyone who illegally obtains information that constitutes a commercial secret or who discloses such information in violation of the law or a contract. Information is categorized as a commercial secret if it has "actual or potential commercial value by virtue of its being unknown to third persons, there is not free access to it on a legal basis, and the holder of the information takes measures for the protection of its confidentiality." This is an exceptionally broad definition that might easily be argued to extend to many data that a credit bureau might ordinarily collect and disseminate.[6]

[4] The Law on Personal Data appears to have been adopted pursuant to Armenia's commitment in its treaty with the E.U. to harmonize its national legislation with the E.U. directives.

[5] For instance, a data subject can block processing of data if he or she disagrees with the accuracy of the data without having first to prove that the data are, in fact, inaccurate. This could cause significant problems for the operation of a credit bureau, which would have to block the data, then prove the accuracy and then, if the data are accurate, reinstate them.

[6] In addition, the Civil Code contemplates that such information may also be protected under other laws, although no separate law on commercial secrets has been adopted to date.

D. Adequacy of Personal Data Privacy, Data Accuracy and Commercial Secrecy Protections

Although current Armenian law is, as a whole, protective of individuals' privacy and data accuracy concerns as well as commercial secrecy, there are certain gaps. Perhaps paramount among these gaps is the absence of limits on the types of information that may be legally processed (e.g., information on a data subject's race, ethnic origin or religion). Furthermore, the Armenian law does not have the limitation regarding transborder transfers of personal data that is required by the E.U. directive and that may ultimately be of significance given consolidation in the credit information sector (through cross-border mergers and acquisitions of credit bureaus). As for commercial secrecy concerns, the Civil Code gives broad protection; any exception to such protections (for example, permitting the provision of credit- and payment-related information to and by a credit bureau) must be explicitly provided for by legislation.

IV. Recommendations for Changes in Armenian Legislation

In order to have a clear and unambiguous legal setting for the operation of private credit bureaus in Armenia while also providing adequate protection of the privacy, commercial secrecy and data accuracy interests of individuals and legal entities whose information will be gathered and disseminated, the Armenia MEDI research indicates the advisability of seeking amendments to existing Armenian legislation as described generally below or alternatively the passage of a specialized law on private sector credit bureaus together with conforming changes to the existing laws.

A. Amendments to Existing Legislation

If a decision is made to proceed only with amendments to existing legislation, the Armenia MEDI research indicates that the following types of amendments[7] warrant consideration:

Law on Bank Secrecy

The law should permit banks to provide customer information that would constitute a bank secret to private credit bureaus without requiring a customer's written consent. (Customer protection against misuse of the information by a private credit bureau, including such issues as customer consent to the use of his or her personal data in the preparation of credit reports and dissemination of credit reports to third parties, availability of the data to the customer and correction of inaccurate data, would be provided through the Law on Personal Data as it is proposed to be amended below.)

- Additional, more minor changes would be advisable to clarify certain other provisions of the law. For example, the article that currently permits banks to provide bank secrets to

[7] The proposed amendments discussed below do not constitute by any means an exhaustive list of all changes that might be advisable. It should be noted that many topics – particularly those concerning individual privacy interests and how to balance these against market promotion objectives – are topics of fervent debate in countries such as the U.S. and the member states of the E.U. where credit information services markets are already well-developed. This list tends to focus, therefore, on less controversial law changes that would facilitate the establishment of a private credit and payment information services market in Armenia.

the Central Bank in connection with the Central Bank's supervisory role should also explicitly authorize the disclosure of bank secrets by banks to the existing public credit registry.

Law on Personal Data

- The law should be amended to extend the legal basis for processing of personal data to include a relatively broadly defined range of additional situations in which data processing might be necessary[8] or alternatively amended specifically to refer to the processing of personal data by credit bureaus as a separate legal basis. In the second case, a definition of the term "credit bureaus" or a description of the activity of providing credit information services would be needed as well.

- The law should be amended to clarify the legal effect of an attempt to withdraw consent to the use of personal data in certain cases, such as after the parties have begun to perform a contract. (Alternatively, withdrawal of consent could be prohibited entirely once the parties have begun to perform the types of contracts that might be the subject of data processed by a credit bureau.)

- The law should be amended to prohibit an individual from selectively exercising his or her right to have data removed from a data controller's data base in the case of the types of information supplied to a credit bureau, in order to prevent individuals from removing only negative data (resulting in misleading credit reports).

- The power of a data subject to block data simply by an allegation of inaccuracy should be clarified, at least in the case of data collected by a credit bureau.

- Consideration should be given to permitting individuals to opt-out of the provision of their personal data for direct marketing purposes (as is now provided for under the E.U. directive).

- Consideration should be given to prohibiting the processing of personal data such as those relating to race or ethnic origin, political opinions, religious or philosophical beliefs, trade union membership, health or sex life given the important privacy issues related to these data as well as the prominently positioned and strongly worded provision in the E.U. directive addressing this concern.

- The law should be amended to prohibit the transfer of personal data to a third country that does not ensure at least the level of data protection and data subject rights as are provided for under Armenian law.[9]

[8] The E.U. directive stipulates the following situations in which personal data may be processed in addition to ones stipulated under the Armenian Law: (i) "if…necessary for the performance of a contract to which the data subject is a party or in order to take steps at the request of the data subject prior to entering into a contract" and (ii) "if … necessary for the purposes of legitimate interests pursued by the [data] controller or the … parties to whom the data are disclosed, except where such interests are overridden by the interests for fundamental rights and freedoms of the data subject …." However, the concept of "legitimate interests" may be too broad, given the policy decision made previously in Armenia not to authorize the processing of personal data in such an open-ended range of situations, and there is a risk that such language might be subject to unpredictable interpretation.

[9] It should be noted that the E.U. directive prohibits the transfer of personal data to a third country that does not ensure "an adequate level of protection."

Civil Code

- The provisions on commercial secrets should be amended to establish circumstances under which the provision of credit- and payment-related information by a credit bureau will not expose the credit bureau to damages for unlawful disclosure of commercial secrets.

B. A Separate Law on Private Credit Bureaus and Conforming Amendments to Existing Legislation

Perhaps the principal benefit of separate specialized legislation on private credit bureaus together with conforming changes to existing relevant laws (as distinguished from simply amending the relevant existing laws as discussed immediately above) would be the feasibility of addressing in much greater detail various specific issues related to the operation of credit bureaus that should not necessarily apply outside the credit bureau context.[10] The Bank Secrecy Law and to an even greater extent the Law on Personal Data deal with many important issues that have little or nothing to do with either the feasibility of operating private credit bureaus or protecting the privacy, commercial secrecy and data accuracy interests of the public with respect to credit or payment information. Simply adding provisions to facilitate the operation of private credit bureaus by amendments to relevant existing Armenian legislation could risk the opening of unintended loopholes wholly unrelated to credit bureaus and their operation, particularly in the case of the Law on Personal Data (which covers an exceedingly broad range of situations in which personal data are collected and disseminated).

[10] Examples of such specialized provisions might include detailed procedures for notification to the credit bureau operator of inaccuracies in an individual's credit bureau data and procedures for investigation and correction of inaccuracies, as well as requirements for removal of outdated information. (Under U.S. law, for example, credit reports may not include data on debts that are more than seven years old unless the debt is $150,000 or more or relates to tax liens.)