Retail mortgage default management

Some remarks on the transposition of the Mortgage Credit Directive in Luxembourg law

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Summary
With the transposition of the Mortgage Credit Directive, Luxembourg banks are faced with new consumer protection rules which impact mortgage default management practices. They must exercise 'reasonable forbearance' prior to mortgage enforcement. The author compares the new Luxembourg regime with the rules in France and the United Kingdom. In addition, the author explores some legal issues surrounding the new rules at the intersection with data protection laws.

Chapeau
Avec la transposition de la Directive du crédit hypothécaire, les banques luxembourgeoises sont confrontées à des nouvelles règles de protection des consommateurs qui ont des répercussions sur la gestion des manquements contractuels en matière d'hypothèque. Elles doivent faire preuve d'une « tolérance raisonnable » avant de mettre en œuvre une saisie hypothécaire. L'auteur compare le nouveau régime du Luxembourg avec les règles applicables en France et au Royaume-Uni. En sus, l'auteur explore quelques questions juridiques entourant ces nouvelles règles au regard des lois sur la protection des données.

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1. Introduction

The law of 23 December 2016 transposing Directive 2014/17/EU on credit agreements for consumers relating to residential immovable property[3] (the Mortgage Credit Directive or '**MCD**') and amending the Luxembourg Consumer Code (*Code de la Consommation*, or '**LCCo**') was published in Luxembourg's *Official Gazette* on 28 December 2016.[4] This law (the '**MCL**') has a retroactive effect as it applies to credit agreements signed after 21 March 2016. On 22 February 2017, the Luxembourg regulator (*Commission de Surveillance du Secteur Financier*, or '**CSSF**') published Circular 17/561[5], which outlines the MCL and highlights the application of a set of guidelines issued by the European Banking Authority ('**EBA**').

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2. The views expressed are solely those of the author and this essay is written on his own behalf.
3. Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No. 1093/2010, OJEU L.60, 28 February 2014.
4. Law of 23 December 2016 implementing Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No. 1093/2010 and amending the Luxembourg Consumer Code, *Official Gazette of the Grand Duchy of Luxembourg*, No. 302, 28 December 2016.
5. Circular 17/561 on the Law of 23 December 2016 implementing Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No. 1093/2010 and amending the Luxembourg Consumer Code, Commission de Surveillance du Secteur Financier, 22 February 2017.

One of the main goals of the MCD, and in turn, of the MCL, is to ensure a 'high level of consumer protection in the area of credit agreements relating to immovable property and in order to ensure that consumers looking for such agreements are able to do so confident in the knowledge that the institutions they interact with act in a professional and responsible manner'.[6] The MCD should also 'develop a more transparent, efficient and competitive internal market, through consistent, flexible and fair credit agreements relating to immovable property, while promoting sustainable lending and borrowing and financial inclusion, and hence providing a high level of consumer protection'.[7]

The MCL is introduced at a time where the market for financial services (including consumer mortgage agreements or 'retail mortgages') is changing dramatically. In particular, the use of alternative data sources (social media, electronic devices), algorithms for large-scale predictive data analysis (e.g. default prediction) and automated consumer communication tools, are now key components of innovative lending business strategies. In addition, Regulation (EU) 2016/679[8] (the General Data Protection Regulation, '**GDPR**') will apply from 25 May 2018, altering the data processing regulatory landscape. The aim of this paper is to analyse the possibilities and limitations of retail mortgage default management in light of these changes. In this paper, the regulatory framework of the MCL will be first set out (2). Then, the Luxembourg rules on retail mortgage arrears and foreclosure will be analysed and compared with the transpositions of the relevant MCD rules in France and the United Kingdom (3). Subsequently, some practical issues of mortgage default management surrounding the rule on forbearance will be explored (4). Finally, some conclusions and drafting recommendations will be offered (5).

2. Consumer protection and the MCL

The MCL introduces consumer protection prior to the conclusion and during the term of residential immovable property contracts. The MCL applies to a credit agreement (*contrat de crédit*), which is defined as an agreement pursuant to which a lender agrees or covenants to agree to extending credit to a consumer (*consommateur*) by means of a payment term (*délai de paiement*), a loan (*prêt*) or any other similar payment facility.[9] Two types of credit agreements fall within the scope of the MCL:

A) credit agreements, which are secured either by a mortgage or by another comparable security commonly applied to residential immovable property or secured by a right related to residential immovable property; and
B) credit agreements, the purpose of which is to acquire or retain property rights in land or in an existing or projected building.[10]

A limited number of credit agreements are explicitly excluded from the scope of the MCL, such as credit agreements in which the lender extends credit without charging interest or other costs, except for charges which cover costs directly related to the security provided under the credit agreement.[11]

The MCL sets out conditions which must be satisfied prior to the conclusion of a residential immovable property contract. It sets out, *inter alia*, rules relating to advertising and marketing communications[12], general and pre-contractual information[13], tying practices (*vente liée*)[14], creditworthiness assessment (*évaluation de la solvabilité*)[15], advisory services[16], rules regarding foreign currency and variable rate loans[17] and the calculation of the annual percentage rate of charge (APRC).[18] It also contains rules on the supervision of credit intermediaries[19], the execution of residential immovable property contracts[20] and conduct of business obligations.[21] The CSSF is designated as the competent authority charged with the supervision of the MCL (and compliance by lenders with its provisions).[22] A lender[23] contracting with a consumer, may be a credit institution[24], a professional performing lending operations[25] or a person granting consumer credit incidental to the pursuit of the person's

6. Recital (5) MCD. See also P. Partsch, *Droit Bancaire Européen et Protection des consommateurs*, Brussels, Larcier, 2016, p. 671-682, for a general overview of the MCD.
7. Recital (6) MCD.
8. Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and of the free movement of such data repealing Directive 95/46/EC, OJEU L.119, 4 May 2016.
9. Art. L. 226-2(2) LCCo. A consumer is 'any natural person acting for purposes outside the scope of his or her commercial, industrial, artisanal or professional activities', see L. 010-1(1) LCCo.
10. Art. L. 226-2 LCCo.
11. Art. L. 226-3 LCCo.
12. Art. L. 226-5 and L. 226-6 LCCo.
13. Art. L. 226-7 to L. 226-10 LCCo.
14. Art. L. 226-11 LCCo.
15. Art. L. 226-12 to L. 226-14 LCCo.
16. Art. L. 226-15 LCCo.
17. Art. L 226-17 and L. 226-18 LCCo.
18. Art. L. 226-19 LCCo.
19. Art. L. 226-23 to L. 226-35 LCCo.
20. Art. L. 226-20 to L. 226-22 LCCo.
21. Art. L. 226-36 LCCo.
22. Art. L. 226-1(1) and L. 226-4 LCCo.
23. Art. L. 226-1 sub 19 LCCo: a 'natural or legal person which enters into or agrees to enter into a residential immovable property contract in the exercise of his or her commercial or professional activities'. In this essay, 'lender' and 'creditor' will be used interchangeably.
24. Art. 1(12) of the law of 5 April 1993 on the financial sector, *Official Gazette of the Grand Duchy of Luxembourg*, No. 27, 10 April 1993, as amended ('**FSL**').
25. Art. 28-4 FSL.

activities covered by the law of 2 September 2011 on the right of establishment.[26]

3. Arrears and foreclosure under the Mortgage Credit Directive

The MCD seeks to encourage the resolution of credit repayment by consumers in payment difficulties in order to avoid foreclosure. Recital (27) states:
'Given the significant consequences for creditors, consumers and potentially financial stability of foreclosure, it is appropriate to encourage creditors to deal proactively with emerging credit risk at an early stage and that the necessary measures are in place to ensure that creditors exercise reasonable forbearance and make reasonable attempts to solve the situation through other means before foreclosure proceedings are initiated. Where possible, solutions should be found which take account of the practical circumstances and reasonable need of living expenses of the consumer.'

To this end, the MCD contains minimum harmonization rules on arrears and foreclosure. Article 28(1) requires member states to adopt measures to encourage creditors to exercise reasonable forbearance before foreclosure proceedings are initiated. Article 28(2) allows member states to require that, where the creditor is permitted to define and impose charges on the consumer arising from the default, those charges are no greater than what is necessary to compensate the creditor for costs it has incurred as a result of the default. Article 28(3) states that member states may allow creditors to impose additional charges on the consumer in the event of default, but that member states shall place a cap on those charges.

In general, there are two kinds of regulatory tools available to member states to encourage creditors to exercise forbearance using legal commands: rules and standards.[27] Rules or 'bright-line norms' provide a clear directive for behaviour (e.g. a 30-day grace period), while standards must be evaluated and interpreted in light of the relevant circumstances and then converted into guidance by the creditor.[28] The former must be applied equally irrespective of the circumstances, while the latter must be applied while taking into consideration the relevant circumstances. Therefore, rules provide more certainty at the cost of rigidity, while standards provide more flexibility at the cost of uncertainty and varying levels of consumer protection.

3.1 Luxembourg

In Luxembourg law, the mortgage confers on the creditor the right to seize the property, to initiate a public sale and to satisfy the obligation from the proceeds of the sale.[29] The creditor can request a judge to order a seizure of immovable property (*saisie immobilière*), allowing the creditor to proceed with a public sale of the property.[30] Now, in case of arrears, lenders must prove that they exercised reasonable forbearance (*tolérance raisonnable*) before initiating foreclosure proceedings.[31] The Luxembourg legislator has explained that pursuant to Circular CSSF 12/552[32] credit institutions and professionals conducting lending operations must have clear policies (*politiques claires*), which define the available measures if a debtor does not respect or signals that he is not able to respect the contractual provisions of his commitment.[33] The same circular imposes on those credit institutions and professionals the obligation to have internal rules in place to manage past due payments and doubtful commitments to pay.[34] The Luxembourg legislator has motivated the rule in Article L. 226-22(1) LCCo by mentioning that it reflects the Luxembourg market practice to exhaust other alternatives before deciding on foreclosure. Lenders shall try to agree on a repayment plan, following which (after an appropriate delay) the lender avails itself of contractually assigned assets (*mécanismes de cession*) or the garnishment of wages (*saisie sur rémuneration*) (including any personal and real security provided). Only after exhausting those measures shall the bank initiate the public sale. It is also general practice that the lender takes into consideration the specific situation of the consumer and his or her needs to have sufficient means for living expenses.[35] The MCL further implements Article 28(2) MCD, stating that if the lender imposes charges on the consumer, those charges cannot be greater than what is necessary to indemnify the costs incurred as a result of the default.[36] In conclusion, the Luxembourg legislator has chosen a 'standards-based'

26. Art. 28-4(3) FSL. For example, a *syndic de copropriétés* incidentally lending funds to a person acquiring an apartment would be covered under the rules of the MCL.
27. L. Kaplow, 'Rules versus Standards: An Economic Analysis', *Duke Law Journal*, 1992, 42(3), p. 557-629.
28. For more, see F. Parisi, 'Rules versus Standards' in: F. Parisi, *Production of Legal Rules: Volume 7 Encyclopedia of Law and Economics*, second edition, Edward Elgar Publishing, 2012, p. 43 *et seq*.
29. Art. 2114 LCCi and 2204 LCCi; R. Watgen and M. Watgen, *La propriété immobilière*, Promoculture-Larcier Windhof, 2013, p. 467-515.
30. Art. 879 New Civil Procedure Code (*Nouveau Code de Procédure Civile*), as amended.
31. Art. L. 226-22(1) LCCo.
32. Circular 12/552 on central administration internal governance and risk management, Commission de Surveillance du Secteur Financier, 11 December 2012 ('**CSSF 12/552**').
33. Draft law on (1) implementing of the Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No. 1093/2010 and (2) amending Luxembourg Consumer Code, *parl. Doc.*, Ch., 2015-2016, No. 7025, p. 38 ('**CHD**'); Circular CSSF 12/552.
34. Circular CSSF 12/552, No. 221 to 227.
35. CHD, p. 38.
36. Art. L. 226-22(2) LCCo.

regime, omitting any bright-line rules, in order to implement Article 28 MCD.

The CSSF Circular seeks to highlight the EBA Guidelines on arrears and foreclosure and defers to those EBA Guidelines to provide more detail.[37] The EBA Guidelines are legally binding on financial institutions, but are not prescriptive; member states can comply in different ways and competent authorities can determine how to implement them.[38] With the Guidelines, the EBA aims to avoid foreclosure proceedings[39] and the Guidelines contain three instruments to realize that objective: (1) internal policies and procedures, (2) engagement with and assistance to the consumer, and (3) a resolution process.

3.1.1 Policies and procedures

Pursuant to the EBA Guidelines, the creditor should establish (and keep up to date) procedures to detect, as early as possible, consumers going into payment difficulties.[40] In addition, the creditor should establish (and keep up to date) policies and procedures for the effective handling of, and engagement with, consumers in payment difficulties. Adequate information and support should be available for those consumers.[41]

3.1.2 Engagement, information and assistance

The EBA Guidelines provide for an active role of the creditor. The creditor must engage with the consumer who is in payment difficulties, in order to establish why those difficulties have arisen and to 'take appropriate steps'. The contact and communication with the consumer must be 'proportionate to the information requirements, and not excessive'.[42] The determination of which steps are 'appropriate', is left to the discretion of financial institutions.[43] However, in its interactions with the consumer who is having the payment difficulties, the creditor should 'respect the consumer's privacy'.[44] Furthermore, the creditor should 'communicate clearly and in plain language', and provide some mandatory elements of information regarding the credit arrangement, the importance of cooperation to resolve the situation and (if payment difficulties persist) the consequences of missing payments and available (government) support.[45]

3.1.3 Resolution process

The EBA's guidelines on resolution constitute the core of the forbearance framework. The creditor 'should take into account the individual circumstances of the consumer, the consumer's interests and rights and his/her ability to repay, when deciding on which steps or forbearance measures to take'.[46] Such forbearance *may* include (1) a total or partial refinancing of the credit agreement and/or (2) a modification of the previous terms and conditions of a credit agreement.[47] The guidelines provide a non-exhaustive list of measures which may be included in the creditor's policies. Ultimately, the forbearance measures are decisions to be made by the creditor, in accordance with the legal framework of its member state.[48]

3.2 France

The transposition into French law of the MCD by Ordonnance 2016-351 of 25 March 2016[49], differs significantly from the MCL. Under the modified French Consumer Code ('**FCCo**'), lenders are faced with a more 'bright-line' regime. In case of arrears, and if the lender does not require the immediate repayment of the entire outstanding amount, the lender can temporarily raise the interest rate as long as it does not exceed the rate fixed by decree, until the consumer resumes the repayments according to the contract.[50] Alternatively, if the lender seeks to terminate the contract, he can request the repayment of the outstanding principal and interest, as well as payment of an indemnity which cannot exceed the amount fixed by decree.[51] Of course, if in default, the consumer can request the lender to grant a grace period. However, if the parties do not reach an agreement, the consumer can request the courts to impose a grace period.[52]

3.3 United Kingdom

In the United Kingdom, the Financial Conduct Authority decided that the rules of the Mortgage and

37. Final Report – Guidelines on arrears and foreclosure, European Banking Authority, EBA/GL/2015/12, 19 August 2015 (**'EBA Guidelines'**). See CSSF Circular 17/561, p. 1 (as well as p. 4, where the content of the EBA Guidelines is summarised).
38. EBA Guidelines, section 2 sub 6(b) and response to feedback on the public consultation (**'response'**) No. 18.
39. EBA Guidelines, response No. 49.
40. EBA Guidelines, guideline 1.1.
41. EBA Guidelines, guideline 1.2.
42. EBA Guidelines, guidelines 2.2 and 2.3. This means specifically being considerate towards the particular stresses that the defaulting consumer may experience.
43. See, for example, EBA Guidelines, response No. 17 (case to case reviews).
44. EBA Guidelines, guideline 2.2.
45. EBA Guidelines, guidelines 3.1 to 3.3.
46. EBA Guidelines, guideline 4.1.
47. *Ibid*.
48. EBA Guidelines, response No. 44.
49. Ordonnance No. 2015-351 of 25 March 2016 on consumer credit in terms of property for residential use, *Official Gazette of the Republic of France*, No. 0073, 26 March 2016.
50. Art. L. 313-50 FCCo.
51. Art. L. 313-51 FCCo.
52. Art. L. 314-20 FCCo.

Home Finance Conduct of Business sourcebook ('**MCOB**') meet the requirements of the MCD.[53] Section 13 of the MCOB also provides a 'bright-line' regime. Rule 13.3.2A specifically provides that lenders (1) make reasonable efforts to reach an agreement with the customer, (2) allow reasonable time for the payment shortfall to be repaid (also, the establishment of a payment plan which is practical taking into consideration the circumstances of the consumer), (3) grant, unless they have good reason not to do so, a consumer's request for a change to the payment date and payment method, (4) if no reasonable payment arrangement can be agreed, allow the customer to remain in possession for a reasonable period to effect the sale, and (5) not repossess the property unless all other reasonable attempts to resolve the position have failed. Also, consumers must be given a reasonable period of time to consider any proposals for dealing with the payment difficulties.[54] Furthermore, the rules specifically require a lender to consider whether, given the individual circumstances of the customer, it is appropriate to extend the term of the contract, change its type or to defer payment of due interest, among other alternatives.[55]

3.4 In a nutshell

The MCL is generally seen as more lender-friendly than the transpositions of the MCD in France and the United Kingdom. Instead of providing precise directives, the Luxembourg legislator has adopted in a *verbatim* fashion the MCD's standards to encourage reasonable forbearance and the option to limit the lender's indemnity for incurred costs. The CSSF has not provided more detailed guidelines, but defers to the EBA Guidelines, which consist mainly of broad standards. As a result, there is a significant discretionary space for Luxembourg lenders to design policies and procedures to deal with payment defaults in compliance with the MCL. The advantage of such discretionary space is that lenders can craft solutions which are tailored to their operations and balance the interests of the parties in each individual case. The next section addresses some practical issues lenders may face while designing these policies and procedures.

4. Forbearance and practical issues of mortgage default management

4.1 What is reasonable forbearance?

Neither the MCD nor the text of the EBA Guidelines provides a definition of forbearance. The EBA has clarified that their guidelines are meant to give effect to Article 28 MCD by encouraging financial institutions to make reasonable concessions[56] and that forbearance measures are ultimately the result of party agreements.[57] The absence of specific rules, such as the length of the forbearance period, is motivated by the fact that (1) it is up to member states and competent authorities to implement those rules and (2) ultimately, forbearance rules are to be decided by the individual company because it is 'in the interest of the company and the creditor to find a good solution to the problem'.[58] Summarizing the European rules, it must be concluded that they do not provide bright-line obligations for lenders.

Based on the commentary of the Luxembourg legislator, the statutory rule of reasonable forbearance could be interpreted as the mere exhaustion of other alternatives before resorting to foreclosure proceedings.[59] There is no imposition of bright-line rules regarding the duration of the forbearance period, the mandatory consideration of certain modifications of the credit agreement or judicial imposition of a grace period. Luxembourg law grants lenders significant discretion to design forbearance policies and procedures, as long as (a) they can prove that they took the consumer's individual circumstances and ability to repay into account and (b) they execute the credit agreement in an honest, fair, transparent and professional manner, taking into consideration the rights and interests of the consumers.[60] This is beneficial to lenders, since they can determine the optimal forbearance period on a case-by-case basis.

4.2 Detection, handling and engagement procedures: automation

The MCL does not specify the content of policies and procedures regarding the detection of payment difficulties or the handling and engagement procedures, beyond the proof requirement in Article L. 226-22(1) LCCo.[61] The rules of CSSF Circular 12/552 also lack specificity in this regard. The EBA Guidelines stipulate the lender's obligation to design procedures

53. Consultation Paper – Implementation of the Mortgage Credit Directive and the new regime for second charge mortgages Financial Conduct Authority, CP14/20, September 2014, p. 36; *Financial Conduct Authority Handbook*, section Mortgages and Home Finance: Conduct of Business sourcebook, Financial Conduct Authority, available via https://www.handbook.fca.org.uk/.
54. Rule 13.3.3A MCOB.
55. Rule 13.3.4A MCOB.
56. EBA Guidelines, response No. 43.
57. EBA Guidelines, response No. 46.
58. EBA Guidelines, responses No. 8 and 57.
59. See section 3.1. Since Art. L. 226-22 is a lex specialis, other statutory provisions codifying principles of reasonableness and fairness do not apply.
60. See Art. L. 226-22(1) and L. 226-36(1) LCCo.
61. The rules on staff requirements of L.226-37 LCCo do not apply to the execution phase.

and policies to detect payment difficulties and to effectively handle and engage with consumers with payment difficulties, in order to exercise reasonable forbearance. Focusing on the EBA Guidelines, it is clear that they do not provide much detail: specific rule-making is a task of the member states, the competent authorities and the financial institutions. The comments of the EBA also seem to support discretion. For example, the engagement with the consumer does not need to be face-to-face.[62] Also, in their procedures, banks can require consumers to contact them at any time to inform them of (expected) payment difficulties.[63]

Given such discretionary space and the absence of express prohibitions, it is safe to conclude that lenders are permitted to use technology to automate decision-making in respect of, and communication with, consumers. Specifically, lenders should be able to use decision rules codified in software scripts and *chat web robots* (‘chatbots’), provided that those decisions and communications are recorded and are in compliance with the lender’s policies and procedures. The main benefit of using chatbots is that customer handling and engagement can be done in a uniform manner at low operational costs. Chatbots can also be used to collect the requisite information from consumers to agree on a repayment plan.[64] However, given the great variety in and potential complexity of individual circumstances of consumers, lenders should also employ staff to deal with cases which cannot be resolved with chatbots.

4.3 Payment difficulties and repayment planning: data processing

In today’s connected and data-rich world, lenders have extensive possibilities to collect (real-time) data on consumers which is not transmitted directly by consumers themselves. Such ‘alternative’ or ‘non-traditional’ data can be collected from the consumer’s payment accounts, but also from his or her credit card usage, smartphone and ‘Internet-of-Things’ devices (e.g. a smart voice-enabled speaker).[65] In other words, lenders can avail themselves of a multitude of data sources to analyse the causes of payment difficulties and create a tailored repayment plan, by sketching a reasonably accurate picture of the consumer’s private life.

4.3.1 Data processing and forbearance

How far can a bank go with the data processing?

At present, personal data processing is governed by the rules of Directive 95/46/EC[66], as transposed by the member states. Pursuant to the law of 2 August 2002 on the protection of persons with regard to the processing of personal data, as amended[67] (‘**DPL**’), processing of personal data is defined as ‘any operation or set of operations performed upon personal data, whether or not by automatic means, such as collection, recording’.[68] Consent given by the data subject is one of the valid grounds for the lawfulness of processing.[69] Such consent must be free, specific for the purposes of processing and informed.[70] If the data concerns location and other device data, explicit consent in accordance with the rules of the law of 30 May 2005 considering the protection of persons with regard to personal data in the electronic communications sector is required.[71] Explicit consent is also required for special categories of data, such as health data.[72] Relevant limitations on data processing by lenders are the data quality conditions, in particular the requirement that the purpose must be legitimate and the data collected in relation to that purpose shall be adequate, relevant and not excessive.[73] Therefore, with consumer consent, lenders can be granted access to the data collected by third parties and granted permission to combine such data with data directly collected from the consumer, for the purposes of mortgage default resolution.[74]

Under the GDPR and to the extent relevant here, the processing of personal data is lawful if (1) the consumer has given consent to the processing of his or her personal data for one or more specific purposes, (2) the processing is necessary for the performance of a contract to which the data subject is party or in order to take steps at the request of the data subject prior to entering into a contract, (3) processing is necessary for compliance with a legal obligation to which the controller is subject, (4) processing is necessary for the purposes of the legitimate interests pursued by the controller or by a third party, except where such

62. EBA Guidelines, response No. 27.
63. EBA Guidelines, response No. 11.
64. See *supra* section 3.
65. However, there is no public database on consumers with payment difficulties in the Grand Duchy of Luxembourg. See CHD, p. 31.
66. Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of the personal data and of the free movement of such data, OJEC L.281, 23 November 1995.
67. Law of 2 August 2002 on the protection of persons with regard to the processing of personal data, as amended, *Official Gazette of the Grand Duchy of Luxembourg*, No. 91, 13 August 2002.
68. Art. 2(r) DPL.
69. Art. 5(1)(f) DPL.
70. See Art. 2(c) and 2(n) DPL.
71. Art. 5(4) and 9(3) of the law of 30 May 2005 considering the protection of persons with regard to personal data in the electronic communications sector, *Official Gazette of the Grand Duchy of Luxembourg*, 7 June 2005, No. 73. See also par. 3.4 of Opinion 02/2013 on apps on smart devices, Art. 29 Working Party, 00461/13/EN, WP 202, 27 February 2013. The opinions of the Article 29 Working Party are available via http://ec.europa.eu/.
72. Art. 6 DPL.
73. Art. 4(1) DPL.
74. The definition of processing in Art. 2(r) DPL includes ‘disclosure by transmission’.

interests are overridden by the interests or fundamental rights and freedoms of the data subject which require protection of personal data.[75] Consent is any freely given, specific, informed and unambiguous indication of the data subject's wishes by which he or she, by a statement or by a clear affirmative action, signifies agreement to the processing of personal data relating to him or her.[76] 'Informed' means that the consumer must be at least aware of the identity of the controller and the purposes for which the data is intended.[77] Moreover, if the processing has multiple purposes, consent should be given for all of them.[78]

Given the absence of any express statutory provision to the contrary, creditors are able to process consumer data regardless of the source, provided that the consumer has contractually consented to the processing of the data from each respective source for the purposes of the detection of payment difficulties, the engagement with the creditor or the elaboration of a payment plan in conformity with the GDPR.[79] Alternatively, processing of consumer data without the consumer's consent, could also take place on the basis of necessity, in conformity with the applicable rules of the GDPR.

4.3.2 Profiling, payment difficulties and repayment planning

Lenders which maintain a large portfolio of retail mortgages, can increase economic efficiency by creating consumer profiles, predicting payment default by analysing a number of shared consumer characteristics by means of *predictive analytics*[80] and using those insights to decide upon appropriate forbearance measures.[81] The MCL does not provide any information regarding the use of profiling. That being said, profiling and predictive analytics seem allowed under the MCD[82], within the limits of data protection regulation.[83]

Under the current rules, the consumer's consent is sufficient to grant the lender permission to construct consumer profiles using his or her data[84], since profiling is allowed.[85] Automated decision-making based on consumer profiles producing legal effects (such as the decision not to cease the exercise of reasonable forbearance) is also allowed, since the requirement for the entering into or the performance of the contract, lodged by the data subject, has been satisfied.[86]

Under the GDPR, 'profiling' means any form of automated processing of personal data consisting of the use of personal data to evaluate certain personal aspects relating to a natural person, in particular to analyse or predict aspects *inter alia* concerning that natural person's reliability or behaviour.[87] The profiling may be based on the consumer's explicit consent and any profiling must be disclosed to the consumer.[88] The creditor is allowed to engage in automatic decision-making pursuant to consumer profiling, but must implement suitable measures 'to safeguard the data subject's rights and freedoms and legitimate interests'.[89] Explicit consent is required for special data categories, including racial and ethnic origin, political opinions, religious and philosophical beliefs and data concerning health.[90] In short, given the discretion the MCL grants to creditors in deciding upon detection, engagement, handling and forbearance measures, the outcomes of profiling can be used in automatic decision-making regarding such measures provided that the consent (as set out in IV.3.b) has been given by the consumer. Moreover, profiling is a useful measure to manage doubtful commitments to pay, allowing the lender to deal with its obligations under CSSF Circular 12/552.[91]

Opponents of profiling often warn against the unfair treatment of consumers as a consequence of such profiling. However, no two consumers are the same and given the obligation to take into account the individual circumstances of each consumer before taking 'appropriate steps', automatic-decision making

75. Art. 6 subs (a)-(c) and (f) GDPR.
76. Art. 1 (11) GDPR.
77. Recital (42) GDPR. See also Opinion 15/2011 on the definition of consent, Art. 29 Working Party, 001197/11/EN, WP187, 13 July 2011.
78. Recital (32) GDPR.
79. Particularly important are the requirements which the request for consent must satisfy, see Art. 7(2) GDPR.
80. Predictive analytics is a term used for technology that learns from data to predict the future behaviour of individuals or other events. The academic foundations of this technology are mainly statistics and computer science, more specifically the interdisciplinary field of research known as 'machine learning'. See E. Siegel, *Predictive Analytics*, revised and updated edition, Hoboken, Wiley 2016, p. 15-16.
81. NB: detection of payment difficulties in and of itself does not equal profiling as defined in the GDPR. See EBA Guidelines, response No. 9.
82. EBA Guidelines, response No. 59. The EBA states that identifying customers susceptible to arrears and performance tracking systems to proactively segment the pre-arrears populations, are 'welcome' suggestions which 'could be considered' by financial institutions.
83. See also Recital (62) MCD.
84. Art. 2(r) DPL in conjunction with 5(1)(f) DPL. See also Andrej Savin, *Profiling in the Present and New EU Data Protection Frameworks*, Nielsen, P.A., Schmidt, P.K., Dyppel Weber, K. (eds.) Erhvervsretlige emne, Juridisk Institut CBS, December 2015, p. 254-258.
85. See *inter alia*, Article 29 Working Party, 'Opinion 2/2010 on online behavioral advertising', 00909/EN, WP 171, par. 2.3 *et seq*; Court of Justice of the European Union, 13 May 2014 (Google Spain SL and Google Inc. v Agencia Española de Protección de Datos (AEPD) and Mario Costeja González), C-131/12, *Court Reports*, available via https:/curia.europa.eu.
86. Art. 31 DPL.
87. Art. 4(4) GDPR.
88. Art. 22(c) and 13(2)(f) GDPR.
89. This includes the right to obtain human intervention and to contest the decision, see Art. 22(3) GDPR.
90. Art. 22(4) GDPR. See also recital (71) GDPR.
91. For example, a commitment could be categorized as doubtful if based on a predictive analysis using the available consumer data, the estimated probability that the consumer will not (be able to) respect the contractual obligations exceeds a certain threshold.

(partly) based on consumer profiling does not *per se* entail a violation of the creditor's obligation under Article L226-36(1) LCCo.

4.4 Allocation of default-related and forbearance costs

The Luxembourg legislator has neither provided any indication of the type of costs incurred as a result of a default in accordance with L. 226-22(2) LCCo, nor imposed (absolute or relative) caps on the fees charged to cover those costs. The MCD does not contain any further explanation of the rule in Article 28(3). The EBA saw no need to further detail the rule, merely stating that charges incurred by a creditor 'may vary between countries'.[92]

The rule of Article L.226-22(2) requires (i) that the creditor has defined and imposed these default-related mortgage servicing fees on the consumer and (ii) an assessment of the mortgage servicing costs actually incurred by the creditor. The rule is *subjective*, as it merely refers to the indemnification of incurred costs and does not include any objective standard, such as the reasonableness of the costs. Also, due to the requirement of a causal relationship between the costs and the default, entirely non-consequential costs (e.g. overhead costs) cannot be discounted (included) in those fees.

To the extent that the imposition of charges in case of default serves as an indemnity for the damages of the creditor, those charges are governed by Article 1229 of the Luxembourg Civil Code ('**LCCi**'), which allows the creditor to recover the costs incurred as a result of the non-performance of the debtor.[93] Most of these costs are common to all creditors. An example of such costs is that as a result of the default, the creditor incurs costs due to the missed opportunity to reinvest the expected funds. Another group of costs directly related to the default are the administration costs to record the default (e.g. the amount in arrears). Closely related to these costs are the costs which the creditor incurs if a direct debit is processed on an account with insufficient funds (*non-sufficient funds fee*) or if the creditor must initiate the realisation of any personal securities (*sûretés personelles*). As these costs are damages which the creditor would not have incurred in case of payment in conformity with the credit agreement, all abovementioned costs fall under the application of Article 1229 LCCi.

The MCL introduces another category of costs on the creditor, i.e. the costs *incurred due to engagement and resolution measures taken by the creditor*. These costs are not necessarily the result of prejudice caused by the non-performance of the obligation, but are those additional costs the creditor incurs in order to comply with the legal obligation of Article L. 226-22(1) LCCo. The exact amount of these costs may vary between creditors, depending on the policies and procedures of each creditor. In the contractual instrument used, the creditor and the consumer agree on the steps and measures the former will take to find a solution to the payment difficulties. As long as these costs are directly related to (one or more) defaults, the creditor can define and impose fees to cover these costs, as they stem from a synallagmatic contract.[94] There is a third category of costs closely related to this second category: outsourcing costs. Some creditors may (partially) outsource engagement and resolution processes to a third party (e.g. engagement or handling by a specialized company or an IT platform) and charge the creditor on a per-user or per-default basis. The outsourcing costs of those third parties may vary and as a result, the fees charged to indemnify the creditor may differ. Under the MCL, given that these costs are incurred by the creditor, they could be charged to the consumer, provided that they are not abusive.[95]

In practice, the creditor will include the definition of the costs in the terms and conditions of the credit agreement or a separate fee schedule. The costs may have the form of a fixed fee or a percentage of the amount of the default (default interest, *intérêt moratoire*).

5. Conclusions and drafting recommendations

The management of retail mortgages involving Luxembourg consumers has changed with the transposition of the Mortgage Credit Directive. In particular, the obligation to exercise reasonable forbearance (*tolérance raisonnable*) before initiating foreclosure proceedings has introduced some uncertainty with regard to the creditor's discretion to design pre-foreclosure mortgage default procedures and policies. That being said, the Luxembourg transposition is favourable to lenders, because the legislator has sought to align the rules with current market practice and has avoided the imposition of clear directives to encourage such forbearance.

92. EBA Guidelines, response No. 39.
93. P. Ancel, *Contrats et obligations conventionnelles en droit luxembourgeois,* Brussels, Larcier 2015, p. 796 *et seq*. Note that courts may squash these clauses if they are excessive, Art. 1231 LCCi.
94. Art. 1134-1 LCCi.
95. Art. L. 211-2(1) LCCo. Judges may, when considering the entire set of contracts involved (e.g. credit agreement and outsourcing agreement), consider that in light of the circumstances the contractual relationship is unbalanced to the disadvantage of the consumer. See also T. Alonso-Pérez, 'L'article 28 de la directive No. 2014/17: conséquences du défaut de paiement du consommateur dans le prêt immobilier', *Revue de l'Union européenne, 2015*, p.479-482.

To minimize the costs of mortgage default management under the MCL, creditors could:

1. design detailed policies and procedures which distinguish pre-arrears and post-arrears customers, specify in which cases and in which order specific forbearance measures will be taken and the consequences of non-compliance (foreclosure);
2. implement these procedures using (a) chatbots, while allowing engagement with staff for complex cases, and (b) predictive analytics software, which collects data from multiple sources and allows the lender to predict and detect payment difficulties;
3. clearly describe the procedures in contractual instruments (general terms and conditions, credit agreements) and provide separately an overview of the data processing procedures in plain language to request informed consumer consent; and
4. specify any default-related charges in a separate fee list, detailing the nature of the costs and under which conditions they are imposed on the consumer.